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Budgeting for Bad Debt; Collecting Delinquent Assessments is Not Going to Get Easier Anytime Soon

By David C. Swedelson, Swedelson & Gottlieb

It is budget time for many California community associations, and most associations need to consider a budget category/line item for bad debt. If you've been reading the newspapers or watching the news, you likely know that through at least 2011, things are not going to get much better for California community associations in terms of assessment collection. The fact is that many, if not most condominium, co-op and planned development homeowner and community associations are going to experience assessment collection problems. This may likely result in your association's inability to collect any money from one or more owners for payment of assessments or fees.

A couple of weeks ago, there were news reports that dealt with the delays that we are seeing with lenders foreclosing on their trust deeds; they were not moving all that fast to foreclose. The news reports indicated that lenders were intentionally proceeding slowly with the actual foreclosure sales, as they did not want to inundate the market with too many properties at once. This makes sense for the lenders, who don't really want to take properties that are part of community associations into their inventory, as they will then, among other things, need to start paying the monthly fees or assessments to the associations. However, this is bad news for community associations who have already been suffering with the delays hoping that the lenders will foreclose. Considering the fact that California is not a super lien state (several states have laws that obligate senior lienholders to pay up to six months of the assessments that were owed by the prior foreclosed owner), most associations will likely not recover assessments that are owed on a particular unit or property from the foreclosing lender.

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As if things were not bad enough, there were recent reports that problems had been discovered with many lenders and their review of the files on properties that they are foreclosing on. Bank of America announced that it was going to stop foreclosing on any property on which it holds a security interest until it can be confirmed that there has been a proper review of each of those files and compliance with the applicable state law. There has also been a call for another national moratorium on foreclosures.

What does this mean for California community associations? For those that have been waiting for lenders to foreclose on properties, it does not appear that lenders are going to be doing so anytime soon, at least not with any great volume.

Many community associations may have no choice but to proceed to foreclosure rather than let a delinquent homeowner remain as the owner of the property while taking advantage of the community's amenities without paying assessments, even though the immediate hope that the first trust deed will foreclose the association's interest and become responsible for the assessments on a going forward basis may not happen. For more information on this issue, please read our April 2009 article:

To Foreclose or Not to Foreclose; That Seems to be the Question

…and our recent follow-up blog post:

Part Deux: To Foreclose or Not to Foreclose, That is the Question... So What is the Answer?

In addition, it is no secret that one of the big driving forces behind the foreclosure dilemma is the fact that there are so many people out of work. Recent reports indicate that the unemployment rate is not getting any better. In fact, last week it was announced that nationally, it remained at 9.6% unemployed and is much higher than that in California (12.4%, third highest unemployment rate in the country).

As Swedelson & Gottlieb has been recommending since before 2007, California community associations need to factor in bad debt and budget for same. There is almost no community association that has not had to deal with at least one assessment collection delinquency. For many associations that were developed and sold within the last five (5) years, they are suffering delinquencies at a much higher rate, in some cases as high as thirty percent (30%) of the members being delinquent.

What this all means is that at the very minimum, most community associations cannot reasonably expect to receive all of the income that the association is entitled to collect from owners. California community associations are going to need to take a good look at their delinquencies, perhaps looking at 2009/2010 to determine what percentage of income has not been received. Boards can certainly consider other information and make a determination as to how much should be budgeted for bad debt. If not, many associations will be wondering where they are going to be getting the money they need to pay all of their association's expenses. Don't say we didn't warn you.