Assessment Lien Enforcement and Collection
In a Troubled Economy

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The collection of assessments is central to the viability of any community association as the assessment revenue is typically a community association's sole source of income. The operating premise of most associations is that an annual budget is prepared based on the association's projected expenses for the year (including contributions to a reserve fund), and the association levies assessments in the amount required by the budget. The assessments are divided among the owners either uniformly or in such other proportion as is provided by the association's governing documents. In order for the association to be sufficiently funded, each owner must timely pay their assessments, which are their share of the common expenses.

Unfortunately, most associations do not adequately budget for delinquencies and defaults (bad debt), and for some associations, usually smaller associations, this may not be an option. However, in this troubled economy, a line item for bad debt should be included in all but perhaps the smallest and/or most financially secure community associations.

Regardless of whether an association has adequately prepared for delinquencies, efficient and rigorous compliance and enforcement of the association's collection policies and procedures are an integral component of the successful governance of any association. In addition to the problems that a board of directors faces in operating an association without adequate revenue, delinquent assessments can create tension and animosity among neighbors. In all but perhaps the largest associations, owners have a particular sensitivity to ensuring that their co-owners meet their assessment obligations. Though most of us seem to accept that not everyone will pay their tax obligations, whether income or real estate, few community association owners have the same tolerance for fellow owners failing to meet their assessment obligations. That is because this hits them in their own pocket books. The smaller an association is, the higher the level of awareness is when some owners are carrying the weight of their delinquent neighbors.

Despite both the financial and interpersonal problems that are caused by delinquencies, many associations hesitate to aggressively pursue collections. There are many factors contributing to such hesitation. First, because boards of directors are typically made up of volunteer members, they may be unaware of how to best go about collecting, especially where the association is self managed, and the process may seem like a drain on time and money.

Additionally, there is frequently an assumption that the homeowners are not paying because they don't have the money, and that pursuing collections will leave the association with a judgment that cannot be collected, or title to property with negative equity. Sometimes boards will be overly sensitive to the fact that their neighbor has lost his or her job. As counsel to an association, it is the attorney's duty to ensure that the board members are adequately informed of their fiduciary obligations to their association and all of the other owners and the fact that they are running a business. Counsel needs to advise the boards as to the costs and benefits of diligently pursuing collections, and the most productive way to go about it. While the most effective manner of collection differs from state to state, depending on the availability of nonjudicial foreclosure, the existence of automatic lien or superlien statutes, and a myriad of other factors, it is a universal truth that failure to enforce assessment collection is detrimental to an association.

A primary concern of many associations is the likelihood that if the homeowners are not paying their association, they probably are not paying their (senior lien) lender either. Most homeowners borrow money to purchase their unit, lot or home via a deed of trust or mortgage, by which they pledge a security interest in their property. The lien that homeowners associations are able to record against the property pursuant to the authority provided by both state law and the association's governing documents is typically junior to the lender's lien. This is also generally true for automatic liens when provided by statute.

For example, Connecticut statute provides that although an assessment lien is senior to most liens recorded after the date of recordation of the CC&Rs, there is an exception for first or second security interests in the property, so long as such interests are perfected prior to the date of delinquency. Because of this, association boards are often hesitant to aggressively pursue collections through foreclosure, based on the assumption that one of two things may happen. First, if the homeowner is also missing mortgage payments, it is possible that after the association incurs the expense of beginning the foreclosure process, the lender could foreclose first, thereby wiping out the association's lien, and consequently rendering the expenses the association incurred in pursuing foreclosure a total loss.

Note, however, that approximately 19 states currently have in effect superlien statutes, which provide an association some protection by providing that a portion of an association's lien statutorily survives a foreclosure by a senior lender. This surviving lien is known as the "superlien" and varies by state statute, but is typically limited to an amount not to exceed up to six months' regular assessments, and may or may not include attorneys' fees and other costs in addition to such amount. In superlien states, the association need not worry that its collection efforts might result in a total loss, although it is still not guaranteed to recoup the full amount owed. However, because the superlien limit is a designated number of months, in superlien states, it is logical to pursue collections before the amount of delinquent assessments exceeds the amount that can be recovered under the superlien. In states that do not have superlien statutes[1], it is more of a challenge for a homeowners association attorney to convince its clients that the effort and expenses incurred in aggressive assessment collection are worthwhile.

We are advised that some homeowners association attorneys have in the past successfully made the argument that a foreclosing lender is unjustly enriched by the association's maintenance of its security during the pendency of the foreclosure process (which, especially in states that do not allow for nonjudicial foreclosure, can be

[1] Unfortunately, California, where we practice, has no superlien statute. We had lobbied for a superlien bill during the last recession in the mid 1990s and were not successful. It would be virtually impossible to lobby and/or convince the legislature or the governor of California to implement a superlien bill considering the poor health of most banks and in particular those that made the loans that are now going into default/foreclosure.

a significant amount of time), and therefore, it owes the unpaid assessments that it received the benefit of. As many of the lenders that were the defendants in these cases were receiving and collecting rents from the property during foreclosure, many courts found it to be inequitable for the lenders to receive the benefits of the property without bearing the associated costs. However, more recently, courts have denied such unjust enrichment claims. For example, in Connecticut, which was one of the leading states in which this argument prevailed, an appellate court ruled that the state's superlien statute delineated the priority and the association was limited to the amounts that it could recover thereunder (*Dime Savings Bank v. Muranelli* (1995) 39 Conn. App. 736). More recently, in *U.S. Bank National Assn. v. Tadmore*, 2009 WL 4281301, a Florida appellate court reversed an order that required a foreclosing lender to pay assessments. The trial court found that the lender had unduly delayed the foreclosure process and required the payment of the assessments as a kind of penalty, however, the appellate court reversed on the grounds that the association had available more traditional means to address the delay, such as filing court actions.

The other concern for associations in both superlien and nonsuperlien states is that the amount of equity in the delinquent homeowner's property may be less than the amount of the mortgage. Because any purchaser at the association's foreclosure sale would have to take the property subject to the senior encumbrance(s), there would likely be no bidders at the sale and the association would take title to the property subject to all senior liens.[2] Associations typically assume that they do not want to carry such properties, however this is not necessarily true. By not making payments on the mortgage, an association does not incur any penalties (i.e., its credit is not affected), and it will be able to rent the unit until the lender forecloses, thereby recouping some of the money that it has lost on assessments.

Further, while a large percentage of the first wave of foreclosures that began more then a year ago were the result of subprime mortgages and properties with upside down equity, this is no longer the case. Although the recession is still impacting foreclosures, an increasing number of the owners that are delinquent on both assessments and mortgage payments are delinquent because of job losses or other financial reasons that do not preclude the possibility of their homes having equity. This means two things: First, they are more likely to respond to pre-foreclosure notices and pay the delinquent assessments, because they do have something to lose if the association proceeds. Second, if the association does foreclose, it is more likely to be able to sell to a third party and recover the money that it is owed without taking title.[3]

[2] It is interesting to note that we are seeing third parties bid on these properties even though there is no equity. They advise that they do not have the money for a down payment and it is easier and less expensive for them to buy the property through foreclosure and assume the underlying loans and hope the property increases in value.

[3] See also David Swedelson's article entitled: *Is The "Great Recession" Over Yet? For California Community Associations, Not By A Long Shot.* (Click here or go to www.hoalawblog.com). In addition, see David Swedelson's article entitled: *To Foreclose or Not To Foreclose; That Seems To Be The Question.* (Click here or go to www.hoalawblog.com).

It is worth noting that there are other measures that can be taken to avoid the need to foreclose on delinquent homeowners, to collect when foreclosure is not an option, or to be utilized in conjunction with the foreclosure process, as the goal is not to foreclose but to compel the owners to pay what they owe their association. For example, one effective method of collecting delinquent assessments is by including a rent-pay-over, or assignment of rents, provision in the association's governing documents. Pursuant to such a provision, if owners who rent their units become delinquent on assessments, the association has the authority to collect rent directly from the tenants in the amount of the delinquency. Although not all delinquent homeowners rent their units, absentee homeowners do comprise a disproportionately large percentage of delinquencies. If such a provision does not already exist in the governing documents, it can be added by a simple amendment. Few owner/residents would vote against such an amendment, and therefore unless a complex is predominantly investor owned, incorporating such a provision into an association's governing documents should not be difficult to accomplish. [4]

The good news is that most states have recognized the importance of assessment collection for community associations. In California, the Court of Appeal had this to say regarding assessment collection:

> The Legislature has enacted very specific procedural rules governing condominium assessments. (See Civ. Code, §§ 1366, 1367.) Condominium [29 Cal.App.4th 432] homeowners associations must assess fees on the individual owners in order to maintain the complexes. (Civ. Code, § 1366, subd. (a).) The assessment "shall be a debt of the owner ... at the time the assessment ... [is] levied." (Civ. Code, § 1367, subd. (a).) When an owner defaults, the association may file a lien on the owner's interest for the amount of the fees. (Civ. Code, § 1367, subd. (b).) If the default is not corrected, the association may pursue any remedy permitted by law, including judicial foreclosure or foreclosure by private power of sale. fn. 7(Civ. Code, § 1367, subd. (d).)
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> These statutory provisions reflect the Legislature's recognition of the importance of assessments to the proper functioning of condominiums in this state. Because homeowners associations would cease to exist without regular payment of assessment fees, the Legislature has created procedures for associations to quickly and efficiently seek relief against a nonpaying owner. *Park Place Estates Homeowners Assn. v. Naber* (1994) 29 Cal. App. 4th 427,

When an association pursues collections, homeowners will often attempt to come up with excuses for nonpayment, whether they believe such excuses to be meritorious or are merely attempting to delay the process. Especially in difficult economic times when associations may be strapped for cash and delaying certain improvements, owners who want to get out of paying their assessments commonly withhold assessment payments and present a defense to collection actions of some maintenance issue or other claimed defect or perceived wrong. Thus, an association or association attorney should be

[4] See *How to Perfect An Assignment of Rents Clause in [California] CC&Rs* by Swedelson & Gottlieb Attorney Joan E. Lewis-Heard. (Click here or go to www.hoalawblog.com).

prepared to respond with a supported argument that the obligation to pay assessments is an independent covenant which runs with the land and is not, therefore, subject to withholding, self-help or off-set. There is a plethora of case law to support this position, including *Agassi West Condominium Assn. v. Solum* (N.D. 1995) 527 N.W. 2d 244; *Panther Lake Homeowners Assn. v. Juergensen* (Wash. App. 1995) 887 P.2d 465; *Park Place Estates Homeowners Assn. v. Naber* (1994) 29 Cal. App. 4th 427; *Kirktown Homes v. Arey* (Mo. App. 1991) 812 S.W.2d 198. A helpful discussion of the reasoning behind homeowners' lack of a right to offset is found in the case of *Trustees of the Prince Condominium v. Prosser* (1992) 412 Mass. 723, 726-727, in which the Massachusetts Supreme Judicial Court analogized condominium assessments to real estate taxes and reasoned that:

> Whatever grievance a unit owner may have against the condominium trustee must not be permitted to affect the collection of lawfully assessed common area expense charges. A system that would tolerate a unit owner's refusal to pay an assessment because the unit owner asserts a grievance, even a seemingly meritorious one, would threaten the financial integrity of the entire condominium operation. For the same reason that taxpayers may not lawfully decline to pay lawfully assessed taxes because of some grievance or claim against the taxing governmental unit, a condominium unit owner may not decline to pay lawful assessments.

This analogy to real estate taxes can be useful in explaining the duty to pay assessments. The covenantal and/or statutory obligation springs from the mere existence of the real estate as an incident of ownership. It is not a fee for services, nor a quid pro quo for goods, nor is it premised on a contract to pay. By accepting title to this parcel of real estate, the owner becomes obligated to pay their share of the expenses of the community of which the parcel is a part. The owner does not pick and choose to which expenses they contribute, nor how the money will be spent. Those decisions are within the domain of the governing body of the community.

Nor does the owner have the right to offset for some claimed damage or transgression. The obligation is wholly independent of any duty flowing from the community to the owner. As cited in the *Park Place Estates* c ase referenced above, and citing to *Baker v. Monga* (1992) 32 Mass.App. 450, fn. 8 [590 N.E.2d 1162, 1164]: "The independent nature of the covenant to pay in timely fashion common charges to the condominium unit owner's organization is implicit in the contractual agreement of the association's members that maintenance charges and other proper assessments are necessary to the sound ongoing financial management and stability of the entire complex."

This does not mean that owners are prohibited from questioning the lawfulness of the assessment, and they often do. However, both statutes and case law from various jurisdictions have required that even if a unit owner claims the assessment is illegal, such owner must pay under protest and then seek a determination of the legality and, if appropriate, a refund. See, e.g., *Blood v. Edgar's, Inc.* (1994) 36 Mass. App. Ct. 402 and Cal. Civ. Code §1367.6.

Also making the assessment collection process significantly more difficult is the problem of homeowners declaring bankruptcy. Pursuant to the United States Bankruptcy Code, if a homeowner files for bankruptcy prior to the association's recording a lien for delinquent assessments, assuming that state statute does not provide for automatic liens, the association holds the same status as any other unsecured creditor, which means that it will likely receive nothing. If, at the time bankruptcy is filed, the association has recorded a lien, it will have the status of a secured creditor, and following receipt of a court order granting relief from the automatic stay, the association may pursue collection subject to the rights of other secured creditors. Therefore, although it is possible that the association's lien will be wiped out in either circumstance, it has a much higher chance of collecting if a lien has been recorded. Regardless, pursuant to 11 U.S.C. §523(16), bankruptcy does not discharge any debt for a homeowners association fee or assessment that becomes due and payable after the order for relief so long as the debtor has a legal, equitable or possessory interest in the unit.

Collecting delinquent assessments in this troubled economy is not an easy task, and a successful practitioner will need to consider a number of steps. First, your clients should be prepared for delinquencies. This means both that the associations will have budgeted for bad debt and that they will have strong collection policies in effect and a reputation for diligent enforcement. As an association's legal counsel, you should review the association's collection procedures to ensure that they comply with the governing documents and state law. Next, your clients must be prepared to follow through with collections. This can mean pursuing judicial or nonjudicial foreclosure, filing a small claims action, or exercising other collection remedies available in your jurisdiction. You and your client will need to be prepared to deal with frivolous challenges to the assessments and the possibility that one or more real hurdles may present themselves, including bankruptcy and lender foreclosure. However, despite the numerous obstacles that make assessment collections difficult, taking a firm stance on collections will ultimately benefit associations by reducing the number of delinquencies and collecting on all but the most unworkable cases.

For more information on collecting delinquent assessments, we have posted a number of relevant articles on www.hoalawblog.com.

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