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What Is Wrong With California Senate Bill No. 561? Just About Everything.

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Senate Majority Leader Ellen M. Corbett (D-San Leandro) has introduced SB 561 which will, if signed into law, make some fairly significant changes to the law which will negatively impact how California community associations are able to collect delinquent assessments. This bill is being introduced by Senator Corbett at a time when many California community associations have at least 10% to 20% of their homeowners delinquent and not paying their assessments, and there are many associations with much higher delinquency rates. What Senator Corbett is proposing will make it more difficult for associations to collect fees and costs of collection. We do not think that this is fair or appropriate.

This bill is being predicated on the argument that homeowners are losing their homes to foreclosure by their associations because they can not pay fees or costs of collection related to their delinquent assessments, even though they are able to pay their regular and special assessments. We are aware of no homeowners who have ever lost their homes in an association's foreclosure simply because of unpaid fees and costs of collection.

The Legislative Counsel's Digest states the following about SB 561:

> The Davis-Stirling Common Interest Development Act provides for the establishment and regulation of common interest developments. Existing law authorizes an association to levy regular and special assessments, and, if an assessment is delinquent, authorizes the association to recover reasonable costs and attorney's fees incurred in collecting the assessment in accordance with certain requirements.

This bill requires any third party acting to collect payments or assessments on behalf of an association to comply with the same requirements imposed on the association (e.g., that payments received be applied first to assessments and then to late fees, interest and other costs of collection, such as attorney's fees). As proposed, this bill specifies that a waiver by a homeowner of his/her statutory rights regarding payment applications and a waiver by an association of the association's responsibilities under the Davis-Stirling Act related to same (such waivers are common in payment plan agreements between homeowners and associations) is void as contrary to public policy, and this bill would prohibit a foreclosure proceeding from being initiated or proceeding if it is based on a waiver/agreement that is void. This bill would also prohibit a third party from acting as a trustee in any association foreclosure proceeding.

We happen to know the evolution of this proposed legislation, which is discussed below, and that history is important to our collective understanding of why Senator Corbett was convinced to introduce this bill. There is no evidence that

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any delinquent homeowner has ever lost his/her home to foreclosure resulting from a homeowner's association asking them, as part of a financial settlement of the delinquent homeowner's account (including a payment plan agreement), to waive the provisions of the Civil Code relating to the application of their payments to fees and costs of collection before application of those payments to principal/assessments.

As many of you may know, we are principals of Association Lien Services ("ALS"), an affiliate company of our law firm that collects delinquent assessments for homeowners associations throughout California. ALS was recently sued by a condominium owner in Senator Corbett's district who did not dispute that she was delinquent in the payment of her assessments, but refused to enter into a payment plan agreement that required her to waive the provisions of Civil Code Section 1367.1. Subsection (b) of that Civil Code Section provides, that "Any payments made by the owner of a separate interest…shall first be applied to the assessments owed, and, only after the assessments owed are paid in full shall the payments be applied to the fees and costs of collection, attorney's fees, late charges, or interest."

Why is this important? Because that homeowner who balked at waiving the provisions of Civil Code Section 1367.1(b) made it clear that she wanted to pay down her debt principal/assessments to avoid the $1,800 threshold for foreclosure. She also made it clear that she did not want to pay the fees or costs that her association incurred in attempting to collect her delinquent assessments (including late fees, interest and ALS' collection fees). The court in this case eventually dismissed the homeowner's lawsuit because it was the association's board, and not ALS, that was making that requirement, and the court indicated that ALS was not bound by those provisions of the Civil Code.

If SB 561 were to become law, it would make collection service providers, such as ALS, who are not parties to the association's CC&Rs nor bound by the Civil Code, to be bound by same. This will undoubtedly result in homeowners then failing to make any payments pursuant to an executed payment plan. Many homeowners know that their association cannot continue with the foreclosure sale if all that is owed against their unit or lot are the collection fees and costs, leaving their association with no choice but to just wait until the homeowner sells his/her unit or lot (as the lien is still on the property), or proceed to small claims or superior court to collect the remaining monies owed. We know this will happen, as we have seen many homeowners try to do so in the past.

The problem with Senator Corbett's proposed legislation is that her proposed bill is purportedly designed to help delinquent homeowners, but that help comes at the expense of the homeowners that timely pay their assessments. Lawyers often refer to the old adage that "bad facts make bad law"; while that adage usually applies to lawsuits, here it applies to proposed legislation. This bill is based on

false information, will ultimately do more harm than good and will allow delinquent homeowners the ability to "game" the system. And what is especially galling is the misstatements of fact contained in the bill.

Although the preamble language to SB 561 makes assumptions that are not supported by facts, the most disturbing part of the preamble language, carried over into the body of the bill, is the proposed prohibition of a third party from acting as a trustee in a foreclosure. What (you ask)? Third parties, whether legal counsel, managers or assessment collection companies, always act as the trustee in a foreclosure proceeding. Who is the legislature expecting to act as the trustee – the volunteer board members? The Civil Code currently provides that the trustee must be named if an association intends to foreclose non-judicially. Such requirement presumes that an entity or person, other than the association, will be the trustee. If the legislature truly expects that an association will act as the trustee, the better move would be to just prohibit associations from taking any action against a delinquent homeowner, as the net effect will be the same.

Volunteer boards are already required to assume numerous duties and perform work for which many well-meaning association board members do not have the requisite training and skills. Is the legislature serious that it now wants the association to be the trustee and conduct the foreclosure process, a process that is so complicated and detailed (by the very laws the legislature has enacted to "protect" delinquent homeowners from losing their homes because they cannot pay their financial obligation to their association) that even most attorneys do not understand the procedural requirements?

Consider, for example, other misstatements in SB 561 which are indicative of the problems with this bill:

1. Collection services do not require homeowners to enter into a payment plan with a waiver of their rights; the agreements are between the delinquent homeowner and his/her association. The Civil Code does not require associations to enter into payment plan agreements. That said, if a board wants to enter into a payment plan, it typically directs its managing or collection agents to do so, and the board dictates the terms of the agreement. A payment plan agreement frequently includes provisions requiring that all or part of the costs of collection will be paid first during the payment plan period prior to any assessment delinquencies being paid, requiring a waiver of the statutory provision (discussed above) that is the subject matter of this bill. There is good reason for this– boards know from experience that many homeowners pay the assessment portion of the payment plan agreement but do not pay the costs of collection, knowing full well that the association cannot foreclose for costs of collection only.

When this occurs, it places an even greater financial burden on the association because if the association wants to seek reimbursement of its collection fees and

costs, money rightfully due to the association, the association must sue the owner in small claims court and then try to collect those fees and collection costs. That, of course, results in the association either having to pay the association's manager to go to court for the association or having at least one board member take a day off of work or give up a day of leisure to go to court to prosecute the lawsuit. Assuming the association prevails in the court action, then someone has to try to collect that money judgment on behalf of the association, which is not secured on the property. And we all know that collecting a judgment is not that easy; that is why the legislature allows associations to lien and foreclose for the full amount the delinquent owner owes, including fees and costs.

We understand that some homeowners may only be able to afford assessment payments (and not collection fees and costs), and SB 561's intent is to allow them to keep the balance they owe for assessments below the $1,800 threshold for foreclosure. But really, is it fair for the paying/current homeowners to have to subsidize delinquent homeowners? If a homeowner is delinquent and his/her association incurs collection fees and costs related to that delinquency, the Civil Code makes it clear that the homeowner owes those monies to the association as well the assessments that are delinquent.

2. The assertion that assessment collection services "convince" or "coerce" homeowners to give up their statutory rights is absurd. What does happen, however is, based on the board's mandate, a payment plan agreement is prepared which includes the waiver of the statutory priority of payments (meaning collection fees and costs are paid before assessments/principal). By this time, the homeowner is in collection and the payment plan agreement is a settlement of his/her delinquent account. That agreement is forwarded to the delinquent homeowner who is being given this opportunity to pay back their debt to the association without any reporting to credit agencies and without loss of their unit/lot or any judgment against them. And if they pay what they owe, there is no foreclosure. The homeowner then makes a decision as to whether to take advantage of this opportunity and sign the payment plan agreement, prepared at the board's direction. Or, the homeowner does not have to agree to the terms of the settlement. We are surprised the legislature would actually think that homeowners are incapable of making a decision as to what is in their own best interest.

3. The statement that payment plan agreements result in homeowners sinking deeper into debt is not our experience, and we have a lot of experience (ALS has, on average, 4,000 open collection files for associations statewide at any one time). The payment plan agreements ALS prepares at a board's direction require a payment priority waiver. SB 561 would make this waiver an action against public policy as there is no such statement in the law today. That said, there is precedent for this kind of waiver.

For example, attorneys routinely ask parties to a settlement agreement to waive the provisions of the Civil Code as it applies to releases of claims. Under Civil Code Section 1542, a party to a release agreement does not waive the right to bring a new lawsuit if new or different facts arise. For example, a party is in a typical auto accident. If they did not agree to the waiver of Section 1542 and later discovered that they had a head injury that they did not know about at the time they entered into the settlement, they could file a new lawsuit. That is why most (if not all) insurance companies do not enter into settlements with the waiver of Civil Code Section 1542, and this waiver is sanctioned by law!

Typically, ALS recommends to association boards that they consider a six month payment plan, unless the board directs a longer period of time, which requires that the delinquent homeowner stay current with his/her ongoing assessments that accrue during the payment plan period and make a monthly payment, for example, 1/6th of their debt, to the association, which debt includes assessments owed, interest and late fees, as well as the costs of collection, consistent with the association's governing documents and the Civil Code. The payment plan agreement does not, unless the board directs otherwise, charge interest on the balance that is owed during the payment plan period, and would never charge a late fee, as to do so would be in violation of statute.

The assessment collection service or attorney, or in many cases, the association's managing agent, adds to the delinquency ledger the costs of collection to date, which would include title verification (a hard cost), bankruptcy investigation (a hard cost), the pre-lien or attorney demand letter and the charge for the lien and the lien recording fee (a hard cost). All reputable collection services and legal counsel would recommend the association be a secured creditor during the payment plan period; without such status, the association could not enforce the payment plan if the delinquent homeowner sells his/her property or files bankruptcy, certainly something the legislature would not promote.

4. The statement in the proposed bill that the costs of collection and the waiver of the payment priority make it extremely difficult, if not impossible, for a homeowner to pay delinquent assessments in their entirety before the one year right to foreclosure kicks in is not supported, based on our experience, by any fact or evidence. What is missing is any recognition of the fact that the homeowner incurred the collection fees and costs because they were in collection.

5. The bill states that "[a]s a result" of the payment plan agreement and the waiver of the payment priority, but not the homeowners' obligation to pay the debt they accrued, that homeowners are losing their homes in foreclosure. Really? That's the reason? Where is the data for this? We know that this statement is simply not accurate. And, the innuendo that one in eight foreclosures in Northern California occur when the costs of collection are in excess of $2,500

and the delinquent assessments are only $200 or less is not supported by any data that we know of; that is certainly not our experience.

What we know is that very few homeowners complain about the waiver of the Civil Code provisions discussed above and addressed in the bill, and those that do make it clear that their intent is to pay down the principal to avoid foreclosure and not because they cannot afford to pay the fees and costs of collection. Very few homeowners default on payment plans because of the costs and fees of collection covered under the payment plan; in fact, we are not aware of any homeowners that have defaulted on this basis. We know that boards of directors are often tortured over the decision to foreclose when homeowners owe their associations thousands of dollars, making all of the other homeowners responsible for the deficit in the association's revenue, often resulting in special assessments levied to cover the shortfall, which results in other homeowners falling behind in their payments, exposing them to the risk of losing their homes to foreclosure. Who does Senator Corbett think is going to pay the fees and costs of collection if the delinquent homeowner does not? It will be all of the other homeowners at the association.

6. It would appear that Senator Corbett does not understand that it is the board of an association that makes the decision to put payment priority language in payment plan agreements. If she understood that fact, she would never have added language to the bill stating that the assessment collection companies "force" homeowners to waive their statutory protections. Such a statement is not accurate nor reflective of legislative intent.

What will ultimately happen if SB 561 makes its way to becoming law? Association boards may be less inclined to enter into payment plan agreements if it means that the association, as opposed to the delinquent homeowner, will have to pay the fees and costs of collection. This will result in the homeowner having to pay the full amount of their debt upon demand or lose their home through foreclosure, as payment plans will no longer be a viable financial option.

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