IN THE SUPREME COURT OF THE STATE OF NEVADA

HORIZONS AT SEVEN HILLS HOMEOWNERS ASSOCIATION,

Appellant,

v.

IKON HOLDINGS, LLC, a Nevada limited liability company;

Respondent,

CASE NO. 63178

Dist. Ct. Case No. A-11-647850-B

RESPONDENT'S APPENDIX

VOL. 1

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DATED this 24th day of February, 2014.

ADAMS LAW GROUP, LTD.

/s/ James Adams

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Nevada Administrative Code Currentness
Chapter 232. State Departments
Department of Bnsiness and Industry
Practice Before Department

NAC 232.040

NAC 232.040 Petition for declaratory order or advisory opinion: Authorization; filing; contents. (NRS 233B.120)

1. Except as otherwise provided in subsection 4, an interested person may petition the Director to issue a declaratory order or advisory opinion concerning the applicability of a statute, regulation or decision of the Department or any of its divisions.

2. The original and one copy of the petition must be filed with:

(a) The chief who is authorized to administer or enforce the statute or regulation or to issue the decision; or

(b) The Director, if the statute, regulation or decision is administered or enforced by the Director.

3. The petition must include:

(a) The name and address of the petitioner;

(b) The reason for requesting the order or opinion;

(c) A statement of facts that support the petition; and

(d) A clear and concise statement of the question to be decided by the Director or chief and the relief sought by the petitioner.

4. An interested person may not file a petition for a declaratory order or an advisory opinion concerning a question or matter that is an issue in an administrative, civil or criminal proceeding in which the interested person is a party.

Credits
(Added to NAC by Dep't of Commerce, eff. 12-17-87; A 5-14-92)

Current through July 31, 2013, Supplement 2013-1

NAC 232.040, NV ADC 232.040

RA0001

End of Document

MINUTES OF THE MEETING
OF THE
ASSEMBLY COMMITTEE ON JUDICIARY

Seventy-Fourth Session
April 3, 2007

The Committee on Judiciary was called to order by Chairman Bernie Anderson at 7:43 a.m., on Tuesday, April 3, 2007, in Room 3138 of the Legislative Building, 401 South Carson Street, Carson City, Nevada. The meeting was videoconferenced to Room 4401 of the Grant Sawyer State Office Building, 555 East Washington Avenue, Las Vegas, Nevada. Copies of the minutes, including the Agenda (Exhibit A), the Attendance Roster (Exhibit B), and other substantive exhibits are available and on file in the Research Library of the Legislative Counsel Bureau and on the Nevada Legislature's website at www.leg.state.nv.us/74th/committees/. In addition, copies of the audio record may be purchased through the Legislative Counsel Bureau's Publications Office (email: publications@lcb.state.nv.us; telephone: 775-684-6835).

COMMITTEE MEMBERS PRESENT:

Assemblyman Bernie Anderson, Chairman
Assemblyman William Horne, Vice Chairman
Assemblywoman Francis Allen
Assemblyman Ty Cobb
Assemblyman Marcus Conklin
Assemblywoman Susan Gerhardt
Assemblyman Ed Goedhart
Assemblyman Garn Mabey
Assemblyman Mark Manendo
Assemblyman John Oceguera
Assemblyman James Ohrenschall
Assemblyman Tick Segerblom

COMMITTEE MEMBERS ABSENT:

Assemblyman John C. Carpenter (Excused)
Assemblyman Harry Mortenson (Excused)

STAFF MEMBERS PRESENT:

Jennifer M. Chisel, Committee Policy Analyst
Risa Lang, Committee Counsel
Kaci Kerfeld, Committee Secretary
Matt Mowbray, Committee Assistant

OTHERS PRESENT:

Donna Toussaint, Private Citizen, West Sahara Community, Las Vegas, Nevada
Dan Newburn, Private Citizen, Las Vegas, Nevada
Kevin Janison, Private Citizen, Las Vegas, Nevada
Wallace Riddle, Private Citizen, Las Vegas, Nevada
Sandy Ambrose, Private Citizen, Las Vegas, Nevada
Gary Randall, Private Citizen, Las Vegas, Nevada
Bob Sidell, Representing Value Alliance, Las Vegas, Nevada
Karen Dennison, Representing the American Resort Development Association and Lake at Las Vegas Joint Venture Community, Nevada
Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities
Marilyn Brainard, Commissioner, Nevada Commission for Common-Interest Communities
Gail Anderson, Administrator, Department of Business and Industry, Real Estate Division, Nevada
Shari O'Donnell, Vice President of Government Affairs and Community Relations, Signature Homes, Nevada, Representing Nevada Commission for Common-Interest Communities
Kevin Ruth, Representing Community Association Management Companies through Executive Officers, Nevada
Randy Eckland, Representing the Howard Hughes Corporation and the Summerlin Community Association Management Team, Nevada
David Stone, Owner, Nevada Association Service
David Thomas, Resident, Summerlin Community, Nevada
Judy Farrah, Chairman of the Community Associations Institute of Nevada, and Representing Legislative Action Committee
Michael Trudell, Manager, Caughlin Ranch Homeowners Association, Nevada
Sam McMullen, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada

Mandy Shavinsky, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada
Bruce Arkell, Representing the Nevada Association of Land Surveyors

Chairman Anderson:
[Meeting called to order and roll called.]

I have an email addressed to Assemblyman Goedhart regarding Assembly Bill 371 which needs to be entered into the record (Exhibit C).

Let us open the hearing on Assembly Bill 396.

Assembly Bill 396: Makes various changes to the provisions governing common-interest communities. (BDR 10-1284)

Assemblywoman Francis O. Allen, Assembly District No. 4:
[Read from prepared testimony (Exhibit D). Also submitted proposed amendments (Exhibit E).]

Chairman Anderson:
If a homeowner in a common-interest community wishes to give away their voting rights to a certain person, may they do so?

Assemblywoman Allen:
Yes. This does not prevent proxy voting. They can fill out a form in which a person is named to vote on their behalf. This only prevents the systematic process of delegate voting, where one person represents an entire neighborhood.

Chairman Anderson:
If everyone on the block wants the same person to be their representative, would that be allowed?

Assemblywoman Allen:
The neighbors are allowed to cast ballots. They can acquire a proxy and give it to the person they choose to vote for them. The only thing that this does not allow is the systematic casting of votes, which many people do not even know takes place. For example, in our own races, only 40 or 50 percent of the electorate comes out to vote. What if the incumbent could cast the rest of the balance in their own favor?

Assemblyman Horne:
Is there anything to prevent an association from obtaining proxies that say "you agree that I will be able to cast your vote if at any time should you choose not to cast a ballot?"

Assemblywoman Allen:
No, it would not prohibit that. If a homeowners association (HOA) is determined, they could manipulate their rules to get the incumbents reelected. We can only do a finite amount of things. This would be a strong message from the legislature saying that we believe one man equals one vote.

Assemblyman Horne:
Could there be a provision that uses conspicuous language that states failure to vote in any particular election will allow your vote to be exercised by your delegate and may be cast for themselves? That would give the homeowners a fair warning that should they not vote, their delegate would get it.

Assemblywoman Allen:
That is not afforded to people right now. I am open to any suggestions from the Committee as to how to clarify this portion.

Donna Toussaint, Private Citizen, West Sahara Community, Las Vegas, Nevada:
I believe in the democratic process. Delegate voting disenfranchises everybody in the community. It costs thousands of dollars to hold a delegate election and we have to elect delegates every year. In my community, the homeowners pay $20 per month for assessments. We have seven sub associations, six of whom do not care what the master does. We have 2,208 single units, 60 businesses, and 1,800 apartments. The West Sahara Community Association sends a letter to every unit owner, including businesses, requesting that they submit their name to be a delegate. For each mailing, we have to pay for postage, copies, envelopes, and staff, which is around $800. We need 84 delegates; last year we received twelve, and this year we received eight. We compile the responses we receive with their resumes and send everything back out to the unit owners; another $800. We get the third mailing back and call a special meeting at which we open the ballots in public. After that is done, we have to send all of the information back out to the unit owners; another $800. In our community, for every 50 homes there is one delegate. If everyone in area number one votes in favor of one person, but that area did not have a delegate, those votes cannot be counted. In area number two, if we have one person say they will be a delegate and one person who actually votes, that delegate can cast all 50 votes for all of the homeowners in favor of whoever that delegate wants. I do not know where the equity is in this. It is very expensive for our HOA and the system does not work. Delegates may work when the developer is still

involved, but my community is 22 years old. With seven sub associations, the delegate system has created more apathy than you can imagine. Why would anybody vote for a board of directors when they do not know whether or not their vote will count? The homeowners get very confused as to why there is or is not a delegate. It creates the problem where the homeowners get angry and they feel like they do not have a voice. They do not want someone telling them what they have to say. We do not use proxies in our community because the proxy process was abused so much in the late 80's and early 90's. We need 84 delegates in order to have a complete election. Since 1985, the West Sahara Community Association has not had a legal election because we cannot get 84 delegates. We cannot change our documents because we cannot get enough delegates. We need help from the legislature. Our documents are 22 years old and they are written very poorly. This system is broken, costly, and expensive.

Chairman Anderson:
As I understand it, your community has been divided into districts and the election within each district is determined by the number of people who show up to vote. If you have one person who is nominated in that district and that person is the only one that votes, then they get the seat. Is that correct?

Donna Toussaint:
As far as delegates, that is correct. When you are electing the board of directors, you cannot count someone's vote unless they have a delegate. Once a delegate is elected, they can vote any way they want.

Chairman Anderson:
So a representative is elected because he received the only vote from the district and was the only person willing to take on the responsibility. He then has the responsibility of electing a board of directors, but he is not obligated to vote a particular way.

Donna Toussaint:
We would hope that the delegates would cast the votes the way the members would like them to be cast, but that is not always the situation. We have people who want to vote but we cannot count their votes if they do not have a delegate.

Chairman Anderson:
It is not any different than the election that brought in the 42 of us. We all represent the same number of people, but that does not mean that they are all registered voters. The numbers of registered voters in our districts are

dramatically different. If a representative is elected to make decisions, are they entitled to make decisions whether everybody in the district likes it or not?

Donna Toussaint:
Suppose you were running for election and the state law said that in order for you to be elected, there would have to be a delegate in place to cast the votes. If you received 98 percent of the votes but the delegate just did not like you, he could vote for someone else. If a homeowner decides to cast his vote, the vote should count for the person they want. People do not vote because they know that their vote does not count.

Chairman Anderson:
Representative democracies are difficult to understand because they do not have a direct election.

Donna Toussaint:
I would like the way the state government works to funnel down to HOA and not have a system like the electoral college. I think it would be beneficial to the community and to the homeowners.

Dan Newburn, Private Citizen, Las Vegas, Nevada:
In 1994, the Summerlin Community Baptist Church started with seven people. A few years later, we purchased property in the Summerlin North Association. Shortly after we moved into the building, we were notified that we would need to begin paying a monthly assessment which would be based on the number of houses that could have been built on the four acres we owned. When I purchased my private home in Summerlin, it was made absolutely clear that we were moving into a HOA and there would be a monthly fee. That subject was never brought up when purchasing the church. During the years we owned the property and did not have a building on it, we did not pay any assessments. I inquired among the other churches in the area and found that five of the churches as well as the Hebrew Academy and other nonprofits did not pay a fee, and that only the new churches being built were being assessed. We met with the Board of Directors and felt that they too thought one house of worship should not be treated differently than another house of worship. I felt we were on our way to equality when I discovered that one of the larger churches that had been recently built had approached the association and asked if they could pay $100,000 up front so they would not have to make a monthly payment. The Board of Directors agreed to that, and it was suggested to us that if they exempted the other churches in the community from paying assessments, they would have to rebate that money. It is unfair, and the Board, at different times, also thought it was unfair. If we wanted to minister there, we would have to pay the fee. The only way this could be changed is if the Legislature would

make the change. It would benefit all of the churches. The $6,000 per year that the Summerlin Community Baptist Church pays to the association could be used to do other things to serve the community.

Chairman Anderson:
When purchasing the property, did you tell the HOA of the intended usage?

Dan Newburn:
Yes, they actively solicited that we build a Baptist Church in the Association.

Chairman Anderson:
Did they sell the property to you at a reduced rate as compared to other property in the area?

Dan Newburn:
I suspect they did, but we did not ask them to do that. We paid the price they gave us.

Chairman Anderson:
Discussing this issue on another piece of legislation, the general indication is that the HOA's often want to bring churches in to provide the feeling of community which is not offered in dollars and cents. To attract the churches, they often give an upfront deal on the property as compared to other types of usages.

Dan Newburn:
I know they did that with some of the other places of worship early on because they were very desirous. I do not know what they did with other churches but they gave us a price and we paid that price.

Assemblywoman Allen:
Assemblywoman Marilyn Kirkpatrick and Assemblywoman Sheila Leslie have asked to amend this bill with regard to HOA mailings. I consider it a friendly amendment and agree with what they have to say.

Kevin Janison, Private Citizen, Las Vegas, Nevada:
When you are elected, you represent all of the people in your district, whether they voted for you or not. Representing a constituent on issues is much different then representing a district based upon people who chose not to vote. The Electoral College is determined by the number of votes cast, not the number of votes not cast. If you have a dispute with your HOA, they give you a couple of options. They say that you can move out of your home or you can choose to run for the board. In my HOA where there are 16,000 homes, I can

knock on 7,000 doors and completely convince those people that I am the right man for the job. Even if all of them vote, someone else can be sitting in his living room watching Monday night football and be able to cast 9,000 votes because the turnout is less than 10 percent. It gives the delegates over 90 percent of the votes cast. I do not know of any other place where people get to vote for individual candidates by casting ballots for other people. These people are rewarded if the turnout is low so that they do not have to knock on doors. They can sit back and maintain their seat year after year. It is impossible to get new people that might have a different viewpoint.

There is one other issue that is not part of this bill that my HOA engages in and that is a nominating committee. You cannot decide that you want to run for the board and put your name in; you have to go through a nominating committee. Unfortunately, the members of the nominating committee are already board members, delegates, members of the compliance committee, or members of the design review committee. Every step of the way, the appeal process is the same group of faces. If you are a member of a community, you should have the same rights as everyone else to get your name on the ballot and run for the board without having to pursue acceptance by a nominating committee.

Wallace Riddle, Private Citizen, Las Vegas, Nevada:
I strongly support this bill as submitted by Assemblywoman Allen. There are a few changes I would like to recommend. I would like to use *Nevada Revised Statute* (NRS) 116.31034 as an example for the mailing and return of ballots to the Board. I would also like to see a definition of the mailing of ballots plainly set forth in Section 8(a). I would like there to be a Section 8(d) that states only votes that are returned may be counted. NRS 116.3106 refers to the recall of a board member. I would recommend the usage of the policies stated there. If ballots are counted to elect an individual, the same procedure should be used for recall. Thirty-five percent of the people in my HOA cast a ballot and the majority will either recall or not recall an individual. That does not seem fair to the individual homeowners. If you vote to elect an individual, you should vote to remove them on the same procedures.

Sandy Ambrose, Private Citizen, Las Vegas, Nevada:
I am sure there is concern about the wording "without prior consent." There may need to be language put into the bill that would define what is proper and what is not proper. The *Twin Rivers* appellate decision [*Committee for a Better Twin Rivers v. Twin Rivers Homeowners' Association*, 383 N.J. Super. 22 (App. Div. 2006)] is a very important document with regard to freedom of speech. In that decision, they have mandated that while freedom of speech is an amendment right, it is not absolute. There are limitations that the Board may have of time, place, and manner in which freedom of speech can be provided.

In Section 9 subsection 6, defines "an official publication," but the Board members also provide information on an intermittent basis. If the bill does not expound on the definition of an official publication, it gives the implication that it is a regularly circulated newsletter or publication. When they send out ballots, which are "an official publication", they can send flyers that provide information. These flyers are not "an official publication."

Board members often give oral presentations to explain their position, and their presentation may not be in a written publication or official newsletter. If you do not provide some way of allowing members of an association to give an opposing view, then you are only getting one side of the story. An example can be an executive board meeting. A board member can stand up and provide graphs and documents and provide experts to show their position on it. There is no remedy if you do not provide language in the bill for oral presentation by the opposing side. Inherent with this are problems that come up when you have one Board presenting its opinion when there may be 20 members of an association who have opposing views. How do you relegate whose opposing view gets to be presented? Publication can get rather large if you have to have everybody's position posted. In an oral presentation, whose opinion should be presented? I am happy with the bill, but as I have stated, there are some inherent problems that may come along with it. There needs to be something done with the censorship because you need to limit the language someone can use so that it is not slanderous.

Gary Randall, Private Citizen, Las Vegas, Nevada:
I am very much in favor of this bill. We had a situation in my HOA where the homeowners were required to vote for one issue against another rather than a yes or no vote on each issue. The Board was allowed to set forth their position with that ballot, which resulted in people voting for the position they wanted. There was no opportunity at that time for opposition to be voiced. We feel this should not be limited to an official publication such as a newsletter or website.

Chairman Anderson:
I will now move to those in opposition.

Bob Sidell, Representing Value Alliance, Las Vegas, Nevada:
We have a concern with the portion of the bill that relates to the delegate system. The reality is that the system is not working the way it is supposed to, however going from one extreme to another may not be the best solution. To go from a delegate system to a one person one vote rule may cause more difficulty than we already have. We believe there is a midpoint that will satisfy all HOAs. The idea of a cookie cutter solution does not exist in relation to HOAs; there are some as small as 20 homes and some as large as

20,000 homes. The implementation of their Covenants, Conditions, and Restrictions (CC&Rs) differ because they have different problems. The more complacent a community gets and the better it is being managed, the happier everybody is. Complacency is infectious, and that infection happens at different rates with a small community as opposed to a large one. The idea of going from black to white may not solve the problem, but there are infinite shades of grey. Our suggestion is to have the portion of the bill referring to the elimination of the delegate system be addressed again with the idea in mind of not simply eliminating the system, but fixing it. If there is a delegate, the delegate votes, but if there is no delegate, the individual homeowner's votes would count. That is the direction we believe it should take.

Assemblyman Mabey:
What problem would you foresee if each person had a vote and we did away with the delegate system?

Bob Sidell:
An example would be in a very large association with a very small minority who are always vocal. Because of the complacency of one-on-one voting, a contentious issue does not even bring the voters out. The vocal minority could exercise a lot of effort to push a particular issue. True to form, a 5,000 member association may end up with 300 or 400 total votes. The vote will probably be represented by a majority of the dissidents. Unfortunately, the majority of homeowners are silent, especially when things are good. Presently votes may count in favor toward an issue that only affects a very small percentage of the association and is detrimental to most of it. Unfortunately, that is the reality of what exists. Sociologists have been fighting it for years, and I do not know how we will ever get around it. The major concern is that with one-on-one voting, a very small minority can create problems that are detrimental to the majority of homeowners in that association.

Assemblyman Mabey:
It seems like it could be just the opposite.

Bob Sidell:
It very easily could be. It would be great if a contentious issue would bring out the vast majority. The problem is that HOAs are divided between the homeowners and the Board. People seem to forget that the Board is made up of volunteers that are actually giving their time to guarantee that the CC&Rs are going to be protected. When things are going well, nobody cares. The only people who care are the ones who have an axe to grind and they do not necessarily represent the majority.

Assemblyman Horne:
I have seen where people are quiet and unhappy, so we should not be adopting the position that we should keep things the same because there are just a few malcontents that are making the noise because the others would be making the same noise if they were unhappy. When you said that there should be a middle ground found instead of going from one extreme to the other, you admitted there were some problems with this. Did you contact the sponsor of the bill and propose a middle ground?

Bob Sidell:
Unfortunately, Value Alliance is relatively new. There are so many bills we are involved in that we did not have the chance. We would be delighted to sit down with Assemblywoman Allen and try to work out a compromise. Going from one extreme to another, regardless of what the issue is, there is always the problem of creating a monster worse than what you are getting rid of. There are some alternatives by restricting the use of delegate voting, like only allowing certain things, not being able to abuse the process, and satisfying the end result without creating any upset. It is a lot easier for an association that has 100 people in it to deal with something, where an association with 5,000 or 6,000 has difficulty. The concept of a delegate system is correct. Unfortunately, over the years it has evolved into a system that does not work. It does not work primarily because there are no built-in restrictions for how it should operate. If we could correct that, there would not be a need to do anything else.

Assemblyman Horne:
Many of the emails I received were from board members who do not believe the system is broken at all, which is also why Assemblywoman Allen brought the bill. It was expressed that proxy voting is not going away. Many of the concerns that the board has can still be addressed in that manner. It is not appropriate that if a vote is not cast, a vote is cast by someone else. If you want to give away your vote, you have to get a proxy, which as I suggested, could be conspicuous language saying you have my vote.

Assemblywoman Allen:
With regard to the specific instance where a neighborhood does not have a delegate, you said that their votes are not cast. I believe that in Summerlin North, the board president gets to cast those votes when there is no delegate.

Bob Sidell:
The original CC&R documents say that any district which does not elect a delegate will have the current president represent them. It does not say that he

will cast the vote. The people in the districts without a delegate are not represented by someone on the Board of Directors. There are no restrictions, and it would be simple for this bill to say that where there is no delegate elected, the individual votes of homeowners in that district will be counted. It would only need a one-line sentence stating that they may be represented, which is necessary for being able to disseminate information to the homeowners. If they are not represented by a member on the Board, they can keep their voting rights. Those are simple compromises that will allow the system to continue to work.

Assemblywoman Allen:
The concept of delegate voting for people, whether there is a delegate or not, is an affront to democracy. You said yourself that the CC&Rs in Summerlin allow for the Board President to cast those ballots.

Bob Sidell:
I did not say he could cast their vote for them, I said that he is allowed to represent them.

Karen Dennison, Representing the American Resort Development Association and Lake at Las Vegas Joint Venture Community, Nevada:
I am concerned with the issue of a time-share project in a master association voting through delegates. For example, Lake Las Vegas has a time-share project but does not generally have delegate voting. It has a one-unit, one-vote system for the commercial and residential owners except for time-share projects. With 13,000 time-share owners who own undivided interest in the time-share project, it is unmanageable for that to be a system of a one time-share interval. You would have to have 52 intervals to make one unit vote. We are asking for a narrow exception to say that if a time-share project is part of a master association, it should be allowed to vote through delegates. Proxies do not work for time-share projects because in past sessions, our legislature has narrowly defined who can receive a proxy. *Nevada Revised Statutes* 116.311 states that if you cannot vote through delegates, you are limited as to who can have your proxy. It limits your options to an immediate family member, another unit owner who resides in the community, or your tenant who resides in the common-interest community. The time-share owner would then have to go outside his time-share project and find someone who resides in the community to give a proxy to. This disenfranchises the project itself. There is more to proxies than voting; there is the idea that the delegate would attend a meeting on behalf of the time-share project itself. The delegate would have an opportunity to speak and be heard on issues relative to the time-share project. For this reason, we are hoping that you could make an exception for time-share projects in the delegate voting process. The other

issues that will be brought up are approval of the commission to foreclose, as well as the right of redemption after foreclosure sale and the community manager bond. I would like to say that Lake Las Vegas is in agreement with the common-interest communities' position on those issues.

Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities, Nevada:

Our commission has considered a number of bills, including this one, and has had a number of legislative commission meetings in open hearing. I would like to preface all of our remarks to echo what Mr. Sidell said. The commission is very aware that there are all different kinds of associations throughout the state. For this reason, the commission believes as a general proposition that the changes in NRS 116 need to be very carefully thought out. There are different types of delegate voting systems. The commission opposes the elimination of delegate voting. We do not propose or support any particular type of delegate voting, but we did ask the ombudsman and the Compliance Division of the Real Estate Division whether they have received complaints regarding delegate voting and they did not. There have not been hearings before the commission dealing with problems about delegate voting. The commission is concerned that the prohibition of delegate voting in all cases may have an adverse affect on different types of associations, particularly mixed use projects. *Nevada Revised Statute* 116.311 states that proxies are limited to one specific meeting and they terminate after that meeting. They cannot substitute for delegate voting. There were abuses in proxy voting, so the solution was to limit proxies to only one particular meeting. Subsection four of NRS 116.31034 allows members of the association to get their name on the ballot and has been in effect since the 1990's.

The commission opposes the idea of approving foreclosures. It is not clear if the commission would approve the amount or just the process and if they would be required to review the declaration or the budget in which the assessment is based, and at what point in the foreclosure process would the commission intervene. The commission is also concerned that they would be required to meet much more frequently at greater cost to the state, or that the enforcement of assessment liens would become seriously delayed. Most importantly, the commission does not believe that, since they are a formal body of the State of Nevada, they should be in the business of approving foreclosures as if the state itself were condoning specific foreclosures. We also suggest that activities related to foreclosures or enforcement of liens that violate law be subject to recourse either through the Nevada Real Estate Division which regulates managers who investigate associations, or the Financial Institutions Division which licenses those who conduct foreclosure sales, because they must be approved though the financial institutions.

As far as the equity of redemption, the commission did not take a position for or against. We would like to note that an equity of redemption for mortgage foreclosures is described in NRS Chapter 21 very specifically with lots of rules and procedures. It concerns the commission that none of the details are here.

As far as the official publications, we agree with what Ms. Ambrose said. There are a number of problems with the present wording because there needs to be a limitation on how one's views are shared. You do not want the association to have to mail out 20 pages of what one person thought. The commission recognizes the need for this and supports the proposition of political free speech in associations.

The commission did not take a position on the manager bonding in Section 10 because it needs greater detail. Some of the master associations of high-rise condos could have several millions of dollars and we would need to know how the bonding is going to work.

Lastly, if the houses of worship are no longer paying assessments to which they agreed, that would throw the burden on the homeowners who would have to pick up any deficit. In the interest of time, my testimony has been limited to our specific concerns (Exhibit F).

Assemblyman Mabey:
Is every house of worship treated the same?

Michael Buckley:
I do not know. That was just an observation I made. The commission has voted on some of these things, but we had not really discussed that because it was just heard this morning.

Chairman Anderson:
It seems that there are as many different ways of handling these issues as there are communities in this state.

Marilyn Brainard, Commissioner, Nevada Commission for Common-Interest Communities:
Ms. Ambrose made the comment that she felt people in associations did not have the chance to speak. We have public comment periods mandated for all of our associations, no matter what the size, so that the homeowners can come and speak before the formal board meeting begins. Ms. Ambrose also talked about asking the association to insert any material that was presented by a homeowner in the official publication. Many associations would choose not to publish their newsletter or magazine because of that burden. Lastly,

Ms. Ambrose made reference to the *Twin Rivers* decision. It has been argued to the New Jersey Supreme Court and is under consideration, but the final ruling has not yet been decided.

[Chairman Anderson left room.]

Assemblywoman Gerhardt:
I had a situation where I was at odds with my HOA because I did not believe that they were applying the rules equally to all of the residents. I went to a board meeting and asked if there was any way that I could communicate with the other homeowners about this particular issue, to see if there were other people who were having the same problem that I was. I was told that the only way I could have a voice in the process was to go knock on doors. I believe that people need to have an opportunity to be heard. As a homeowner who pays dues, I think it is absolutely appropriate to have a means of communicating with the other members. I could be brief and concise and it would not be cost prohibitive.

Marilyn Brainard:
In the association I served on, our Committee Manager takes minutes. In the beginning of our minutes, there is a summation of comments that were made. We do not identify the homeowner, but significant comments are recorded. The minutes are posted within 30 days, so the other homeowners can go online and read them. It is not a verbatim transcription, but the general issues are contained in that section. If that did not solve the problem, you always have the redress, which is why we have the ombudsman's office to work with the board to be sure that is included.

[Chairman Anderson returned to room.]

Assemblywoman Gerhardt:
How long does it typically take for ombudsman to resolve an issue?

Gail Anderson, Administrator, Department of Business and Industry, Real Estate Division, Nevada:
The ombudsman started the intervention conference program on July 31, 2006. A letter goes out six weeks before the conference, inviting homeowners to come in and attempt to resolve their issues. This is a new procedure we started last summer.

Shari O'Donnell, Vice President of Government Affairs and Community Relations, Signature Homes, Nevada, Representing Nevada Commission for Common-Interest Communities:
The right to use proxies in the election or removal of board members was done away with in past Legislative sessions. Elections and removals can only be conducted through secret ballot. In response to Assemblywoman Gerhardt's comment, we did require community managers to keep a thorough log of all violations so that you could request those records and see how many notices went out on a particular violation. It takes six weeks to have a matter reviewed by the ombudsman because of the due process involved. That timeframe could be shortened if we shortened the due process.

Assemblywoman Gerhardt:
Anecdotally, I have heard that a year to a year and a half is the norm.

Kevin Ruth, Representing Community Association Management Companies through Executive Officers, Nevada:
We represent over 340,000 homes in hundreds of communities. Everything that has been put forth by the commission in opposing the bill, CAMEO supports. We have also provided the Committee proposed amendments (Exhibit G).

Chairman Anderson:
Have you shared this with Assemblywoman Allen?

Kevin Ruth:
No, sir. It was just put together this morning. Our lobbyist did approach Assemblywoman Allen yesterday to indicate that we would be testifying in opposition.

Randy Eckland, Representing the Howard Hughes Corporation and the Summerlin Community Association Management Team, Nevada:
I believe in the delegate system of the government, therefore I must respectfully oppose A.B. 396. Since arriving in Summerlin in 1992, our delegate system has served our community very well. We have completed successful day to day operations, a major amendment process, and the smooth transition of 15,000 homes to resident control. Before residents were entitled to begin serving on the board, they were naturally eager to engage in the community government system, and the neighborhood delegate system gave them the opportunity to do that. They met regularly and it was an immediate and effective resource that engaged them in government in a positive manner. I have found that neighborhood delegates typically attend more community meetings to help familiarize themselves with the many sides of an issue. They

also tend to vest themselves more in the community government processes, and as a result they demonstrate a higher level of stewardship and responsibility. The neighborhood delegate involvement also broadens their knowledge and perspective as they discuss issues with fellow delegates and residents. The delegate system has also been instrumental in the growth of an expanded and well rounded volunteer governmental base, which is vital to any community association striving for harmony and effectiveness. Many of our early delegates eventually assumed leadership roles on the respected boards of the compliance advisory, design review, and finance committees. Not all communities have had the success that our delegate system has, and I can certainly see what the benefits would be of retooling or change. I am committed to work over the next two years to develop workable solutions. If we are given an opportunity to fix what is not working in this environment, it would be a better approach than simply doing away with it to the detriment of those areas that have used it in a good manner.

There were also misperceptions as relating to the Summerlin North Community association and the proxy to the president of the board. In my experience, the neighborhoods which did not have the ability to elect their own delegate were still returning ballots whenever an issue was brought to vote. To make sure the neighborhood was heard, the president would cast ballots for anybody who took the time to return them. There was no casting of any ballots that were not returned or any votes that were unheard.

David Stone, Owner, Nevada Association Service:
I would like to briefly address Section 7 and Section 8. Section 7 deals with getting permission from the commission. The ombudsmen's office already has a process in place regarding foreclosures and I do not think an extra step to the commission will provide any additional level of assurance. Last year, my office started thousands of collection accounts and foreclosed on only two homes. One of the homes was already in foreclosure by the lender and the other home had been abandoned by the homeowner. This is not a problem that truly exists. Section 8 is vague and does not give any timeline for the right of redemption, who is responsible for paying the mortgage, property taxes, or ongoing assessments. It does not say who needs to pay money in order to redeem the property or how to address the issue if the lender is already in foreclosure. What happens if the lender forecloses during the right of redemption period? Are any of the rights lost by any of the individuals? It needs to be cleaned up and answered those questions.

Chairman Anderson:
I have a letter from Judy Farrah in opposition of Section 7 through Section 10 that needs to be inserted into the record (Exhibit H).

Let me close the hearing on A.B. 396.

Let us open the hearing on A.B. 399.

Assembly Bill 399: Revises the provisions relating to the Office of the Ombudsman for Owners in Common-Interest Communities. (BDR 10-026)

Assemblywoman Francis O. Allen, Assembly District No. 4:
[Read from prepared testimony (Exhibit I).]

Chairman Anderson:
Dispute resolution centers are something that I have supported in the past. Would this be moving it to someone who has the training? What are the qualifications established? It appears the office gets to establish what the criteria is going to be, so is this going to take the legislature out of the process of setting forth the duties and responsibilities of the ombudsman? It is not going to be an immediate solution but a rather prolonged one.

Assemblywoman Allen:
I am open to an interim study on how to best give homeowners this resolution. The Office of the Ombudsman would select at random from a list of licensed private ombudsmen. The legislature would have oversight of it, but in actuality, instead of only having one investigator in Carson City and two in Southern Nevada, this would multiply.

Assemblyman Segerblom:
In law, we use the alternative mediation processes regularly and they are fantastic. I would encourage the concept of using mediation.

David Thomas, Resident of Summerlin Community, Nevada:
I am a resident of Summerlin community and also an attorney. I have practiced for 18 years and have represented more HOAs than I have residents. About eight years ago I got involved with youth sports in Summerlin. It became remarkable to me the number of people who came up to me and had complaints. I heard testimony earlier today that it might be 1 to 2 percent of the community that had complaints about the HOA. I do not profess to be an expert because I do not go to meetings, but I know when I was at the soccer fields and baseball fields, I had complaints from about 10 percent of the kids' parents. The complaints I heard from this HOA are not the normal complaints

about reasonable restrictions. No one has ever come to me and said that the HOA will not allow them to paint their house pink or put a garbage sculpture in their front yard. It seems to be more along the lines of people planting trees without prior approval and having to tear them out. Another example is doing brickwork and yard work and having to tear it out. One person even said their HOA did not like the contractor they used. Most recently, someone put up a Greenbay Packers flag Sunday morning and took it down Sunday night and there were complaints about that. These do not seem to be reasonable complaints from the HOA. When I found out there was talk about changing a law that would give the HOA more power, I was concerned. One of my biggest concerns is that the HOA attorneys feel like they need more power. I do not feel they need more power, they just want more power. I am concerned because of the number of contacts I have made with people. HOA's are necessary, but I am concerned about giving them control and authority over everything in the streets, only because of the people I have dealt with and the stories they have. I have always been concerned that the HOA is taking dues and giving them to an attorney and making some of these people's lives miserable. My personal opinion is that the amount of authority that the HOA has to govern their residents is fine. These are things that need to be handled between neighbors. I am concerned about the number of times people say they have been threatened with an attorney or an attorney has actually been retained.

Chairman Anderson:
Do you perceive that there may be a quicker resolution to HOA's without the use of ombudsmen?

David Thomas:
I believe that is the intent, but I have been involved in two cases where the people have felt like the ombudsman was going to take too long and that it was not going to be resolved. Another common thread with the people who have come to me, is that there was no complaint from the neighbors. Some people even had written documents from neighbors saying that they had no problem with the brickwork or the trees. If the neighbors are not concerned, I do not know why the HOA is.

Chairman Anderson:
The purpose of living in a common-interest community is to make sure people maintain their homes.

David Thomas:
HOA's are absolutely necessary for that, but I have never heard from people that they do not feel like repairing their house or watering their grass.

Assemblywoman Allen:
When the ombudsman's office was originally created by the legislature, it was done to prevent the homeowner from having to retain expensive attorneys and go through a lengthy court battle. We created this ombudsman office where someone can go and get dispute resolution. Now, we as a state are failing in that obligation.

Chairman Anderson:
Let me now move to those in opposition.

Kevin Ruth, Representing Community Association Management Companies through Executive Officers, Nevada:
We are in opposition to A.B. 399. The concept of privatizing what is already in existence may be a good thing down the road. However, we as an organization have seen significant improvement in the system in the past six to nine months. The new ombudsman who has been on the staff for that period of time has instituted a new conferencing concept which we support. Issues should be resolved in a more expeditious way. I am not sure if we are trying to remedy and remove the Alternative Dispute Resolution (ADR) process which is in place right now or if we are trying to deal with the intervention process which is taken care of through the real estate division and not through the ombudsman. We feel that creating a private ombudsman is not in the best interest of HOAs at this time, nor the homeowners. We also have significant issues with the funding. It does not make sense that the aggrieved party would be required to put 10 percent of the estimated fees forth, while the respondent would be required to pay the remaining 90 percent. Once the ombudsman comes up with a determination, that all could be flip-flopped based on whether or not the homeowner was found to be incorrect in their assertions. I am confident that the common-interest community commission and the real estate division have some issues with this also.

Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities, Nevada:
Read from prepared testimony (Exhibit J).

We believe that these changes need to be very carefully thought out and have input from a lot of different people. The ombudsman reports that of the people who participate in her conferences, she believes about 50 percent of them are resolved. She does not keep formal statistics on those because she wants it to be a very informal process.

Assemblywoman Gerhardt:
You said that during the public comment portion they were overwhelmingly in support of the commission's position. How many people are you talking about?

Michael Buckley:
It depends on the meeting.

Assemblywoman Gerhardt:
What is an average?

Michael Buckley:
Only one person showed up for our meeting last week.

Assemblywoman Gerhardt:
Is that an average?

Michael Buckley:
No. It depends on what we are talking about. We had a workshop dealing with reserve study preparers in Carson City last August that had about 20 people. I would say 10-20 people come to regular meetings.

Assemblywoman Gerhardt:
How many people are we talking about in Clark County that are part of common-interest communities.

Michael Buckley:
I do not have that number. I think there are 200,000 to 300,000 units in the state and 2,600 associations, most of them in the south.

Chairman Anderson:
Before adopting regulations, we require information on the number of meetings held and the number of people who attend. It is not unusual to see that there are as few as two people who show up and sometimes as many as 100. It depends on the particular topic being discussed. I was surprised to see how frequently no one shows up, although everybody maintains that it is going to change their lifestyle.

Marilyn Brainard, Commissioner, Nevada Commission for Common-Interest Communities:
Assemblywoman Allen proposes a market-based solution in privatization, which would be a tremendous idea in many aspects of government. However, in looking at the privatization for the ombudsman, I am deeply concerned. By creating multiple people, how would oversight and consistency be

accomplished? Part of the reason we have only one ombudsman is that we like to know that every case is treated equally. I cannot even imagine how creating the oversight for a private ombudsman would be accomplished. Our current ombudsman would be forced into an administrative role when so far her strength has been getting people to resolve their problems amicably. That is what we hope will continue so the private program would be a big concern. I do not know how we could continue to hold these meetings without putting a further strain on the resources of our state government. I would like to point out, in referring to the other side of our legislative process, that Senator Schneider removed the language similar to Assemblywoman Allen's Section 10, realizing that it would be grossly unfair to put the burden on an association. It would be impossible to have the supporting regulations in place by July 1, knowing that the Legislative Counsel Bureau (LCB) must approve all language. Overall, I feel that the parts of this bill that would be considered would have many egregious, unintended, and unfavorable consequences.

Judy Farrah, Chairman of the Community Associations Institute of Nevada, and Representing Legislative Action Committee:
If you brought this bill forward in 2001 or 2003, I probably would have been in support of it because the program was not working. However, we are seeing a significant change in the division and the ombudsman's program. We now have administrative law judges who have been hired by the division to handle these particular types of disputes. We need to give them a chance to do what they have finally been able to put together over the last few months, and hopefully this program will be successful. I have submitted my comments in writing as well (Exhibit K).

Michael Trudell, Manager, Caughlin Ranch Homeowners Association, Nevada:
I am one of the people that attended the commission hearings last week, and I appreciated the opportunity to be able to speak to the commissioners about our concerns. Recently, Caughlin Ranch HOA had an incident where we really needed the ombudsman's office to help with a matter where the reform board that had been elected did not want to conform to the requirements to have a recall election after a recall petition had been submitted to the state. If it was not for the ombudsman's office staff being available and acting quickly, we would have had serious consequences in our HOA. Within two weeks after the meeting on January 10 where the board of directors refused to set a special meeting date for the recall ballot to be counted, the ombudsman's office had assisted me in preparing a removal election plan and approving that plan with other items. We were able to hold that recall election. One of the problems with the process is that there are laws in place which indicate how you are to go about any kind of a complaint. Part of that process is that you must file an intervention affidavit with the ombudsman's office. The gentleman who spoke

earlier indicated that he had spoken to people but they did not want to file with the ombudsman's office because they thought it would be ineffective. If homeowners do not file the affidavit, the ombudsman's office does not have the authority to act. If they do not follow the procedures that are currently in place, the failure of the system is blamed, but it is not because the system does not work; it is because people fail to understand how to use the system properly.

Chairman Anderson:
Oftentimes a group of homeowners is paying for an attorney, so an individual homeowner is at a dramatic disadvantage because he is going to have to engage someone on his own.

Michael Trudell:
At times, that is the issue. We have had very good success with the ombudsman's office and the State's staff.

Chairman Anderson:
Is there anyone else wishing to be on the record for A.B. 399?

Hearing closed on A.B. 399.

It is my intention to give A.B. 396 to Assemblywoman Allen. If you have any suggestions on A.B. 396, please share them with her and Ms. Chisel. Please be cognizant of the concerns that have been raised relative to foreclosures, the placing of foreclosures within the HOA for nonpayment of assessments and how those situations are handled. Also we need to try and find a compromise on the voting process that can be worked out. Assemblywoman Allen, I believe we have offers from Ms. Dennison, Mr. Buckley, Mr. Sidell, and the Hughes Corporation to help work on language.

If there is any amended language that needs to be put forward on A.B. 399, I would also suggest that be done as soon as possible.

Let me open the hearing on Assembly Bill 431.

Assembly Bill 431: Establishes provisions governing condominium hotels. (BDR 10-1056)

William Horne, Assembly District No. 34, Clark County, Nevada:
The purpose of this legislation is to create a new section in statute to deal with the unique situation of common-interest communities, particularly condominium hotels. The law currently rests in NRS Chapter 116, but it does not fit cleanly. The bill you have before you without the amendments is just a skeleton. The

amendments (Exhibit L) are supposed to be part of the bill, but because of time constraints and drafting, they have put out a skeleton bill instead. The bill without the amendments does not make very much sense in what we are trying to do in making a separate Chapter 116B for hotel condominiums. Many of the provisions in Chapter 116 have been placed in Chapter 116B. There are additional provisions that deal with the unique character of hotel condominiums. There are approximately 2,200 hotel condominiums in Clark County alone, and about 6,000 currently under construction in Clark and Washoe Counties. These properties, unlike typical HOAs, are mixed use. They are not designed for single family residences and are not the typical condominiums that we have grown accustom to. These sit on hotel properties. In a typical HOA, a large number of residents are the owners of the condos or single family dwellings. In hotel condominiums, many of the unit owners may not live there. They rent them out to visitors who come and go, but the property is managed by the hotel. The reason this legislation was brought was because many of the common elements in a typical HOA are different in a hotel condominium property. This is going to provide some flexibility and control for hotel operators while also giving the same protections for the unit owners in the property. There is also an executive summary of the amendment (Exhibit M) which should give you a brief overview of what this legislation does. No one has contacted me in opposition or with concerns on this proposal.

Sam McMullen, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada:

As Assemblyman Horne said, this is basically a new animal in terms of common-interest communities. Common-interest communities have multiple interests in certain pieces of property within a parcel or unit. Consequently, they have to interact, which is why we have NRS Chapter 116. In the hotel condo situation, there is a difference in common elements, which are called shared components and owned by the hotel unit. Mandy Shavinsky, who is also with Snell and Wilmer, will be doing most of the speaking to give you a quick summary of the details of the bill and how it changes NRS Chapter 116. Approximately 90 percent of this amendment is exact language from NRS Chapter 116. In respect to proxies, reserves, declarations, construction defects, and the initiation of law suits, this bill reads exactly the same as Chapter 116.

Mandy Shavinsky, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada:

As Assemblyman Horne indicated, condominium hotels are very unique and new products to Nevada. They do not fit squarely within the framework of NRS Chapter 116, which was designed to help govern master planned communities such as Summerlin North and other traditional condominiums. Our thought is

that NRS Chapter 116 does not adequately address situations where you have more than one use, specifically hotel use that is taking place in a condominium hotel. Assembly Bill 431 provides the framework for that. Transient use is permitted in these types of developments, and as result of the hotels, it is really the primary use of these projects. It is possible but extremely unlikely that there will be full-time residents living in these types of projects. Most people live in single family subdivisions, and although we enjoy having the benefits of hotel casinos in our state, we do not want to live in them full-time. As Assemblyman Horne said, we took what worked from NRS Chapter 116 and left many of the same protections in place. We have also built in the concept of a hotel unit which is owned by a hotel operator. The hotel operator manages the hotel on-site. They have to maintain certain quality levels and standards within the condominium hotel in order to make the hotel an attractive destination for the unit owners. Operating and soon to be operating condominium hotels are often associated with hotels such as Hyatt, MGM, and other well known chains. Purchasers and guests in those projects are going to expect a level of quality that may not be possible in a traditional condominium situation where the HOA governs common elements. Essentially, the hotel and residential unit owners are all stake holders, and there is a mutuality of interest that exists in promoting and making the hotel condominium successful that is not present with HOA's.

Assembly Bill 431 has many of the same safeguards as NRS Chapter 116, and the common-interest community commission would continue to have jurisdiction over these types of communities so there would be some avenue of redress for homeowners who do not feel their voice is being heard. The ombudsman would also have jurisdiction over these communities. The same types of consumer protections that are currently in NRS Chapter 116 will also be available here, such as the provision of a public offering statement, which is a statement of statutorily mandated disclosures that homeowners must be provided with. The same five-day rescission right will exist, which is the right of someone who has contracted to purchase one of these units to rescind their purchase within five days of the execution of the purchase agreement. There will also be a reserve requirement for major components as there is in NRS Chapter 116. We believe this legislation will create structure and predictability for, not just the unit owners who have purchased and wish to rent their units out under the structure, but also for the developers that have come in and the hotel operators that are looking to this product as the new wave of hotel and resort development in Nevada.

Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities, Nevada:

We support the concept of having a separate chapter for hotel condos.

Bruce Arkell, Representing the Nevada Association of Land Surveyors:
We have a couple of minor amendments to Section 71 and Section 77 of the mock-up (Exhibit N). The amendments basically take out language that violates licensure laws, and one provides for a vertical datum so that you can find the units from space. The last one allows for a better definition of the units.

Karen Dennison, Representing the American Resort Development Association and Lake at Las Vegas Joint Venture Community, Nevada:
I would like to put on the record that we are in favor of a separate NRS Chapter for condominium hotels for many of the reasons that Mandy Shavinsky pointed out to you. We have not yet had an opportunity to review the amendment, but we will do so and work with the others in support.

Sam McMullen:
I would also be happy to work on this bill. If there are any questions or concerns, please direct them to me.

Chairman Anderson:
Is there anyone else who needs to get on the record? [There were none.]

Let me close the hearing on A.B. 431.

It is the intent of the Chairman to assign A.B. 431 to Assemblyman Horne.

[Meeting adjourned at 10:48 a.m.]

RESPECTFULLY SUBMITTED:

_____
Kaci Kerfeld
Committee Secretary

APPROVED BY:

_____
Assemblyman Bernie Anderson, Chair

DATE:_____

EXHIBITS

Committee Name: Committee on Judiciary

Date: April 3, 2007 **Time of Meeting: 7:43 a.m.**

Bill	Exhibit	Witness / Agency	Description
	A		Agenda
	B		Attendance Roster
A.B. 371	C	Nevada Legal Press	Email to Assemblyman Goedhart
A.B. 396	D	Francis Allen, Assemblywoman District 4	Prepared testimony
A.B. 396	E	Francis Allen, Assemblywoman District 4	Proposed amendment mock-up
A.B. 396	F	Michael E. Buckley, Nevada Commission for Common Interest Communities	Prepared testimony
A.B. 396	G	Kevin Ruth, Cameo, Inc.	Proposed amendments
A.B. 396	H	Judy Farrah, Capital Consultants Management Corporation	Comments on A. B. 396
A.B. 399	I	Francis Allen, Assemblywoman District 4	Prepared testimony
A.B. 399	J	Michael E. Buckley, Nevada Commission for Common Interest Communities	Prepared testimony
A.B. 399	K	Judy Farrah, Capital Consultants Management Corporation	Comments on A. B. 399.
A.B. 431	L	William Horne ,Assemblyman District 34	Proposed amendment
A.B. 431	M	William Horne ,Assemblyman District 34	Executive summary of proposed condominium hotel legislation from Snell & Wilmer
A.B. 431	N	Bruce Arkell, Nevada Association of Land Surveyors	Proposed amendments to A. B. 431

AMENDMENTS TO
UNIFORM COMMON INTEREST OWNERSHIP ACT

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-SEVENTEENTH YEAR
IN BIG SKY, MONTANA
JULY 18 – 25, 2008

WITH PREFATORY NOTE AND COMMENTS

December 8, 2008

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DRAFTING COMMITTEE ON AMENDMENTS TO UNIFORM COMMON INTEREST OWNERSHIP ACT

The Committee appointed by and representing the National Conference of Commissioners on Uniform State Laws in amending this Act consists of the following individuals:

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AMENDMENTS TO UNIFORM COMMON INTEREST OWNERSHIP ACT

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APPLICABILITY

[ARTICLE] 2
CREATION, ALTERATION, AND
TERMINATION OF COMMON INTEREST COMMUNITIES

[ARTICLE] 3
MANAGEMENT OF THE COMMON INTEREST COMMUNITY

[ARTICLE] 4
PROTECTION OF PURCHASERS

[ARTICLE] 5
ADMINISTRATION AND REGISTRATION
OF COMMON INTEREST COMMUNITIES

a minimum heat in their units of 55 degrees. The teenage son of the Owner of Unit C turns off all the heat after his last run on Sunday, and on Monday night, the pipes in Unit C burst. A finder of fact might properly conclude that the son of the owner of Unit C was grossly negligent.

SECTION 3-116. LIEN FOR ~~ASSESSMENTS~~; SUMS DUE ASSOCIATION; ENFORCEMENT.

(a) The association has a statutory lien on a unit for any assessment levied against attributable to that unit or fines imposed against its unit owner. Unless the declaration otherwise provides, reasonable attorney's fees and costs, other fees, charges, late charges, fines, and interest charged pursuant to Section 3-102(a)(10), (11), and (12), and any other sums due to the association under the declaration, this [act], or as a result of an administrative, arbitration, mediation, or judicial decision are enforceable in the same manner as unpaid assessments under this section. If an assessment is payable in installments, the lien is for the full amount of the assessment from the time the first installment thereof becomes due.

(b) A lien under this section is prior to all other liens and encumbrances on a unit except:

~~(i)~~(1) liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances which that the association creates, assumes, or takes subject to;~~,~~

~~(ii)~~(2) except as otherwise provided in subsection (c), a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent~~,~~ or, in a cooperative, the first security interest encumbering only the unit owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent;; and

~~(iii)~~(3) liens for real estate taxes and other governmental assessments or charges against the unit or cooperative.

(c) A ~~The~~ lien under this section is also prior to all security interests described in

subsection (b)(2) ~~clause (ii) above~~ to the extent of both the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien and reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien. ~~This subsection~~ Subsection (b) and this subsection ~~does~~ do not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association. [~~The~~ A lien under this section is not subject to ~~the provisions of~~ [insert appropriate reference to state homestead, dower and curtesy, or other exemptions].]

~~(c)~~(d) Unless the declaration otherwise provides, if two or more associations have liens for assessments created at any time on the same property, those liens have equal priority.

~~(d)~~(e) Recording of the declaration constitutes record notice and perfection of the lien. No further recordation of any claim of lien for assessment under this section is required.

~~(e)~~(f) A lien for unpaid assessments is extinguished unless proceedings to enforce the lien are instituted within ~~[3]~~ [three] years after the full amount of the assessments becomes due.

~~(f)~~(g) This section does not prohibit actions against unit owners to recover sums for which subsection (a) creates a lien or prohibit an association from taking a deed in lieu of foreclosure.

~~(g)~~(h) A judgment or decree in any action brought under this section must include costs and reasonable attorney's fees for the prevailing party.

~~(h)~~(i) The association upon written request made in a record shall furnish to a unit owner a statement setting forth the amount of unpaid assessments against the unit. If the unit owner's interest is real estate, the statement must be in recordable form. The statement must be furnished within [10] business days after receipt of the request and is binding on the association, the

executive board, and every unit owner.

~~(i)~~[(j)] In a cooperative, upon nonpayment of an assessment on a unit, the unit owner may be evicted in the same manner as provided by law in the case of an unlawful holdover by a commercial tenant, and the lien may be foreclosed as provided by this section.

~~(j)~~[(k)] The association's lien may be foreclosed as provided in this subsection and subsection (p):

(1) ~~In~~ in a condominium or planned community, the association's lien must be foreclosed in like manner as a mortgage on real estate [or by power of sale under [insert appropriate state statute]];

(2) ~~In~~ in a cooperative whose unit owners' interests in the units are real estate ~~(Section 1-105)~~, the association's lien must be foreclosed in like manner as a mortgage on real estate [or by power of sale under [insert appropriate state statute]] [or by power of sale under subsection ~~(k)~~(l)]; [or and]

(3) ~~In~~ in a cooperative whose unit owners' interests in the units are personal property ~~(Section 1-105)~~, the association's lien must be foreclosed in like manner as a security interest under [insert reference to Article 9, Uniform Commercial Code][;and]

[(4) ~~In the case of~~ in a foreclosure under [insert reference to state power of sale statute], the association shall give the notice required by statute or, if there is no such requirement, reasonable notice of its action to all lien holders of the unit whose interest would be affected].]

[(l)][(k) ~~In a cooperative, if~~ If the unit owner's interest in a unit in a cooperative is real estate, the following requirements apply ~~(Section 1-105)~~:

(1) The association, upon ~~non-payment~~ nonpayment of assessments and compliance with this subsection, may sell that unit at a public sale or by private negotiation; and

at any time, date, and place. ~~Every aspect of the sale, including the method, advertising, time, place, and terms must be reasonable.~~ The association shall give to the unit owner and any ~~lessees~~ lessee of the unit owner reasonable ~~written~~ notice in a record of the time, date, and place of any public sale or, if a private sale is intended, or of the intention of entering into a contract to sell and of the time and date after which a private disposition may be made. The same notice must also be sent to any other person ~~who~~ that has a recorded interest in the unit which would be cut off by the sale, but only if the recorded interest was on record seven weeks before the date specified in the notice as the date of any public sale or seven weeks before the date specified in the notice as the date after which a private sale may be made. The notices required by this subsection may be sent to any address reasonable in the circumstances. ~~Sale~~ A sale may not be held until five weeks after the sending of the notice. The association may buy at any public sale and, if the sale is conducted by a fiduciary or other person not related to the association, at a private sale.

(2) Unless otherwise agreed, the ~~debtor~~ unit owner is liable for any deficiency in a foreclosure sale.

(3) The proceeds of a foreclosure sale must be applied in the following order:

~~(i)~~(A) the reasonable expenses of sale;

~~(ii)~~(B) the reasonable expenses of securing possession before sale; the reasonable expenses of holding, maintaining, and preparing the unit for sale, including payment of taxes and other governmental charges; and premiums on ~~hazard and liability~~ insurance,; and, to the extent provided for by agreement between the association and the unit owner, reasonable attorney's fees, costs, and other legal expenses incurred by the association;

~~(iii)~~(C) satisfaction of the association's lien;

~~(iv)~~(D) satisfaction in the order of priority of any subordinate claim of

record; and

~~(v)~~(E) remittance of any excess to the unit owner.

(4) A good faith purchaser for value acquires the unit free of the association's debt that gave rise to the lien under which the foreclosure sale occurred and any subordinate interest, even though the association or other person conducting the sale failed to comply with ~~the requirements of~~ this section. The person conducting the sale shall execute a conveyance to the purchaser sufficient to convey the unit and stating that it is executed by ~~him~~ the person after a foreclosure of the association's lien by power of sale and that ~~he~~ the person was empowered to make the sale. Signature and title or authority of the person signing the conveyance as grantor and a recital of the facts of ~~non-payment~~ nonpayment of the assessment and of the giving of the notices required by this subsection are sufficient proof of the facts recited and of ~~his~~ the authority to sign. Further proof of authority is not required even though the association is named as grantee in the conveyance.

(5) At any time before the association has disposed of a unit in a cooperative or entered into a contract for its disposition under the power of sale, the unit owners or the holder of any subordinate security interest may cure the unit owner's default and prevent sale or other disposition by tendering the performance due under the security agreement, including any amounts due because of exercise of a right to accelerate, plus the reasonable expenses of proceeding to foreclosure incurred to the time of tender, including reasonable attorney's fees and costs of the creditor.]

~~(f)~~(m) In an action by an association to collect assessments or to foreclose a lien for ~~unpaid assessments~~ on a unit under this section, the court may appoint a receiver to collect all sums alleged to be due and owing to a unit owner before commencement or during pendency of the action. The receivership is governed by [insert state law generally applicable to

receiverships]. The court may order the receiver to pay any sums held by the receiver to the association during pendency of the action to the extent of the association's common expense assessments based on a periodic budget adopted by the association pursuant to Section 3-115.†

(n) An association may not commence an action to foreclose a lien on a unit under this section unless:

(1) the unit owner, at the time the action is commenced, owes a sum equal to at least [three] months of common expense assessments based on the periodic budget last adopted by the association pursuant to Section 3-115(a) and the unit owner has failed to accept or comply with a payment plan offered by the association; and

(2) the executive board votes to commence a foreclosure action specifically against that unit.

(o) Unless the parties otherwise agree, the association shall apply any sums paid by unit owners that are delinquent in paying assessments in the following order:

(1) unpaid assessments;

(2) late charges;

(3) reasonable attorney's fees and costs and other reasonable collection charges; and

(4) all other unpaid fees, charges, fines, penalties, interest, and late charges.

(p) If the only sums due with respect to a unit are fines and related sums imposed against the unit, a foreclosure action may not be commenced against the unit unless the association has a judgment against the unit owner for the fines and related sums and has perfected a judgment lien against the unit under [insert reference to state statute on perfection of judgments].

(q) Every aspect of a foreclosure, sale, or other disposition under this section, including the method, advertising, time, date, place, and terms, must be commercially reasonable.

Comment

1. Section 3-116(a) was amended in 1994 to delete the language "from the time the assessment or fine becomes due." The deleted clause was intended to make clear that the lien was enforceable at the time the assessment became due. Commentators have observed, however, that the language caused confusion with respect to priority issues. The intention of the statute, as demonstrated by the Comments, was that the inchoate statutory lien was the functional equivalent of real estate taxes except with respect to the special priorities identified in subsection (b) of the section. The deletion of the language as suggested makes clear that the lien arises immediately upon the effective date of the statute for old common interest communities and upon recording of the declaration for new common interest communities.

As a result of this deletion, it is clear that in the absence of an exception in a title insurance policy for common charges, a title insurer would be liable for post-insurance obligations which have a priority established prior to the time the policy was issued. This, however, is no different than in other inchoate liens such as real estate taxes and mechanics liens, all of which have become standard exceptions in the title industry.

2. To ensure prompt and efficient enforcement of the association's lien for unpaid assessments, such liens should enjoy statutory priority over most other liens. Accordingly, subsection (b) provides that the association's lien takes priority over all other liens and encumbrances except those recorded prior to the recordation of the declaration, those imposed for real estate taxes or other governmental assessments or charges against the unit, and first security interests recorded before the date the assessment became delinquent. However, as to priorfirst security interests the association's lien does have priority for six months' assessments based on the periodic budget. A significant departure from existing practice, the six months' priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders. As a practical matter, secured lenders will most likely pay the six months' assessments demanded by the association rather than having the association foreclose on the unit. If the lender wishes, an escrow for assessments can be required. Since this provision may conflict with the provisions of some state statutes which forbid some lending institutions from making loans not secured by first priority liens, the law of each State should be reviewed and amended when necessary.

In cooperatives, the association has legal title to the units and depending on the election made in the declaration pursuant to Section 2-118(i) may have power to create, assume, or take subject to security interests in the units which have priority over the interest of unit owners. Obviously, the cooperative association's lien should not have priority over an interest which the association itself has given, assumed, or taken subject to and subsection (b) expressly so provides.

The special reference to cooperatives in subsection (b)(ii)(2) merely recognizes that in a cooperative both the association and the unit owner have an interest in a unit.

3. Units may be part of two common interest communities. For example, a large real estate development may consist of one or more condominiums which are also part of a larger planned community. In that case, the planned community association might assess the

condominium units for the general maintenance expenses of the planned community and the condominium association would assess for the direct maintenance expenses of the building itself. In such a situation, subsection ~~(c)~~(d) provides that unpaid liens of the two associations have equal priority regardless of the relative time of creation of the two regimes and regardless of the time the assessments were made or became delinquent.

4. Subsection ~~(f)~~(g) makes clear that the association may have remedies short of foreclosure of its lien that can be used to collect unpaid assessments. The association, for example, might bring an action in debt or breach of contract against a recalcitrant unit owner rather than resorting to foreclosure.

5. The rights of the association against a unit upon nonpayment of an assessment on that unit depends on whether the common interest community is a condominium or planned community on the one hand, or a cooperative on the other.

In the typical cooperative the association will have a substantial underlying mortgage on all or a substantial portion of the real estate in the cooperative and a large part of each unit owner's periodic assessment will go toward payment of that particular unit's proportionate share of the mortgage. If the unit owner fails to pay his assessment on time, the association may be forced into default on its own mortgage payments with consequent possible foreclosure of the underlying mortgage and loss by all unit owners of their interests in the cooperative. Therefore, in the cooperative context it is essential that the cooperative association have a fast and effective remedy for failure of a unit owner to pay his assessment. The act provides in subsection (i) that upon nonpayment the cooperative unit owner may be evicted in the same manner as an unlawfully holding over commercial tenant. Those rules will ordinarily be the most rapid and efficient rules in the State as to eviction of tenants.

If the unit owner's interest is real estate, subsection ~~(j)~~(k)(2) then offers the State two alternatives as to nonjudicial foreclosure of a cooperative association's lien. The first alternative is power of sale under any existing state statute authorizing power of sale under mortgages. If there is no power of sale statute or if the legislature chooses to adopt a special power of sale provision for foreclosure of the lien on cooperative units, the State can choose the 2d alternative: power of sale under subsection ~~(k)~~(l) of this section.

Subsection ~~(k)~~(l), which is patterned after the power of sale foreclosure provisions of the Uniform Land Transactions Act, is a modern power of sale provision which frees private power of sale foreclosure from many of the costly, time consuming, and inefficiency producing strictures of most existing private power of sale statutes. At the same time, it provides reasonable protection to the unit owner and junior interests.

If the unit owners' interest in a cooperative is personal property, the association's lien is foreclosed as if it were a security interest under Article 9 of the Uniform Commercial Code. Article 9 foreclosure is generally less expensive and faster than either judicial or power of sale real estate foreclosure. This difference in cost and speed of foreclosure, both for association liens and security interests, is one of the major factors to be considered in choosing whether, under Section 1-105, the unit owner's interest in a cooperative will be real property or personal property. Article 9 foreclosure is currently used in foreclosing security interests in mobile homes, and has been accepted in the various States as a permissible method of foreclosure in that

housing area without serious challenge.

In a condominium or planned community, there is not likely to be a substantial underlying mortgage for which unit owners are assessed. Therefore, failure to pay assessments on time will have less serious consequences for the association than in the case of cooperatives. The section provides that the association lien in a condominium or planned community is to be foreclosed according to the rules generally applicable to real estate mortgages in the State rather than setting out a special faster method of foreclosure in the statute.

6. New subsection (f)(m) makes clear that the courts have authority to appoint receivers upon request by associations to aid in collection of common charges.

7. Few issues are more contentious in common interest communities than the prospect of unit owners losing their homes as a consequence of non payment of common charges – and the loss of all or most of their equity – when the association forecloses. The reaction in state legislatures in recent years has been widespread.

At the same time, it is crucial that the association be able to secure timely payment of common charges in order to provide services to all the residents of the common interest community.

In an effort to balance these competing interests, the 2008 amendments provide additional safeguards governing foreclosure of liens for unpaid common charges. These new procedures may be summarized as follows:

First, Section 3–116(n) bars foreclosure for sums that are less than 3 months of common charges;

Second, Section 3–116(n) also requires the association board, to first, offer the delinquent owner a payment plan which the owner rejects, and second, expressly approve each foreclosure action;

Third, Section 3–116(o) requires that payments of delinquent assessments be applied first to principal rather than to interest and fees, in order to avoid the usual practice of accruing additional interest and late charges as the monthly fees remain unsatisfied while the attorneys fees and interest are paid first.

Fourth, Section 3–116(p) bars any foreclosure for fines alone unless the association first secures a personal judgment against the unit owner.

Finally, Section 3–116(q) requires that if a foreclosure does go forward, any sale of a unit must be commercially reasonable. In the first reported case of foreclosure arising in a state that has adopted this Act, the court required that the sale be reasonable. See *Will v. Mill Condominium Owners Association et al*, 176 VT 380, 848 A2d 336 [2004].

These special procedures would comprise an overlay on existing state foreclosure procedures, whether judicial or non-judicial. Taken together, they respond in a concise but responsible way to the widespread reports of abuses in this field. Hopefully, they will also be

viewed by the various States as a responsible and balanced response to the issues confronting elected officials, defaulting unit owners and homeowners association directors with a fiduciary responsibility to maintain the property.

8. Associations must be legitimately concerned, as fiduciaries of the unit owners, that the association be able to collect periodic common charges from recalcitrant unit owners in a timely way. To address those concerns, the section contains these 2008 amendments:

First, subsection (a) is amended to add the cost of the association's reasonable attorneys fees and court costs to the total value of the association's existing 'super lien' -- currently, 6 months of regular common assessments. This amendment is identical to the amendment adopted by Connecticut in 1991; see C.G.S. Section 47-258(b). The increased amount of the association's lien has been approved by Fannie Mae and local lenders and has become a significant tool in the successful collection efforts enjoyed by associations in that state.

Second, subsection (f) has been amended to emphasize that the association has a variety of other remedies available against a unit owner in addition to the foreclosure remedy. In many cases, an action for sums due may be less costly, less disruptive and more efficient than a foreclosure action in collecting the funds properly due the association.

9. Section 3-116 rejects more extreme provisions favoring defaulting unit owners espoused in various forums. For example, extensive provisions were adopted by North Carolina regarding fines enforcement and collection which may pose significant impediments to the financial well being of unit owner associations. See, e.g., 2205 North Carolina Session Act No. 422). Similarly, the section does not adopt the extensive borrower protections contained in the Uniform Non-Judicial Foreclosure Act. That act contains provisions dealing with repetitive and detailed default notices, mandated meetings before foreclosure, a period of limitation on foreclosures, mandated judicial supervision of foreclosures, extensive redemption rights after foreclosure, and the like. In those cases where foreclosure is supervised by a judge, those procedures are not likely to be of significant benefit to defaulting to unit owners, but will impose significant transaction costs on associations in non-judicial foreclosure states; there is no reason to distinguish common interest community foreclosures from every other procedure.

10. The issue of how the association protects itself from non-payment of assessments may be of concern in a state with a homestead exemption. Either direct foreclosure of the association's statutory lien for unpaid assessments, or foreclosure of a perfected judgment lien which the association might have secured in lieu of foreclosure, may conflict with existing homestead statutes. Further consideration of this issue in those states, in order to reconcile conflicting statutes, would then be appropriate.

11. In requiring a delay for 3 months in commencement of a foreclosure proceeding, subsection 3-116(n)(1) imposes some risk on the association. Since the association's lien has only a limited priority over that of a first mortgage, anything which delays the commencement and completion of a foreclosure by the association, but does not result in the unit owner bringing his or her account current, may be seen as simply raising the cost to the association, and, therefore, to all of the other unit owners who are paying their common charges on time.

12. It may be that the reaction of some legislators to this Section will depend on the

extent to which foreclosure actions in the respective states are subject to judicial supervision. In states where non-judicial foreclosure is either not available or not used in association lien foreclosures, the active role played by the court may minimize the need for certain of the borrower protections in this section.

SECTION 3-117. OTHER LIENS.

(a) In a condominium or planned community:

(1) Except as otherwise provided in paragraph (2), a judgment for money against the association [if recorded] [if docketed] [if [insert other procedures required under state law to perfect a lien on real estate as a result of a judgment]], is not a lien on the common elements, but is a lien in favor of the judgment lien holder against all of the other real estate of the association and all of the units in the common interest community at the time the judgment was entered. No other property of a unit owner is subject to the claims of creditors of the association.

(2) If the association has granted a security interest in the common elements to a creditor of the association pursuant to Section 3-112, the holder of that security interest shall exercise its right against the common elements before its judgment lien on any unit may be enforced.

(3) Whether perfected before or after the creation of the common interest community, if a lien, other than a deed of trust or mortgage, including a judgment lien or lien attributable to work performed or materials supplied before creation of the common interest community), becomes effective against two or more units, the unit owner of an affected unit may pay to the lien holder the amount of the lien attributable to his the unit, and the lien holder, upon receipt of payment, promptly shall deliver a release of the lien covering that unit. The amount of the payment must be proportionate to the ratio which that the unit owner's common expense liability bears to the common expense liabilities of all unit owners whose the units of which are subject to the lien. After payment, the association may not assess or have a lien against that unit owner's unit for any portion of the common expenses incurred in connection with that lien.

West's Nevada Revised Statutes Annotated
Title 10. Property Rights and Transactions (Chapters 111-120A)
Chapter 116. Common-Interest Ownership (Uniform Act) (Refs & Annos)
Administration and Enforcement of Chapter
General Provisions

N.R.S. 116.623

116.623. Petitions for declaratory orders or advisory opinions: Regulations; scope; contents of petition; filing; period for response

Effective: October 1, 2009
Currentness

1. The Division shall provide by regulation for the filing and prompt disposition of petitions for declaratory orders and advisory opinions as to the applicability or interpretation of:

(a) Any provision of this chapter or chapter 116A or 116B of NRS;

(b) Any regulation adopted by the Commission, the Administrator or the Division; or

(c) Any decision of the Commission, the Administrator or the Division or any of its sections.

2. Declaratory orders disposing of petitions filed pursuant to this section have the same status as agency decisions.

3. A petition filed pursuant to this section must:

(a) Set forth the name and address of the petitioner; and

(b) Contain a clear and concise statement of the issues to be decided by the Division in its declaratory order or advisory opinion.

4. A petition filed pursuant to this section is submitted for consideration by the Division when it is filed with the Administrator.

5. The Division shall:

(a) Respond to a petition filed pursuant to this section within 60 days after the date on which the petition is submitted for consideration; and

(b) Upon issuing its declaratory order or advisory opinion, mail a copy of the declaratory order or advisory opinion to the petitioner.

Credits

Added by Laws 2009, c. 491, § 5.

N. R. S. 116.623, NV ST 116.623

Current through the 2011 76th Regular Session of the Nevada Legislature, and technical corrections received from the Legislative Counsel Bureau (2012).

End of Document

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STATE OF NEVADA

DEPARTMENT OF BUSINESS AND INDUSTRY

IN THE MATTER of the Petition of Prem Investments, LLC., a Nevada limited liability company, Rutt Premsrirut, Manager, for an application for Advisory Opinion and Declaratory Order pursuant to NAC §232.040 Petition for declaratory order or advisory opinion	Docket No.

COMES NOW, Petitioner Prem Investments, LLC., a Nevada limited liability company, Rutt Premsrirut, Manager ("Petitioner" or "Prem Investments") and hereby applies by Petition to the Nevada Department of Business and Industry for an Advisory Opinion and Declaratory Order concerning the applicability of a statute. This application for Petition for Advisory Opinion and Declaratory Order is made pursuant to NAC §232.040, Petition for declaratory order or advisory opinion; Authorization; filing; contents. This Petition is made to the Director of the Nevada Department of Business and Industry pursuant to NAC §232.040(2)(b). In support of this Petition, Prem Investments, by and through its counsel, states as follows:

I

PETITIONER

Prem Investments is not a party in any administrative, civil or criminal action concerning the matters contained in this Petition. Prem Investments is in the business of purchasing single family residences ("Real Property") through foreclosure auctions held by the first mortgage lender of said Real Property. Prem Investments has been the recipient of demands by Nevada collection agencies

licensed under NRS §649 and purporting to represent Nevada common interest communities ("homeowners' associations") in the collection of homeowners' associations' liens placed upon the Real Property. Said liens comprise debts which were incurred by the prior owner of the Real Property but which have been extinguished pursuant to NRS §116.3116 by the first mortgage lender's foreclosure auction. Regardless that the liens have been legally extinguished and the debt is not owed by Petitioner, Nevada collection agencies are demanding and collecting said lien amounts from Petitioner and refusing to clear title of the Real Property unless payment is made.

All correspondence can be mailed to Prem Investments at: 520 S. Fourth Street, Second Floor, Las Vegas, NV 89101, with copy to Adams Law Group, Ltd., at 8681 W. Sahara Ave., Suite 280, Las Vegas, NV 89117.

II.

THE FACTS

Homeowners' associations and their collection agents are enforcing and collecting extinguished association liens and instituting wrongful foreclosure proceedings against the Real Property of Petitioner, and other owners of real property including lenders, government mortgage insurers and investors who take title to single family residences through foreclosure auctions. In Nevada, pursuant to NRS §116.3116, once a first mortgage lender forecloses on a unit located within a homeowners' association, an association's lien is extinguished but for a limited and finite portion of the lien called the "super priority lien amount." However, the practice of homeowners' associations and their collection agents is to regularly violate Nevada law and charge to the new owner (who acquires title at the auction) the entire lien amount, not just the limited, super priority lien amount.

The scheme, which has purported to net Nevada homeowners' associations and collection agencies tens of millions of dollars over the last few years, generally unfolds as follows:

- A homeowner, owning property within an association, becomes delinquent in the payment of his mortgage. Simultaneously, the homeowner stops paying his association assessments.

- The association assesses fines, late fees, and penalties against the homeowner and, most notably, employs a collection agency to collect the past due amounts. Even though the association assessments are often less than $100 per month, the associations and collection agencies add thousands of dollars of "collection" fees onto the homeowner's bill.

- Knowing that these fees constitute a statutory lien on the homeowner's property, the associations and collection agencies are secure in knowing that their many thousands of dollars in "collection" fees will get paid, or else the homeowner's title will remain clouded.

- Then, due to the homeowner's inability to pay his mortgage, the homeowner's lender ultimately forecloses on the property. At the foreclosure auction, the lender, lenders' mortgage insurer or an investor will take title to the property.

- Once this happens, under Nevada law, the association's lien is extinguished by the foreclosure auction, but for the limited, "super priority lien amount" which equals a maximum of 9 times the association's monthly assessments.

- However, instead of informing the new owner that the association's lien has been extinguished but for the super priority lien amount, the associations through their collection agencies represent that they have the legal right to collect from the new owner all monies owed by the original homeowner, including the thousands of dollars of "collection" fees added onto the original homeowner's bill.

- Knowing that title is clouded by the maintaining of the lien and also knowing that the new owner cannot sell the property without clear title, the associations and collection agencies demand vastly more amounts of money than Nevada law requires the new owner to pay.

- Ultimately, in order to clear title and to prevent the association from foreclosing its unlawful lien amount, the new owner pays the improperly demanded amounts and gets the dubious distinction of having paid to Nevada collection agencies thousands of dollars which he did not owe.

This alleged scheme is purported to have been conducted thousands of times resulting in the overpayment by lenders, government mortgage insurers and investors of tens of millions of dollars.

III.

THE ISSUES

The reason for requesting this order and opinion is to determine whether the foreclosure by a first mortgage lender on a property located within a Nevada common interest community extinguishes an existing homeowners' association lien against said property. More particularly, the issues upon which the advisory opinion and declaratory order are sought are the following:

1. Under NRS §116.3116, a homeowners' association has a lien on a unit for any assessment levied against that unit or any fines imposed against the unit's owner from the time the assessment or fine becomes due. Pursuant to NRS §116.3116, what portion of the lien, if any, is superior to the unit's first mortgage lender's security interest ("super priority lien") and may the sum total of the super priority lien amount, whether it be comprised of assessments, fees, costs of collection, or other charges, ever exceed 9 times the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS §116.3115, plus any charges incurred by the association on a unit pursuant to NRS §116.310312 (unit repair expenses)?
2. Pursuant to NRS §116.3116, does a "super priority lien" exist in the absence of a homeowners' association's failure to file a complaint with a court to enforce the lien, i.e., the failure to institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3?

IV.

RELEVANT LAW AND HISTORY

A. Introduction of the Uniform Common Interest Ownership Act

The Uniform Common Interest Ownership Act ("UCIOA") was originally promulgated in 1982 by the National Conference of Commissioners on Uniform State Laws ("Uniform Law

Commissioners" or "ULC"). In 1991, Nevada passed the UCIOA which is embodied in Nevada Revised Statutes §116. As of October 31, 2009, there were 2,961 registered Nevada common interest communities ("homeowners' associations") subject to NRS §116 having a total of 472,777 units within them.[1] UCIOA is a comprehensive act that governs the formation, management, and termination of a common interest community, whether that community is a condominium, planned community, or real estate cooperative. It also provides for disclosure of important facts about common interest property at sale to a buyer, including resale disclosure for any sale after the initial sale by the developer of the property; for warranties of sale; for a buyer's recision rights in a sale contract; and for escrow of deposits made to secure a sale contract. Importantly, it also governs the creation, treatment, foreclosure and extinguishment of homeowners' associations' liens on units within their communities.

B. The Legislative History & the Super Priority Lien

The UCIOA governs liens against properties located within homeowners' associations and, regarding association liens against units, generally states as follows:

a. Homeowners associations have a statutory lien on any unit of real property located within their associations for any assessment imposed against a unit or fine imposed against the unit's owner from the time the assessment or fine becomes due;

b. However, the associations' liens are junior to the first security interest of the unit's first mortgage lender except for a certain, limited and specified portion of the lien as defined in §3-116 which remains senior to the first security interest of the unit's first mortgage lender, provided that the associations had instituted an "action" to enforce their liens (the "Super Priority Lien Amount").

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[1] Executive Summary of the Ombudsman, Reporting Period: July 1, 2009 through October 31, 2009

Thus, in a break with traditional lien priority law, the UCIOA granted the association a lien priority over first mortgages recorded before any assessment delinquency. However, as shall be noted below, the associations' lien priority is only available to a certain and limited extent.

The original language of the 1982 UCIOA regarding §3-116 and super priority liens is as follows:

> (a) The association has a lien on a unit for any assessment levied against that unit or fines imposed against its unit owner from the time the assessment or fine becomes due. Unless the declaration otherwise provides, fees, charges, late charges, fines, and interest charged pursuant to Section 3-102(a)(10), (11), and (12) are enforceable as assessments under this section. If an assessment is payable in instalments, the full amount of the assessment is a lien from the time the first instalment thereof becomes due.
>
> (b) A lien under this section is prior to all other liens and encumbrances on a unit except (i) liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances which the association creates, assumes, or takes subject to, (ii) a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent, or, in a cooperative, the first security interest encumbering only the unit owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent, and
>
> (iii) liens for real estate taxes and other governmental assessments or charges against the unit or cooperative. The lien is also prior to all security interests described in clause (ii) above to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien. This subsection does not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association. [The lien under this section is not subject to the provisions of [insert appropriate reference to state homestead, dower and curtesy, or other exemptions]. *(See Exhibit "I")*

Thus, the "super priority" portion of the homeowners' associations' liens were capped "to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding an action to enforce the lien." While an underlying association lien may have been for a higher amount, the only amount which could achieve "super priority" status over the first mortgage lender was an amount equaling 6 times the monthly assessments.

Interestingly, the Super Priority Lien Amount was intended to be a fixed amount, i.e., one that a lender could approximate prior to lending funds to a borrower who was purchasing within a common interest community. This was so that the lender could escrow, from the borrower funds, the predetermined Super Priority Lien Amount in case the borrower failed to pay the assessments. As noted in the comments section of the 1994 draft of the UCIOA:

> To ensure prompt and efficient enforcement of the association's lien for unpaid assessments, such liens should enjoy statutory priority over most other liens. Accordingly, subsection (b) provides that the association's lien takes priority over all other liens and encumbrances except those recorded prior to the recordation of the declaration, those imposed for real estate taxes or other governmental assessments or charges against the unit, and first security interests recorded before the date the assessment became delinquent. However, as to prior first security interests the association's lien does have priority for six months' assessments based on the periodic budget. A significant departure from existing practice, the six months' priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders. As a practical matter, secured lenders will most likely pay the six months' assessments demanded by the association rather than having the association foreclose on the unit. **If the lender wishes, an escrow for assessments can be required.** *(See Exhibit "2," Comments, UCIOA 1994, page 159-160.)*

Thus, since the lender would know what the assessments were prior to lending, and since the lender would know, pursuant to §3-116 of the UCIOA, that the Super Priority Lien Amount was limited to 6 months of assessments, it could require the borrower to escrow, prior to closing, exactly that amount of funds for which the lender might be liable, i.e., the Super Priority Lien Amount. The lender, therefore, had protection if it had to pay the Super Priority Lien Amount, and the association was assured of payment of a maximum figure equal to 6 months of assessments if the borrower/homeowner defaulted on his obligations to his association. Thus, the "equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders" was accomplished.

C. Nevada Revised Statutes §116.3116

In 1991, Nevada adopted the 1982 version of the UCIOA. The provisions relating to homeowners' association liens were embodied in NRS §116.3116. On October 1, 2009, NRS §116.3116 was amended by the Nevada legislature in two important ways. First, it increased the

Super Priority Lien Amount to a figure equaling 9 times (formerly 6 times) the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS §116.3115 (see Nevada Assembly Bill 204). In calculating the Super Priority Lien Amount, it also allowed to be added any charges incurred by the association on a unit pursuant to NRS §116.310312 (repair expenses of a unit) (see Nevada Assembly Bill 361). The most recent adoption of NRS §116.3116 states in pertinent part:

> 1. The association has a lien on a unit for any construction penalty that is imposed against the unit's owner pursuant to NRS 116.310305, any assessment levied against that unit or any fines imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due.
>
> (2) A lien under this section is prior to all other liens and encumbrances on a unit except:
>
> (b) A first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent or, in a cooperative, the first security interest encumbering only the unit's owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent;
>
> The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien.

The figure equaling 9 times the association's monthly assessment amount has been dubbed the "Super Priority Lien Amount" because it is that figure which remains senior or superior to the first security interest holder's trust deed. It is only the Super Priority Lien Amount, not all association lien amounts, which is super to the first mortgage holder's trust deed. Any amounts greater than the Super Priority Lien Amount still remain a lien against the owner's unit, but it is a lien which is junior to the first security interest holder. The "junior" portion of the lien, therefore, is extinguished by a foreclosing first mortgage lender and the "super priority" portion of the lien survives extinguishment by the foreclosing first mortgage lender.

D. Necessity for the Institution of an Action

As a condition precedent to the establishment of a super priority lien, homeowners' associations need to file "an action to enforce the lien...." Nevada and Massachusetts have nearly identical language in their homeowners' association super priority lien statutes regarding the necessity for the institution of an action to enforce the lien:

NRS 116.3116	MA ST 183A s 6
The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien....	This lien is also prior to the mortgages described in clause (ii) above to the extent of the common expense assessments based on the budget adopted pursuant to subsection (a) above which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien....

Citing nearly identical language as that of the Nevada statute, the Massachusetts courts have held that the institution of a lawsuit (i.e., a civil action) is a condition precedent for homeowners' associations' achievement of super priority status for any portion of its lien amount. The Massachusetts courts have held:

> The condominium lien achieves "super priority" status over the first mortgage when a condominium association institutes "an action to enforce the lien." Thus, Section 6(c) provides that: [t]his lien is also prior to the mortgages described in clause (ii) above to the extent of the common expense assessments based on the budget adopted pursuant to subsection
>
> (a) above which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien...
>
> ***Accordingly, the institution of an action by a condominium association is a condition precedent to achieving "super-priority" status for the condominium lien. However, even when the association files such an action, the condominium lien is given a "super-priority" status only to the extent of unpaid condominium fees for the preceding six months.***
>
> ***It is uncontested by the parties that a lawsuit is required before a lien for unpaid condominium fees achieves a "super-priority"***

> ***status***. See also In re Stern, 44 B.R. 15, 19 (Bankr.D.Mass.1984). ("the establishment of the lien is not dependent on the commencement of a lawsuit, which is only a step necessary to elevate the status of the lien to a position superior to other encumbrances, other than municipal liens and first mortgages.")...
>
> In this regard, M.G.L. ch. 183A, § 6(c) specifically provides that, without the commencement of an enforcement action by a condominium association, a lien for unpaid condominium fees is "prior" to all other liens and encumbrances "except ... (ii) a first mortgage on the unit recorded before the date on which the assessment sought to be enforced became delinquent ..." (emphasis added). ***That exception makes the lien junior at least until an action is commenced. Indeed, if the lien was anything but junior to the first mortgage, there would be no reason to require that an action be filed in order to grant that lien super-priority status.*** *Trustees of MacIntosh Condominium Association v. F.D.I.C., et.al. 908 F.Supp. 58 at 63 (1995).*

Thus, as a "condition precedent" to elevate a portion of a homeowners' association's lien (in Nevada, an amount equaling 9 times the monthly assessments) from "junior" status to "super priority" status, a homeowners' association must file an "action" to enforce the lien. Nevada Rules of Civil Procedure 2 states, "There shall be one form of action to be known as 'civil action.'" Nevada Rules of Civil Procedure 3 states, "A civil action is commenced by filing a complaint with the court." Therefore, until a homeowners' association files a complaint with the court to enforce its lien, no amount of its lien can achieve "super priority" status. While the lien remains a lien on the owner's unit, it is in "junior" status to the first security holder's deed of trust. Thus, until the filing of a complaint with the court to enforce its lien, upon the first mortgage holder's foreclosure, the association's junior lien is extinguished in its entirety.

So in first addressing question 2 above, "Pursuant to NRS §116.3116, does a "super priority lien" exist in the absence of a homeowners' association's failure to file a complaint with a court to enforce the lien, i.e., the failure to institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3?" the answer must be no. Pursuant to NRS §116.3116, a homeowners' association's filing of a complaint with the court to enforce its lien is a condition precedent for any portion of its lien to achieve "super priority" status.

E. Collection Costs and the Super Priority Lien Amount Limit

Even if a homeowners' association does file a complaint with the court to enforce its lien, the lien is only given a "super-priority" status to the extent of a maximum amount equal to 9 times the monthly assessment amount adopted by the association in its last budget *(see NRS 116.3116(2), "The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien....").* All other portions of the lien which exceed that limit are junior to the first mortgage lender *(see NRS 116.3116 (2)(b), "A lien under this section is prior to all other liens and encumbrances on a unit except... A first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent....").*

It is important to note, however, that any association penalties, fees, charges, late charges, fines and interest are enforceable as assessments are enforceable *(see NRS 116.3116(1)), "... any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS 116.3102 are enforceable as assessments under this section....").* In other words, penalties, late fees, and collection charges may be included within the Super Priority Lien Amount, as long as the total Super Priority Lien Amount does not exceed an amount which equals 9 times the association's monthly assessment amount (plus unit repair expenses under NRS 116.310312). Again, as the statute states, *"The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien....") (NRS 116.3116(2).*

Indeed, it is critical to make clear that while assessments, late fees, charges, interest, and costs of collecting, etc., may all be included within the Super Priority Lien Amount, in no instance

may the sum total of the super priority portion of the lien exceed 9 times the monthly assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115, plus any charges incurred by the association on a unit pursuant to NRS 116.310312 (repair expenses). With the exception of the addition of repair expenses pursuant to NRS 116.310312, the Super Priority Lien Amount is a finite number which is not to be exceeded. It is a ceiling. It is a limit. It may, however, contain within it more than just assessments.

In 1991, both Nevada and Colorado adopted the UCIOA with language mirroring UCIOA Section 3-116 (1982 version). As noted by the Colorado Supreme Court, "The Colorado Common Interest Ownership Act was originally adopted in 1991, effective July 1, 1992. Ch. 283, sec. 1, §§ 38-33.3-101 to -319, 1991 Colo. Sess. Laws 1701-57. It was adopted, among other reasons, to provide stability to the finances of common interest communities by granting them a super-lien for unpaid assessments, and to provide uniformity and predictability to lenders in order to promote the availability of financing." *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 450 (Colo.App..2008).* A comparison of the two statutes is as follows:

NRS 116.3116 - NV Super Priority Language	**CO ST s 38-33.3-316 - CO Super Priority Language**
The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien...	... a lien under this section is also prior to the security interests described in subparagraph (II) of paragraph (a) of this subsection (2) to the extent of: (I) An amount equal to the common expense assessments based on a periodic budget adopted by the association under section 38-33.3-315(1) which would have become due, in the absence of any acceleration, during the six months immediately preceding institution by either the association or any party holding a lien senior to any part of the association lien created under this section of an action or a nonjudicial foreclosure either to enforce or to extinguish the lien.

The Colorado Court of Appeals and the author of a Wake Forest Law Review article quoted by the Colorado courts both concluded that although the assessment portion of the super priority lien is limited to a finite number of months, because the assessment lien itself includes "fees, charges,

late charges, attorney fees, fines, and interest," these charges may be included as part of the Super Priority Lien Amount. The Colorado language is the same as NRS §116.3116, which states that "fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS §116.3102 are enforceable as assessments." Therefore, as NRS §116.3116 states that assessments are enforceable through liens, so are collection charges, late charges, fines, fees, etc., enforceable through liens. However, while such charges may be included in the Super Priority Lien Amount, as noted by the Colorado Supreme Court, the maximum amount of the super priority lien is capped:

> We conclude that the plain language of the statute supports Sunstone's position. Within the meaning of subsection (2)(b), a "lien under this section" may include any of the expenses listed in subsection (1), including "fees, charges, late charges, attorney fees, fines, and interest." Thus, although the maximum amount of a super priority lien is defined solely by reference to monthly assessments, the lien itself may comprise debts other than delinquent monthly assessments.
>
> We note that our view matches that of a commentator who has examined the uniform act on which § 38-33.3-316 was based. This commentator has concluded that, under the uniform act, the super priority lien may comprise debts other than delinquent assessments:
>
> A careful reading of the ... language reveals that the association's Prioritized Lien, like its Less-Prioritized Lien, may consist not merely of defaulted assessments, but also of fines and, where the statute so specifies, enforcement and attorney fees. The reference in section 3-116(b) to priority "to the extent of" assessments which would have been due "during the six months immediately preceding an action to enforce the lien" **merely limits the maximum amount of all fees or charges for common facilities use or for association services, late charges and fines, and interest which can come with the Prioritized Lien.** *First Atlantic Mortg., LLC v. Sunstone North Homeowners Ass'n 121 P.3d 254, 255 -256 (Colo.App.,2005).*

Thus, the words "to the extent of" (found in both Nevada's and Colorado's §3-116) limit the maximum amount of all fees, charges, costs and assessments which can comprise the super priority lien to an amount which does not exceed 9 times (6 times in Colorado) the association's monthly assessment amount. In Nevada and Colorado, collection costs and attorney's fees are not added on top of the 9 month amount, but may be incorporated within that amount, provided the Super Priority Lien Amount does not exceed 9 times the association's monthly assessments.

The Colorado Supreme Court recently punctuated the above point in its 2008 case of *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 450 (Colo.App.,2008).*

> The association then has a super-priority lien over the lender's otherwise senior deed of trust in the event of a foreclosure commenced by the association or the lender, which lien is limited to delinquent assessments accruing within six months of the initiation of foreclosure proceedings. § 38-33.3-316(2)(b)(I). Further, the association's super-priority lien includes interest, charges, late charges, fines, and attorney fees **so long as the total does not exceed the limit**. *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 451 (Colo.App.,2008)*

So long as the total of all assessments, fees, costs and other charges do not exceed the limit of an amount equal to 9 times (6 times in Colorado) of monthly assessments, the super priority lien includes interest, charges, late charges, etc. The Colorado Supreme Court, applying Colorado Code Section 38-33.3-116 (which is nearly identical to Nevada's NRS 116.3116,) made clear that the 6 or 9 month assessment total is a super priority limit which cannot be exceeded. This was "... to provide uniformity and predictability to lenders in order to promote the availability of financing." *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 450 (Colo.App.,2008).*

Nowhere is this distinction made clearer than by the very law review article cited by the Colorado courts. James Winokur, in his treatise, "Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Ownership Act," 27 Wake Forest L. Rev.353, states as follows:

> In its most heralded break with traditional law, UCIOA grants the association a lien priority over first mortgages recorded before any assessment delinquency "to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding an action to enforce the lien." Any excess of total assessment defaults, in addition to other lienable fines or costs over this six-month ceiling remains a lien on the property. The portion of the association lien securing this excess will be junior to the first mortgage on the unit, but senior to other mortgages and encumbrances not recorded before the declaration. Thus, although the association's lien is a single lien, its varying priority effectively separates the association's rights in a given unit into what may be conceived of as two liens, which are hereinafter referred to as the "Prioritized Lien" and the "Less-Prioritized Lien."
>
> A careful reading of the quoted language reveals that the association's Prioritized Lien, like its Less-Prioritized Lien, may consist not merely

> of defaulted assessments, but also of fines and, where the statute so specifies, enforcement and attorney fees. The reference in section 3-116(b) to priority "to the extent of" assessments which would have been due "during the six months immediately preceding an action to enforce the lien" merely limits the maximum amount of all fees or charges for common facilities use or for association services, late charges and fines, and interest which can come within the Prioritized Lien. So, for example, if a unit owner fell three months behind in assessments, the Prioritized Lien might include--in addition to the three months of arrearages--the other fees, charges, costs, etc. enforceable as assessments under UCIOA. However, for any assessments or other charges to be included within the Prioritized Lien, there must have been a properly adopted periodic budget promulgated "at least annually" by the association from which the appropriate six months assessment ceiling can be computed. *(James Winokur, Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Ownership Act, 27 Wake Forest L. Rev.353. See Exhibit "3").*

The following examples may assist:

Case 1: A homeowner's assessments adopted through the association's last budget are $100 per month. He is 4 months delinquent ($400). The association has charged $80 in late fees and $375 in costs of collecting. The association has incurred no repair costs under NRS 116.310312. Thus, the total amount of the homeowner's delinquency is $855. Because the association has a lien for assessments under NRS 116.3116, and because any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS 116.3102 are enforceable as assessments, and because the association lien is prior to all first security interests only to the extent of the assessments for common expenses during the 9 months immediately preceding institution of an action to enforce the lien, assuming the institution of an "action" by the association, the maximum super priority lien amount is $900 (9 x $100 of monthly assessments). Thus, the full $855 is included in the super priority lien. Mathematically, $855 (the association lien) is prior to the first mortgage lien to the extent of $900 (9 times the monthly assessments).

Case 2: A homeowner's assessments adopted through the association's last budget are $100 per month. He is 12 months delinquent ($1,200). The association has charged $240 in late fees and $1,600 in costs of collecting. The association has incurred no repair costs under NRS 116.310312. Thus, the total amount of the homeowner's delinquency is $3,040. Because the association has a lien for assessments under NRS 116.3116, and because any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of

subsection 1 of NRS 116.3102 are enforceable as assessments, and because the lien is prior to all first security interests only to the extent of the assessments for common expenses during the 9 months immediately preceding institution of an action to enforce the lien, assuming the institution of an "action" by the association, the maximum super priority lien amount is still $900 (9 x $100 of monthly assessments). Mathematically, $3,040 (the association lien) is prior to the first mortgagelien only to the extent of $900 (9 times the monthly assessments). Thus, $900 is the Super Priority Lien Amount and the remaining $2,140, while still a lien against the unit, is junior to the first mortgage. This analysis is consistent with the holdings of the Colorado Supreme Court and James Winokur's *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Ownership Act, 27 Wake Forest L. Rev.353*. Winokur described the $900 portion of the lien as the "Prioritized Lien" (i.e., super priority lien) and the $2,140 portion as the "Less Prioritized Lien" (i.e., junior lien).

Thus, the Super Priority Lien Amount does not change from neighbor to neighbor depending upon costs of collection. It is always an amount equal to 9 times the association's monthly assessment. The only time the Super Priority Lien Amount can change is when the assessments change in the association's budget or when the association incurs repair expenses for a unit pursuant to NRS §116.310312.

F. The Connecticut Amendment

As stated above, in 1991, Nevada and Colorado adopted the UCIOA with language mirroring UCIOA Section 3-116 (1982 version). Connecticut also adopted a version of the UCIOA, but with a significant and fundamental amendment to §3-116. This amendment was adopted by Connecticut in 1991 (see C.G.S. Section 47-258(b) as amended by No. 91-359 of the Public Acts of 1991). A comparison of the three statutes as originally enacted is as follows:

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NV Super Priority Language	CO Super Priority Language	CT Super Priority Language
The lien is also prior to all security interests described in paragraph (b) to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien. This subsection does not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association.	... a lien under this section is also prior to the security interests described in subparagraph (II) of paragraph (a) of this subsection (2) to the extent of: (I) An amount equal to the common expense assessments based on a periodic budget adopted by the association under section 38-33.3-315(1) which would have become due, in the absence of any acceleration, during the six months immediately preceding institution by either the association or any party holding a lien senior to any part of the association lien created under this section of an action or a nonjudicial foreclosure either to enforce or to extinguish the lien.	The lien is also prior to all security interests described in subdivision (2) of this subsection to the extent of (A) an amount equal to the common expense assessments based on the periodic budget adopted by the association pursuant to subsection (a) of section 47-257 which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce either the association's lien or a security interest described in subdivision (2) of this subsection **and (B) the association's costs and attorney's fees in enforcing its lien.**

As can be observed, Connecticut added a new provision to UCIOA's Section 3-116, which Nevada and Colorado did not adopt. While Nevada and Colorado's super priority lien was limited to the extent of an amount equal to just 6 months of assessments only, the Connecticut legislature intentionally permitted adding the association's costs and attorney's fees on top of the 6 month assessment figure. This is a fundamental distinction between Connecticut's law, and the laws of the states of Nevada and Colorado (and other states like Alaska, Minnesota, West Virginia, and New Jersey).

However, unlike in Connecticut, in the states of Nevada and Colorado, consistent with the original language of the 1982 UCIOA, while the Super Priority Lien Amount may include collection costs and charges, the sum total of all assessments, fees, and collection costs may not exceed the figure equaling 6 times (now 9 times in Nevada plus unit repair costs) the monthly assessments. As previously mentioned, any amounts which are over that limit still constitute a lien on the homeowner's unit, but it constitutes a lien which is junior to the first mortgage (i.e., a less prioritized lien which may be extinguished by a first mortgage holder's foreclosure).

In July of 2008, the National Conference of Commissioners on Uniform State Laws held its annual conference where it incorporated Connecticut's costs and fees amendment into the Uniform Law Commissioners' 2008 revised version of the UCIOA. Under the 2008, revised UCIOA (which has not been adopted in Nevada,) the UCIOA super priority lien now consists of both six months of assessments and attorney's fees and costs:

> (c) A The lien under this section is also prior to all security interests described in subsection (b)(2) clause (ii) above to the extent of both the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien and reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien. *2008 Amendments to the UCIOA*

As noted in the comments section on Page 198 of the 2008 Amendments to the UCIOA, "First, subsection (a) is amended to add the cost of the association's reasonable attorneys fees and court costs to the total value of the association's existing 'super lien' – currently, 6 months of regular common assessments. This amendment is identical to the amendment adopted by Connecticut in 1991; see C.G.S. Section 47-258(b). The increased amount of the association's lien has been approved by Fannie Mae and local lenders and has become a significant tool in the successful collection efforts enjoyed by associations ***in that state.***" *(See Exhibit "4").*

It is vital to note, however; that in 2009 Nevada had the opportunity to adopt the newly revised UCIOA, but chose not to. The October 1, 2009, revisions to NRS §116.3116 are conspicuously absent of the Connecticut amendment. Instead, the Nevada legislature increased the super priority lien cap to an amount equal to 9 times the association's monthly assessments, up from 6 times, and also added unit repairs costs under NRS §116.310312 to the super priority lien.

Because Nevada and Colorado (and other states like Alaska, Minnesota, West Virginia, and New Jersey) adopted the unaltered super priority language of the original1982 UCIOA, and did not adopt the Connecticut amendment, the current state of the law regarding super priority lien amounts in states which did not adopt the Connecticut amendment is as the Colorado courts have held: "The reference in section 3-116(b) to priority "to the extent of" assessments which would have been due "during the six months immediately preceding an action to enforce the lien" **merely limits the**

maximum amount of all fees or charges for common facilities use or for association services, late charges and fines, and interest which can come with the Prioritized Lien..." *First Atlantic Mortg., LLC v. Sunstone North Homeowners Ass'n 121 P.3d 254, 255 -256 (Colo.App., 2005),* and "... the association's super-priority lien includes interest, charges, late charges, fines, and attorney fees **so long as the total does not exceed the limit**." *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 451 (Colo.App., 2008).*

Again, collection costs are not added on top of the 9 month amount (as in Connecticut,) but may be incorporated within that amount (as in Nevada, Colorado, Alaska, Minnesota, West Virginia, and New Jersey). While the Nevada legislature may, at some point in the future, wish to adopt the Connecticut amendment, the current law in Nevada is as stated by the Colorado courts and James Winokur's commentary.

V.

CONCLUSION

This Petition requested action in two areas:

1. Pursuant to NRS §116.3116, what portion of a homeowners' association lien, if any, is superior to the unit's first mortgage lender's security interest ("super priority lien") and may the sum total of the super priority lien amount, whether it be comprised of assessments, fees, costs of collection, or other charges, ever exceed 9 times the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS §116.3115, plus any charges incurred by the association on a unit pursuant to NRS §116.310312 (unit repair expenses)?

2. Pursuant to NRS §116.3116, does a "super priority lien" exist in the absence of a homeowners' association's failure to file a complaint with a court to enforce the lien, i.e., the failure to institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3?

As the existing law makes clear, in Nevada, assessments, late fees, costs of collecting and other charges may be included in the Super Priority Lien Amount. However, as the plain language of NRS §116.3116 states, and as noted by the Colorado courts and James Winokur's commentary, there is a ceiling on the Super Priority Lien Amount of 9 times (6 times in other states) the association's monthly assessment amount for common expenses based on the periodic budget adopted by the association (plus repair expenses pursuant to NRS §116.310312). In addition, the total amount of assessments, late fees, costs of collecting and other charges may not exceed that

ceiling in order to be considered a "super priority lien" rather than a "junior" lien. With the exception of the repair expenses pursuant to NRS §116.310312, the Super Priority Lien Amount is limited to a finite number, i.e., an amount which cannot exceed a figure equaling 9 times the monthly assessments which immediately preceding institution of an action to enforce the lien.

Additionally, as a "condition precedent" to elevate a portion of a homeowners' association's lien from "junior" status to "super priority" status, a homeowners' association must file an "action" to enforce the lien. Nevada Rules of Civil Procedure 2 states, "There shall be one form of action to be known as 'civil action.'" Nevada Rules of Civil Procedure 3 states, "A civil action is commenced by filing a complaint with the court." Thus, until a homeowners' association files a complaint with the court to enforce its lien, no amount of its lien can achieve "super priority" status. Therefore, while the lien remains a lien on the homeowner's unit, it is in "junior" status to the first security holder's deed of trust. Thus, until the filing of a complaint with the court to enforce its lien, upon the first mortgage holder's foreclosure, the association's junior lien is extinguished in its entirety. Pursuant to NRS §116.3116, a homeowners' association's filing of a complaint with the court to enforce its lien is a condition precedent for any portion of its lien to achieve "super priority" status.

Dated this 25 day of June, 2010.

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DISTRICT COURT

CLARK COUNTY, NEVADA

A-10-630298-C

19

NEVADA ASSOCIATION SERVICES, INC.; RMI MANAGEMENT, LLC; ANGIUS & TERRY COLLECTIONS, LLC, Plaintiffs, v. STATE OF NEVADA, DEPARTMENT OF BUSINESS AND INDUSTRY, FINANCIAL INSTITUTIONS DIVISION; GEORGE E. BURNS, individually and in his official capacity as Commissioner of State of Nevada, Department of Business and Industry, Financial Institutions Division, Defendants.	Case No. Dept. No. **EX PARTE APPLICATION FOR TEMPORARY RESTRAINING ORDER AND MOTION FOR PRELIMINARY INJUNCTION**

A-10-630298-C
EPAP
Ex Parte Application
1077804

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CLERK OF THE COURT

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Plaintiffs Nevada Association Services, Inc. ("NAS"), RMI Management, LLC ("RMI"), and Angius & Terry Collections, LLC ("Angius & Terry"), by and through their attorneys of record, Holland & Hart LLP, hereby submit this Ex Parte Application for Temporary Restraining Order[1] and Motion for Preliminary Injunction.

///

///

[1] In accordance with NRCP 65, Plaintiffs are providing a copy of this Application and Motion to Daniel Ebihara, Esq., Deputy Attorney General and counsel for the FID.

This Application and Motion is made pursuant to NRS 33.010 and NRCP 65, and is based on the attached Memorandum of Points and Authorities and supporting documentation, the papers and pleadings on file in this action, and any oral argument this Court may allow.

DATED this 1st day of December 2010

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By _____
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MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF EX PARTE APPLICATION FOR TEMPORARY RESTRAINING ORDER AND MOTION FOR PRELIMINARY INJUNCTION

I.

INTRODUCTION

In this Application for Temporary Restraining Order and Motion for Preliminary Injunction, Plaintiffs NAS, RMI, and Angius & Terry ask this Court to enjoin enforcement of a Declaratory Order and Advisory Opinion Regarding Collection Agency Fees from Homeowner Association Liens Following Foreclosure (the "Opinion"), unlawfully issued by Defendant State of Nevada, Department of Business and Industry, Financial Institutions Division (the "FID"). A copy of the Opinion is attached hereto as **Exhibit "1"**. ***In short, the Opinion was considered and issued without jurisdiction, in blatant violation of NRS 116.615, NRS 116.620, NRS 116.623, and NAC 232.040.***

Plaintiffs are collection agencies that work on behalf of several homeowners' associations ("HOAs") in the State of Nevada. Among other things, Plaintiffs pursue past due charges from delinquent homeowners on behalf of HOAs. This is a task of particular importance in the foreclosure crisis currently overwhelming the Nevada housing market. Indeed, without such collection agencies and the ability to pursue collection costs from the delinquent homeowners, HOAs would have little or no ability (or financial means) to pursue the never-ending list of delinquent charges from homeowners, thereby significantly increasing the costs to those homeowners who do pay their bills.

The Nevada Legislature appreciated the importance of permitting HOAs to recover from delinquent homeowners and thus granted HOAs a "super-priority" lien under NRS 116.3116(2), which is a lien on real property, senior to even the first position deed of trust. Despite the importance of granting HOAs the ability and the means to recover past due charges, several real estate speculators or "flippers," who have made hefty sums of money by flipping foreclosure properties, have filed storms of litigation in the past year disputing the interpretation of the super-priority lien statute, undoubtedly with the goal of fattening their bottom line.

Indeed, Plaintiffs have been named as defendants in several such lawsuits, including actions by or directly related to the Petitioner requesting the Opinion (Rutt Premsrirut) and by Mr. Premsrirut's attorneys (Puoy Premsrirut and James Adams). These various actions include an arbitration brought by Mr. Adams and Ms. Premsrirut against Plaintiffs that currently is involved in heavy briefing in arbitration before the Nevada Real Estate Division, are focused in large part on obtaining a judicial statutory interpretation of NRS 116.3116(2) to determine whether and to what extent collection costs are included in the super-priority lien.

Despite Mr. Premsrirut's and Mr. Adams' clear knowledge that the interpretation of NRS 116.3116(2) is a hotly-contested issue in any number of lawsuits and arbitrations, they engaged the FID *ex parte* and requested that he issue an advisory opinion on these matters, providing absolutely no notice to any party with a competing viewpoint. Thus, without considering Plaintiffs position or any opposing views, on or about November 18, 2010, George E. Burns, Commissioner (the "Commissioner") of the FID issued the Opinion. Plaintiffs have since been informed that the Commissioner intends to immediately enforce this advisory Opinion and institute disciplinary proceedings—including license revocation proceedings—against any collection agency that does not follow it immediately. However, the following issues are among the many problems with the attached Opinion:

- The Commissioner had and has no jurisdiction to interpret the provisions of NRS Chapter 116. In fact, NRS 116.615, NRS 116.620, and NRS 116.623 specifically states that the Real Estate Division has exclusive jurisdiction to issue advisory opinions concerning applicability or interpretation of NRS Chapter 116.

- The request made to the Commissioner to render an advisory opinion violated NAC 232.040(2). This regulation specifically requires that the original and a copy of the petition be forwarded to the "chief who is authorized to Administer or enforce the statute or regulation or to issue the decision." The Commissioner clearly did not forward the petition to the Real Estate Division, which possesses express jurisdiction over the rendering of advisory opinions involving interpretation sof NRS Chapter 116. *See* NRS 116.615, NRS 116.620, and NRS 116.623.

- The request made to the Commissioner to render an advisory opinion violated NAC 232.040(4). Parties with an interest in current legal proceedings may ***not*** file a petition for a declaratory order or an advisory opinion concerning a question or matter involved in those legal proceedings.

- The opinion squarely contradicts the order of District Court Judge Jackie Glass in ***Korbel Family Trust v. Spring Mountain Ranch Master Ass'n***, Eighth Judicial District Court Case No. A-06-523959-C, which has been recognized as the industry standard for several years now.

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- The advisory opinion was sought improperly, in an attempt to influence a pending arbitration before the Nevada Real Estate Division. When presenting its petition to Commissioner Burns, counsel for the petitioner purposefully did not advise the parties to the arbitration that this opinion was being sought. As a result, the Commissioner issued his unlawful advisory opinion based on an incomplete record and a one-sided view of the law presented to him.

- To this day, Plaintiffs have been unable to obtain a copy of the Petition that was submitted to the Commissioner. Both the FID and counsel who submitted said Petition have steadfastly refused to provide a copy, and there is no way at this time to know what kind of *ex parte* communications took place between FID and the Petitioner.

The foregoing issues demonstrate that the Opinion not only fails on substantive grounds but, quite simply, could never have been issued due to the Commissioner's clear lack of jurisdiction. Accordingly, because Plaintiffs demonstrate a likelihood of success on the merits, enforcement of the Opinion will cause irreversible harm to Plaintiffs' businesses, and public policy considerations weigh heavily in favor of injunctive relief, Plaintiffs request the Court grant their Application for Temporary Restraining Order and Motion for Preliminary Injunction.

II.

FACTUAL BACKGROUND

A. The Korbel Case

Some background is necessary in this matter. In 2006, Eighth Judicial District Court Judge Jackie Glass heard and decided ***Korbel Family Living Trust v. Spring Mountain Ranch Master Ass'n***, Eighth Judicial District Court Case No. A-06-523959-C. The principal issue in that case was whether HOA collection fees survived foreclosure based upon the so-called "super priority" lien of NRS 116.3116. Upon a specific request for briefing by Judge Glass, the issue was thoroughly briefed (*see* briefs attached hereto as **Exhibit "2"** and **Exhibit "3"**) and decided by Judge Glass in an Order dated December 22, 2006, a copy of which is attached hereto as **Exhibit "4"**.

While the prevailing counsel who prepared the order did not prepare specific findings, it is clear from the ruling, after specific briefing ordered by Judge Glass (*see* minutes attached

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hereto as **Exhibit "5"**), that Mr. Korbel's challenge under NRS 116.3116 did not prevail. As a result, Judge Glass concluded that the HOA was entitled to recover the following:

- Assessments for common expenses;
- Late fees imposed for non-payment of assessments for common expenses;
- Interest on the principal amount of unpaid assessments for common expenses;
- The HOA's "costs of collection, which may include legal fees and costs, that accrue prior to the date of foreclosure of the first deed of trust"; and
- The transfer fee for conveyance and change of ownership of the property foreclosed upon pursuant to the first deed of trust.

See Exhibit 4. Mr. Korbel did not appeal Judge Glass's decision.

Since then, the ***Korbel*** decision has been relied upon as binding precedent in the industry, including the Federal Home Loan Mortgage Corporation ("Freddie Mac"), arguably one of the largest purchasers of homes through foreclosures in the State of Nevada. For example, attached hereto as **Exhibit "6"** is a request for a super-priority payoff demand from the attorney for Freddie Mac. ***According to Freddie Mac's attorney, Korbel controls the determination of the super-priority lien after a bank foreclosure***:

> Federal Home Loan Mortgage Corporation intends to pay immediately all sums properly due and owing to the Association pursuant to NRS § 116.3116(2), also know as a "super-priority demand." . . . Pursuant to the Clark County District Court's interpretation of the statute (***Korbel vs. Spring Mountain Ranch Master Association***), the amount may include 9 months of pre-foreclosure common area expenses, interest, late fees, and reasonable costs of collection.
>
> . . .
>
> It is the intent of Federal Home Loan Mortgage Corporation to immediately pay all sums which are properly due and owing to the Association at this time, and to arrange for payment of monthly assessments as a new property owner and member of the Association.

Exhibit 6. Indeed, permitting recovery of interest, late fees, and costs of collection (with no numerical cap) is and has been common practice in the industry for years. *See* Affidavit of

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Paul P. Terry, Jr., attached hereto as **Exhibit "7"**.

B. The Prem Challenge and Egregious Efforts at Forum Shopping

Earlier this year, the Prem Deferred Trust ("Prem") commenced a civil action against NAS and RMI seeking, among other things, a declaration concerning whether collection fees and costs imposed by HOAs and their collection agents survive as part of the so-called "super priority" lien under NRS 116.3116. The co-trustees of Prem are Rutt Premsrirut and his sister, Attorney Puoy Premsrirut.

The lawsuit was plainly barred by NRS 38.310, which compels arbitration of such claims before the Nevada Real Estate Division. ***See Hamm v. Arrowcreek Homeowners' Ass'n***, 124 Nev. 28, 183 P.3d 895, 902 (2008). Accordingly, NAS and RMI filed a motion to dismiss based upon NRS 38.310 and ***Hamm***. In response, one of the trustees, Rutt Premsrirut (Petitioner seeking the Opinion at issue here), filed an affidavit sworn under penalty of perjury, claiming that Prem was the owner of nine parcels of land. A copy of this Affidavit is attached hereto as **Exhibit "8"**. This sworn attestations were made in attempt by Prem's counsel to persuade the court that foreclosure of these parcels was imminent, which would have allowed the court to hear the matter under NRS 38.310. A review of the pertinent public real estate records, however, demonstrated that Prem ***no longer owned*** eight of the nine properties. In one instance, a parcel was sold the very same day that Mr. Premsrirut signed his affidavit. In other instances, Prem had resold its properties as long as six (6) months prior to execution of the affidavit.

Needless to say, the motion to dismiss was granted. A copy of this Order is attached hereto as **Exhibit "9"**. Prem did not appeal.

In the meantime, James Adams, Esq. commenced a similar lawsuit on behalf of a number of real estate investors entitled ***Higher Ground, LLC, et al. v. Nevada Association Services, Inc., et al.***, Eighth Judicial District Court Case No. A-10-609031-C. That case was dismissed by the Honorable Jennifer P. Togliatti, also under NRS 38.310. A copy of this Order is attached hereto as **Exhibit "10"**. Plaintiffs in that case did not appeal.

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Shortly thereafter, Prem and Mr. Adams joined forces and filed yet another lawsuit, seeking the same relief from a different judge. Even though two similar matters had already been dismissed based upon NRS 38.310 and binding Nevada Supreme Court authority, Mr. Adams and Prem commenced ***Prem Deferred Trust, et al. v. The Signature at MGM Grand, et al.***, Eighth Judicial District Court Case No. A-10-617551-C. This case was dismissed by the Honorable Valerie Adair, also pursuant to NRS 38.310 and ***Hamm***. A copy of the order of dismissal is attached hereto as **Exhibit "11"**. Once again, Prem did not appeal.

Also in the meantime, Prem was fully involved with proceedings before the Nevada Real Estate Division Commission for Common-Interest Communities and Condominium Hotels (the "CIC") concerning collection fees and the "super-priority" lien under NRS Chapter 116. The result of those proceedings was a draft advisory opinion penned by Michael Buckley, Chairman of the CIC. A copy of Mr. Buckley's draft advisory opinion, and proof of Ms. Premsrirut's receipt thereof by email, are attached hereto as **Exhibit "12"**. When Prem saw the draft advisory opinion, the Premsriruts simply sought a different advisory opinion from the FID.

Prem's co-trustee, Ms. Puoy Premsrirut, is now co-counsel with Mr. Adams in Nevada Real Estate Division Case No. 10-87 (the "Higher Ground Arbitration") against Plaintiffs and others. A copy of the Amended Demand for Arbitration is attached hereto as **Exhibit "13"**. That case is currently pending before Arbitrator Persi Mishel. Certain interim rulings were received recently from Mr. Mishel—all but one claim was dismissed, and Plaintiffs are currently in the process of seeking clarification from Mr. Mishel on several issues, including the applicability and scope of NRS 116.3115 to this matter. A final arbitration award has not been issued, and discovery has not even commenced in that matter. ***See*** Exhibit 7.

C. ***The Advisory Opinion Is Based on Only Prem's Side of the Story.***

According to the advisory opinion, Prem Investments, LLC petitioned the Commissioner for an advisory opinion. ***See*** Exhibit 1. Plaintiffs have never seen this petition. Exhibit 7. Mr. Adams, Ms. Premsrirut, and the FID have all refused to provide a copy of this petition to Plaintiffs, and the existence of the petition itself was never disclosed in the ***Higher***

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Ground arbitration. ***Id.*** As such, Plaintiffs were never given an opportunity to be heard in the matter, even though it plainly relates to a pending arbitration before the Real Estate Division. ***Id.***

Plaintiffs are not aware of what was actually argued to the Commissioner. ***See*** Exhibit 7. Plaintiffs are also unaware as to what was presented to the Commissioner and what *ex parte* communications, if any, took place between the parties. ***Id.*** One could only suspect that a very one-sided presentation was made, whatever form it took. Needless to say, as none of the Plaintiffs were made aware of this petition, and had no input during its consideration, Plaintiffs (and likely any collection agency or HOA) were effectively shut out of the process.

D. Prem's Unclean Hands Get Dirtier

In the Higher Ground Arbitration, Mr. Adams and Ms. Premsrirut repeatedly attempted to distance themselves from the ***Korbel*** opinion. However, recently, Plaintiffs became aware of the existence of a joint checking account between Mr. Premsrirut ***and Richard Korbel***. A partially redacted copy of this check is attached hereto as **Exhibit "14"**.

Plaintiffs thus far have been unable to determine the exact nature or length of the relationship between Mr. Korbel and Mr. Premsrirut. However, this relationship was ***not*** disclosed to the parties or the Arbitrator in the Higher Ground Arbitration. Plaintiffs' counsel is currently investigating whether Mr. Korbel's telling absence from the pending litigation and arbitration was essentially an act of plaintiff shopping—based upon a desire by Prem to distance itself from the ***Korbel*** opinion, and to avoid issues of *collateral estoppel*. Notably, in the first Prem lawsuit, Prem's counsel was the Cooper Castle law firm, which also represented the Korbel Family Trust in ***Korbel***. ***See*** Exhibit 8.

E. The FID Plans to Enforce the Opinion

On approximately November 22, 1010, Paul Terry, a managing member of Plaintiff Angius & Terry, was advised by a senior auditor at the FID that FID intended to start enforcing the Opinion immediately. ***See*** Exhibit 7. Moreover, Mr. Terry was informed that any collection agency found in violation of the Opinion will be subject to discipline and potential loss of license. ***Id.*** To protect their businesses, Plaintiffs have filed the Complaint in this

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action, seeking an order declaring the Opinion null and void and enjoining any enforcement thereof.

III.

LEGAL ARGUMENT

A. Legal Standard

In Nevada, Rule 65 of the Nevada Rules of Civil Procedure and NRS 33.010 govern the issuance of injunctions. A temporary restraining order or preliminary injunction therefore should be issued when plaintiffs demonstrate "that the nonmoving party's conduct, if allowed to continue, will cause irreparable harm for which compensatory relief is inadequate and that the moving party has a reasonable likelihood of success on the merits." ***Boulder Oaks Community Ass'n v. B&J Andrews Enterprises, LLC***, — Nev. —, 215 P.3d 27, 31 (2009); *see also* NRS 33.010. The court may also consider the balance of hardships between the parties. ***Univ. & Comty College Sys. of Nev. v. Nevadans for Sound Government***, 120 Nev. 712, 721, 100 P.3d 179, 187 (2004). Preliminary injunctive relief may be used to preserve the status quo and undo wrongful conditions. ***Leonard v. Stoebling***, 102 Nev. 543, 550-51, 728 P.2d 1358, 1363 (1986).

B. Plaintiffs Will Succeed on the Merits.

An applicant for an injunction must "show a reasonable likelihood of prevailing on the merits." ***Dixon v. Thatcher***, 103 Nev. 414, 416, 742 P.2d 1029, 1030 (1987). Here, Plaintiffs can demonstrate a reasonable likelihood of success on the merits, i.e., demonstrating the Opinion should be not be enforced and should be rendered null and void, on at least three (3) grounds. First and foremost, the Commissioner exceeded his jurisdiction in rending the Opinion and, in doing so, plainly violated NRS 116.615, NRS 116.620, and NRS 116.623. This alone warrants injunctive relief.

Second, Mr. Adams and Mr. Premsrirut's request to the Commissioner to render an advisory opinion—and the Commissioner's consideration thereof—violated NAC 232.040(2 and 4) and was completely inappropriate. Third, the Opinion is based on only one view of the

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interpretation of a hotly-contested statute, which currently is the subject of litigation and arbitration and which likely will end up being decided by the Nevada Supreme Court.

1. The Commissioner Exceeded His Jurisdiction and Violated Nevada Law.

In this matter, Commissioner Burns unquestionably exceeded his statutory jurisdiction and violated Nevada law, Plaintiffs therefore have a strong likelihood of succeeding on the merits of their Complaint. In the Opinion, the Commissioner asserted only that he had jurisdiction to issue his Advisory Opinion under NRS Chapter 649, which governs collection agencies. However, the Commissioner then proceeded to draft an opinion that offered several legal opinions interpreting NRS Chapter 116, the Nevada Common Interest Ownership Act, over which he has absolutely no jurisdiction.

NRS 116.615 provides in pertinent part as follows:

> 1. The provisions of this chapter ***must be administered by the [Real Estate] Division***, subject to the administrative supervision of the Director of the Department of Business and Industry.
>
> 2. The [CIC] and the [Real Estate] Division may do ***all things necessary and convenient to carry out the provisions of this chapter, including, without limitation, prescribing such forms and adopting such procedures as are necessary to carry out the provisions of this chapter.***
>
> 3. The [CIC], or the Administrator with the approval of the [CIC], may adopt such regulations as are necessary to carry out the provisions of this chapter.

NRS 116.615 (emphasis added). In addition, NRS 116.620 states as follows:

> The Attorney General shall render to the [CIC] and the [Real Estate] Division opinions upon all questions of law relating to the construction or interpretation of [NRS Chapter 116], or arising in the administration thereof, that may be submitted to the Attorney General by the [CIC] or the [Real Estate] Division.

NRS 116.620(3).

Finally, advisory opinions concerning NRS Chapter 116 fall within the ***exclusive*** jurisdiction of the Real Estate Division.

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> The [Real Estate] Division shall provide by regulation for the filing and prompt disposition of petitions for declaratory orders and advisory opinions as to the applicability or interpretation of:
>
> (a) ***Any provision of this chapter*** or chapter 116A or 116B of NRS;
>
> (b) Any regulation adopted by the [CIC], the Administrator or the Division; or
>
> (c) Any decision of the [CIC], the Administrator or the [Real Estate] Division or any of its sections.

NRS 116.623(1) (emphasis added). The foregoing language could not be more clear—the Commissioner stepped far beyond his jurisdiction when he signed the unlawful Advisory Opinion. Such an advisory opinion is only permitted by the Real Estate Division.

Despite this clear lack of jurisdiction, staff at the FID have informed Plaintiffs that the Commissioner intends to immediately begin enforcement of this Advisory Opinion and to impose regulatory discipline—which may include immediate license suspension and revocation proceedings—against Plaintiffs and other similarly situated companies. ***See*** Exhibit 7. Neither the Commissioner nor the FID, however, have such authority, due to the clear lack of jurisdiction. Because the jurisdiction for such an opinion and any subsequent actions rests with the Real Estate Division, not the FID, Plaintiffs will most definitely succeed on the merits in this action, i.e., in obtaining declaratory relief to enjoin enforcement of the Opinion and to declare it null and void.

2. The Request for the Opinion Violated Nevada Law.

The Nevada Administrative Code also makes it clear that a party may ***not*** seek an advisory opinion concerning a question that is at issue in a current legal proceeding:

> 1. Except as otherwise provided in subsection 4, an interested person may petition the Director to issue a declaratory order or advisory opinion concerning the applicability of a statute, regulation or decision of the Department or any of its divisions.
>
> . . .
>
> 4. An interested person ***may not file a petition for a declaratory order or an advisory opinion concerning a question or matter that is an issue in an administrative, civil or criminal proceeding in which the interested person is a party.***

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NAC 232.040 (emphasis added). In addition, NAC 232.040(2) specifically provides that an original and copy of any petition must be filed with the "chief who is authorized to administer or enforce the statute or regulation or to issue the decision" or to the "director" if "the statute, regulation or decision is administered or enforced by the director." That obviously did not occur here, as the Director of the FID was petitioned to provide an advisory opinion that plainly was outside the scope of his authority.

Here, the Commissioner set forth NAC 232.040 as establishing the procedure for filing a petition for a declaratory order. ***See*** Exhibit 1 at 2 (incorrectly citing NAC 232.040 as 323.040). The Opinion, however, does not mention the substance of subsection 4, which clearly prohibits a party with an interest in ongoing litigation from requesting an advisory opinion on an issue in that litigation. The arbitration with the Nevada Real Estate Division currently proceeding against Plaintiffs was brought by Mr. Adams and Ms. Premsrirut, the co-trustee of Prem, on behalf of several real estate speculators. It is not hard to see that theletter and spirit of NAC 232.040 were violated here, and that the parties are engaging in a convoluted scheme to seek their desired result by any and all means necessary. However, they simply had no right to request an advisory opinion when the same issues were and are being litigated in arbitration with the Real Estate Division. And, in making his Opinion, the Commissioner plainly violated Nevada law—and his Department's own rules—concerning advisory opinions.

While it certainly would not shocking to find out that Prem and Mr. Adams concealed their interest in the arbitration proceedings from the Commissioner, the Commissioner simply had no authority to render the Opinion when the requesting parties were currently involved in litigation on the same issue. As such, NAC 232.040(2) and (4) provide yet another ground by which the Opinion should be held unenforceable. Plaintiffs, therefore, will suceeed on the merits in this action.

3. The Opinion Is Based on a One-Sided View of a Hotly-Contested Statute and Is Contrary to the Only Known Nevada Precedent.

Notwithstanding the clear lack of jurisdiction for the FID's Opinion, the FID Opinion also should be rendered null and void and unenforceable due to the simple fact that it

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was based on only one side of the story, the self-serving argument of real estate speculators. Although the dispute over interpretation of the super-priority lien of NRS 116.3116 affects, at a minimum, homeowners, buyers of homes, sellers of homes, HOAs, collection agencies, and lenders, only real estate speculators, those who flip real estate for substantial profits, have gotten a say in the matter. Tellingly, the Opinion flies in the face of the only known Nevada District Court authority on point—the ***Korbel*** decision. ***See*** Exhibit 4. Indeed, the Opinion does not even mention ***Korbel***, leading to only one conclusion—the Commissioner never was informed of that important authority. ***See*** Exhibit 1.

Despite all of the ongoing litigation on this very matter, Prem took it upon itself to seek a favorable forum on an *ex parte* basis, without notifying any other interested party, in its never-ending efforts to attain its desired result. Indeed, the foregoing matter has been hounded by blatant and egregious forum shopping of the worst sort. More than three years after ***Korbel*** was decided, the various players in this matter filed a lawsuit and lost, filed another lawsuit and lost, and filed a third lawsuit and lost. When they did not like the draft advisory opinion from CIC, they sought a different one from the FID, shutting out Plaintiffs and all others similarly situated in the process. There is no doubt that Prem and Mr. Adams will now wave their result (uncontested as it was) in front of every arbitrator and every court in every case in which they appear in support of their position.

Setting aside the fact that the Commissioner's Advisory Opinion contradicts the ***Korbel*** decision and the draft CIC advisory opinion, that the advisory opinion was sought for an improper purpose, or whether the Commissioner wittingly or unwittingly decided to inject himself into hotly contested litigation, this matter is going to be decided ultimately by the Nevada Supreme Court, not the FID. Whether he intended to do so or not, it is not the business of the Commissioner to influence pending litigation.

Accordingly, due to the Commissioner's clear lack of jurisdiction and the fact that the Opinion analyzes only one, very small, side of the story by a party that will go to any extreme to achieve its desired results, Plaintiffs have a large likelihood of success in enjoining enforcement of the Opinion and declaring it null and void *ab initio*.

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C. Absent a TRO and Preliminary Injunction, Plaintiffs Will Suffer Irreparable Harm

"[A]cts committed without just cause which unreasonably interfere with a business or destroy its credits or profits, may do an irreparable injury and thus authorize issuance of an injunction." ***Sobol v. Capital Mgmt. Consultants, Inc.***, 102 Nev. 444, 446, 726 P.2d 335, 337 (1986). "The right to carry on a lawful business is a property right" and acts which interfere with that will be restrained. ***Guion v. Terra Mktg. of Nev., Inc.***, 90 Nev. 237, 240, 523 P.2d 847, 848 (1974).

Here, despite the clear lack of jurisdiction for the Opinion, staff at the FID have informed Plaintiffs that the Commissioner intends to immediately begin enforcement of this Advisory Opinion and to impose stiff regulatory discipline. ***See*** Exhibit 7. Such actions may include immediate license suspension and revocation proceedings against Plaintiffs. ***See id.*** Any of such actions will be devastating to Plaintiffs. Plaintiffs, as collection agencies for HOAs, obviously rely on their licenses to conduct business on behalf of the HOAs. ***See id.*** Any question as to Plaintiffs' licenses will not only damage, and possibly destroy, Plaintiffs' businesses, but it would also wreak havoc on HOAs' abilities to collect on past due assessments, an act typically done through utilization of collection agencies such as Plaintiffs. ***Id.***

Moreover, for several years, Plaintiffs and others in the industry have been conducting their businesses pursuant to the ***Korbel*** decision. Indeed, even Freddie Mac agrees that it must pay fees pursuant to the ***Korbel*** holding, as the only Nevada authority on point. ***See*** Exhibit 6. A sudden change in how the players in the industry must conduct themselves will create upheaval in the industry, most likely at the expense of HOAs and the homeowners living within those HOAs. In any event, if such an upheaval is to occur, it should occur after a full and thorough analysis of the relevant issues, not after one party dead set on increasing its speculation profits at the expense of all others involved files a secret request for an advisory opinion with an inappropriate state agency.

Therefore, because Plaintiffs will suffer immediate, irreparable harm if the FID enforces the Opinion, injunctive relief is warranted. In other words, Plaintiffs request a

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temporary restraining order and preliminary injunction to maintain the status quo until a court, likely the Nevada Supreme Court, has made a decision on this hotly-contested issue after a full view of the issues based on input from all interested parties.

D. The Public Interest and Potential Hardships Weigh in Favor of Injunctive Relief

In considering preliminary injunctions, courts also weigh the potential hardships to the relative parties and others, and the public interest. ***Univ. & Comty College Sys. of Nev.***, 120 Nev. at 721, 100 P.3d at 187. Here, the potential hardships clearly weigh in favor of granting injunctive relief. As discussed above, Plaintiffs will endure substantial hardships if injunctive relief is not granted enjoining enforcement of the Opinion. Namely, Plaintiffs' licenses are at stake, as is their entire business model. On the contrary, the State's interest is minimal at most. Although the State certainly has an interest in protecting its citizens, the HOA industry has been operating for years under methods that are contrary to the limitations now set forth in the Opinion, with no negative effects on the State's citizens. However, the change suggested by the Opinion will cause great turmoil in the HOA industry. Indeed, whereas any person who believes they have been damaged by the current state of the industry will be able to recover monetary damages for any purported overpayment, the damage to Plaintiffs, in the form of loss of their licenses and businesses, will be irreversible.

From a public interest standpoint, this Opinion has the potential to seriously damage the citizens of Nevada, particularly those living in neighborhoods governed by HOAs. Because the Opinion severely limits the rights of HOAs to recover collection costs, the practical result of the Opinion will be to shift HOA fees, collection costs, and interest back to the HOAs as opposed to the delinquent homeowner. ***The result is that homeowners who live by the rules, pay their mortgages, and pay their HOA fees, will have to absorb these costs by paying increased HOA fees while real estate speculators like Prem will enjoy a "free ride" by not having to pay those fees.*** Hardly a just or equitable result.

Moreover, this action concerns—and has the potential to significantly impact—the role of HOAs during these difficult economic times. With more foreclosures in Nevada than in any other state, HOAs have stepped in to maintain homes that have fallen into disrepair. Dead or

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overgrown landscaping is a common problem, as is unattended pools ripe with algae. Poorly kept residences can create neighborhood blight that depresses surrounding property values that have already been devastated by the worst housing market downturn in Nevada history. If HOAs are unable to recover outstanding lien amounts, which include late fees, collection costs, and interest, their task of maintaining these communities becomes much more daunting. Because the practical result of the Opinion will be that HOAs will not be able to recover any such collection costs, the Opinion will result in a significant burden on HOAs and homeowners.

Accordingly, the public interest and the balance of hardships weigh heavily in favor of granting the injunctive relief requested by Plaintiffs.

E. Any Bond Should be Nominal.

Finally, any bond required should be nominal. Plaintiffs simply seek to maintain the status quo existing in the industry for years. The temporary restraining order and preliminary injunction would cause no injury to Defendants. Instead, this issue should be permitted to run its course in arbitration and in the district court before ultimately being decided by the Nevada Supreme Court.

IV.

CONCLUSION

For the foregoing reasons, NAS, RMI, and Angius & Terry respectfully request the Court grant their Application for Temporary Restraining Order and enjoin Defendants from enforcing the Opinion until such time as the motion for preliminary injunction is heard. Plaintiffs further request that, following a hearing on Plaintiffs' Motion for Preliminary

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Injunction, the Court enter a preliminary injunction enjoining Defendants from enforcement of the Opinion and declaring the Opinion null and void.

DATED this 1st day of December 2010.

HOLLAND & HART LLP

By _____
Patrick J. Reilly (6103)
Jenny L. Routheaux (11258)
3800 Howard Hughes Parkway, 10th Floor
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CERTIFICATE OF SERVICE

Pursuant to Nev. R. Civ. P. 5(b), I hereby certify that on the 1st day of December 2010, I served a true and correct copy of the foregoing **EX PARTE APPLICATION FOR TEMPORARY RESTRAINING ORDER AND MOTION FOR PRELIMINARY INJUNCTION** via email to the person listed below:

Daniel Ebihara, Esq.
Deputy Attorney General
State of Nevada
555 East Washington Street, #3900
Las Vegas, Nevada 89101
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Susan Thompson
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Selling Guide

Fannie Mae Single Family

Selling Guide: Fannie Mae Single Family

Published December 1, 2010

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Table of Contents

All coverages must be in compliance with local, state, and federal insurance laws.

B4-2.1-06, Priority of Common Expense Assessments (04/01/2009)

Introduction

This topic contains information on priority of common expense assessments.

Priority of Common Expense Assessments

The table below describes the priority of common expense assessments.

If ...	Then ...
the condo or PUD project is located in a jurisdiction that has enacted: • the Uniform Condo Act (UCA), • the Uniform Common Interest Ownership Act (UCIOA), or • other similar statutes that provide for regular common expense assessments, as reflected by the project's operating budget, to have such priority over first mortgage liens.	Fannie Mae allows up to six months of regular common expense assessments for a condo or PUD unit to have limited priority over Fannie Mae's mortgage lien.
Fannie Mae subsequently acquires title to the unit by foreclosure,	Fannie Mae will not be liable for any fees or charges related to the collection of the six months of unpaid assessments that accrued before acquisition of title to the unit.
the condo or PUD project is located in a jurisdiction that allows for more than six months of regular common expense assessments to have priority over Fannie Mae's lien,	Fannie Mae will not purchase a mortgage loan secured by a unit in the project.

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Arbitrator

STATE OF NEVADA

DEPARTMENT OF BUSINESS AND INDUSTRY

REAL ESTATE DIVISION

OFFICE OF THE OMBUDSMAN FOR OWNERS IN COMMON-INTEREST COMMUNITIES AND CONDOMINIUM HOTELS

HIGHER GROUND, LLC, A Nevada limited liability company; RRR HOMES, LLC, a Nevada limited liability company; TRIPLE BRANDED CORD, LLC, Nevada limited liability company; EQUISOURCE, LLC, a Nevada limited liability company; EQUISOURCE HOLDING, LLC, a Nevada limited liability company; APPLETON PROPERTIES, LLC, a Nevada limited liability company; CBRIS, LLC, a Nevada limited liability company; MEGA, LLC, a Nevada limited liability company; SOUTHERN Nevada ACQUISITIONS, LLC, a Nevada limited liability company, VESTEDSPEC, INC., a Nevada corporation; CUSTOM ESTATES, LLC, a Nevada limited liability company; KINGFUTT'S PFM LLC, a Nevada limited liability company; THORNTON & ASSOCIATES, LLC, a Nevada limited liability company; WINGBROOK CAPITAL LLC, a Nevada limited liability company; ELSINORE, LLC, a Nevada limited liability company; MONTESA, LLC, a Nevada limited liability company; EKNV, LLC, a a Nevada limited liability company; on behalf of themselves and as representatives of the class herein defined, Claimants,	NRED Control # 10-87

v.

NEVADA ASSOCIATION SERVICES, INC, a Nevada corporation; RMI MANAGEMENT, LLC, dba RED ROCK FINANCIAL SERVICES, a Nevada limited liability company; HOMEOWNER ASSOCIATION SERVICES, INC., a Nevada Corporation; ALESSI & KOENIG, LLC, a Nevada limited liability company; HAMPTON & HAMPTON, a professional corporation; ANGIUS & TERRY COLLECTIONS, LLC, a Nevada limited liability company; SILVER STATE TRUSTEE SERVICES, LLC, a Nevada limited liability company,

Respondents.

INTERIM AWARD REGARDING ORDER GRANTING IN PART AND DENYING IN PART MOTION FOR SUMMARY JUDGMENT ON CLAIM OF DECLARATORY RELIEF

On October 28, 2010, this arbitrator entered an Order Granting in Part and Denying in Part the Claimants' Motion for Summary Judgment on Claim of Declaratory Relief. He interpreted NRS 116.3116 and found:

1. NRS 116.3116(2) provides for a cap of 9 months on assessments for super priority lien purposes. Therefore, costs and fees related to unpaid assessments are subject to the 9-month cap. This arbitrator granted the Claimants' Motion for Summary Judgment on this issue. Thus, they are the prevailing party regarding this issue.
2. Filing a civil action is not a condition precedent for an HOA's super priority lien to exist. This arbitrator denied the Claimants' Motion for

Summary Judgment on this issue. Thus, the Respondents are the prevailing party of this issue.

There is no Nevada Supreme Court decision addressing these two issues. There are substantial properties involved in this case and the attorneys will be spending substantial time to conduct discovery, prepare the case for arbitration, and arbitration hearings. The parties will be incurring significant expenses for attorneys' fees and costs, and this arbitrator's fees. Therefore, this arbitrator is exercising his discretion under NRS 38.231(1) and pursuant to NRS 38.234 incorporates his Order Granting in Part and Denying in Part the Claimants' Motion for Summary Judgment on Claim of Declaratory Relief into an Interim Award, so that the parties may proceed to the District Court pursuant to NRS 38.234.

Dated the 21 day of March 2011.

Persi J. Mishel, Esq., Arbitrator
2340 Flower Spring St.
Las Vegas, NV 89134
(702) 255-7029

NOTICE

NRS 38.234 provides: "If an arbitrator makes a preaward ruling in favor of a party to an arbitral proceeding, the party may request the arbitrator to incorporate the ruling into an award under NRS 38.236. A prevailing party may make a motion to the court for an expedited order to confirm the award under NRS 38.239, in which case the court shall summarily decide the motion. The court shall issue an order to confirm the award unless the court vacates, modifies or corrects the award under NRS 38.241 or 38.242."

CERTIFICATE OF MAILING

I hereby certify that a copy of the forgoing Interim Award Regarding Order Granting in Part and Denying in Part Motion for Summary Judgment on Claim of Declaratory Relief placed in the United States mail, with proper postage affixed thereto, addressed as follows, on this 21 day of March 2011:

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Persi J. Mishel, Esq.

Community Collateral Damage: A Question of Priorities

*Andrea J. Boyack**

Today's soaring mortgage default rate and the uncertainty and delay associated with mortgage foreclosure proceedings threaten to cause financial tragedies of the commons in condominiums and homeowner associations across the country. Assessment defaults in privately governed communities result in an inequitable allocation of upkeep costs—a phenomenon that current law has failed to prevent. But the collateral damage caused by delayed foreclosures and insufficient recoveries can be minimized by increasing the payment priority of the association lien.

In a majority of states, association liens are completely subordinate to the first mortgage lien. At foreclosure of the mortgage lien, the junior priority assessment lien will be extinguished whether or not there are sufficient proceeds to reimburse for community charges. Assessment delinquencies grow over time, so the longer it takes to complete foreclosure, the greater the costs to the neighborhood. Although several states have adopted a limited lien priority for up to six months' worth of unpaid assessments, foreclosures today take far longer than six months, and the amount ultimately owed to a community can be significant and far exceed that cap. Federal housing policy affects the resolution of the issue because the Federal Housing Administration ("FHA"), Fannie Mae and Freddie Mac only permit qualifying mortgages to be subject to a six-month assessment lien priority. The decelerating pace of foreclosure further exacerbates the already unjustifiable financial impact borne by non-defaulting neighbors. The lien priority status quo fails to adequately protect communities in today's context of widespread, delayed foreclosures and

* Visiting Professor of Law at Fordham University Law School and former Visiting Professor of Law at George Washington University Law School; J.D., University of Virginia School of Law; M.A.L.D., Fletcher School of Law and Diplomacy, Tufts University; B.A., Brigham Young University. I am deeply indebted to both Robert M. Diamond and Professor Dale Whitman for their insight and invaluable input.

under-collateralized mortgage loans. Decreasing the first mortgage lien's priority during a foreclosure delay would mitigate the harm.

Lien priority statutory changes could protect association finances in the future, and such provisions might be applied retroactively as well. In other contexts, states have held that changes to a lien priority regime could apply to existing associations and existing mortgages without unconstitutionally impairing contract or property rights. This has been particularly true where the association's lien was deemed to have been created on the date the community's organizational documents were recorded (prior to any unit's mortgage). Historically, bank lobbyists have opposed any enhanced assessment lien priority. However, supporting property upkeep and making assessments more predictable and collectible would actually benefit lenders by shoring up the value of their collateral. Moreover, increased certainty with respect to homeowner payment obligations would enable more responsible credit underwriting and contribute to economic recovery. Shoring up assessment lien priority would not only ensure a fair allocation of community costs, but also would help to contain the current housing market decline.

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INTRODUCTION

Culpable parties in today's housing crisis are legion,[1] but innocent bystanders are directly and tangibly harmed by the fallout. Nonpayment of upkeep charges by financially strapped owners forces guiltless neighbors to fund the community budget revenue gap. The problem is exacerbated by foreclosure delay, since a property conveyance would replace an insolvent owner with a solvent one. Whether a foreclosure delay results from mortgage lenders' strategic behavior[2] or from procedural missteps by servicers,[3] the result is the same—hard-working,

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1. Mortgage brokers pushed unrealistic loans. Steven Krystofiak, President, Mortgage Brokers Ass'n for Responsible Lending, Statement at the Federal Reserve (Aug. 1, 2006), *available at* http://www.federalreserve.gov/secrs/2006/august/20060801/op-1253/op-1253_3_1.pdf. Appraisers validated unrealistic prices. *See* Jonathan R. Laing, *The Bubble's New Home*, BARRON'S ONLINE (June 20, 2005), http://online.barrons.com/article/SB111905372884363176.html (discussing economist Robert Shiller's forecast of the housing market). Homeowners borrowed money they could not repay, and lenders lent funds while ignoring credit and market risks. Ben Steverman & David Bogoslaw, *The Financial Crisis Blame Game*, BLOOMBERG BUSINESSWEEK (Oct. 18, 2008, 12:01 AM), http://www.businessweek.com/investor/content/oct2008/pi20081017_950382.htm. Secondary market purchasers and investors overly relied on securitization, and regulators and credit rating agencies blessed the entire system in error, negligence, or both. *See, e.g.*, Carol Ann Frost, *Credit Rating Agencies in Capital Markets: A Review of Research Evidence on Selected Criticisms of the Agencies*, J. ACCT., AUDITING, & FIN. (forthcoming 2006), *available at* http://ssrn.com/abstract=941861 (analyzing the criticism of the credit rating agencies); John Patrick Hunt, *Credit Rating Agencies and the "Worldwide Credit Crisis": The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement*, 1 COLUM. BUS. L. REV. 109, 114 (2009) ("It is not plausible to argue that rating agencies have a valuable reputation for rating instruments they have never rated before."); Robert T. Miller, *Morals in a Market Bubble*, 35 U. DAYTON L. REV. 113, 136 (2009) ("Alan Greenspan and his colleagues on the Federal Open Market Committee made some mistakes in the early years of this decade by keeping interest rates very low for a very long time."); Randolph C. Thompson, *Mortgage Backed Securities, Wall Street, and the Making of a Global Financial Crisis*, 5 AM. U. BUS. L. BRIEF 51, 53 (2008) (providing an overview of the "misguided confidence in these debt instruments."); Jeff Madrick, *How We Were Ruined & What We Can Do*, N.Y. REV. OF BOOKS, Feb. 12, 2009, *available at* http://www.nybooks.com/articles/archives/2009/feb/12/how-we-were-ruined-what-we-can-do/ (providing an overview of the securitization and the financial crisis); Ronald Colombo, *A Crisis of Character*, HUFFINGTON POST (May 12, 2009, 4:58 PM), www.huffingtonpost.com/ronald-j-colombo/a-crisis-of-character_b_202562.html (lamenting the erosion of morals in the modern economy).

2. In a normal housing market, pushing foreclosures through quickly is in a lender's best interest. But in a depressed market, lenders have discovered that a foreclosure with a low prospect of a quick resale actually causes them to lose money. In 2009, lenders canceled up to 50% of foreclosure sales in some parts of the country, and many of these delays were inspired by the desire to avoid upkeep costs (maintenance, community assessments, and property taxes) while awaiting a market rebound. Todd Ruger, *Lenders' Latest Foreclosure Strategy: Waiting*, HERALD TRIB., July 12, 2009, at A1.

3. In early October 2010, three of the largest mortgage lenders in the United States—Bank of America, J.P. Morgan Chase, and Ally Financial—announced moratoriums in the twenty-three states that require court-ordered sales to foreclose on mortgages. This was in reaction to

financially responsible homeowners are forced to pay significant, additional amounts of money merely because of their neighbors' payment defaults, and in the many cases where foreclosure sale proceeds do not even cover the loan,[4] such amounts may never be recovered. The additional burden on the non-defaulting neighbors possibly forces such homeowners into their own financial distress. Allocating the cost of a delinquent owner's upkeep share to the paying neighbors is inefficient and unfair.[5] Furthermore, inequitable cost allocation will ultimately lead to additional owner defaults and further impairment of collateral value for every lender.

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increased judicial scrutiny of sloppy—or even fraudulent—servicer foreclosure procedures. *See* Ariana Eunjung Cha & Brady Dennis, *Judges Revisiting Foreclosure Cases May Help Owners but Clog Market*, WASH. POST, Oct. 5, 2010, at A9 (referencing a Florida case). Within a week of the initial announcements of these servicer-initiated moratoriums, Bank of America expanded its freeze on foreclosures nationwide, and attorneys general in all fifty states begun investigative probes into the extent of servicer misconduct in foreclosure procedures. *See* Ariana Eunjung Cha, Steven Mufson & Jia Lynn Yang, *Momentum Builds for Full Moratorium on Foreclosures*, WASH. POST, Oct. 9, 2010, at A11 (reporting that national civil rights groups had called for a government-mandated national moratorium on foreclosures); Jia Lynn Yang & Ariana Eunjung Cha, *Obama Vetoes Foreclosure Bill as Anger Grows*, WASH. POST, Oct. 8, 2010, at A1 (reporting that federal legislation intended to streamline foreclosure proceedings had been vetoed by President Obama, further lengthening the foreclosure process). While moratoriums have now been lifted, the concern that prompted them hangs over foreclosure proceedings, and the increased servicer scrutiny operates to lengthen the foreclosure timeline. *See* Carrie Bay, *Self-Evident Truth in Market Variables: Longer Foreclosure Timelines*, DSNNEWS.COM (Apr. 12, 2011), http://www.dsnews.com/articles/self-evident-truth-in-market-variables-longer-foreclosure-timelines-2011-04-12 (stating that the time period from default to foreclosure continues to increase across the country).

4. According to the Rasmussen Report, 31% of U.S. homeowners with a mortgage owed more on their homes than their homes were worth at the end of 2010. Peter Schroeder, *Poll: Nearly One-Third of Homeowners Underwater on Mortgage*, THE HILL (Mar. 21, 2011, 1:29 PM), http://thehill.com/blogs/on-the-money/801-economy/151039-poll-nearly-one-third-of-homeowners-underwater-on-mortgages. Deutsche Bank predicts that 48% of American homes could have negative equity by the end of 2011. Mortimer B. Zuckerman, *Housing Crisis Represents the Greatest Threat to Recovery*, U.S. NEWS & WORLD REP. (Jan. 27, 2011), http://www.usnews.com/opinion/mzuckerman/articles/2011/01/27/housing-crisis-represents-the-greatest-threat-to-the-recovery.

5. The concept that an unfair enjoyment of benefits by parties not bearing associated costs (free-riding) is inequitable and "wrong" was articulated by H.L.A. Hart in 1955 and was termed the "principle of fairness." H.L.A. Hart, *Are There Any Natural Rights?*, 64 PHIL. REV. 175, 185–86 (1955). This concept has been favorably cited by John Rawls. JOHN RAWLS, A THEORY OF JUSTICE 96 (rev. ed. 1971). Fair allocation of cost demands that all beneficiaries of a cooperative enterprise bear pro rata responsibility for the costs of such enterprise. This formulation of fair allocation is well-suited to the case of upkeep expenses of a common interest community such as a homeowner association or condominium. Unfair cost allocation in communities creates neighborhood contention and lowers quality of life for members of an association. Michelle Conlin & Tamara Lush, *Neighbor vs. Neighbor as Homeowner Fights Get Ugly*, ASSOCIATED PRESS, July 10, 2011, *available at* http://finance.yahoo.com/news/Neighbor-vs-neighbor-as-apf-2524543580.html?x=0.

Today, defaulting neighbors cause millions of blameless homeowners around the country to face such inequitable and unexpected financial burdens.[6] An increasing number of new developments nationwide have adopted a private governance model.[7] Approximately 62,000,000 people in the United States (20% of the country's population) live in one of the 309,600 privately governed common interest communities ("CICs").[8] Nationally, home loan delinquency rates are now between 10% and 13% of all mortgages.[9] Mortgage defaults are concentrated in certain geographic areas, however, so the mortgage delinquency rate in

6. Numerous media accounts have highlighted the stories of suffering by such non-delinquent neighbors. *See, e.g.*, Christine Dunn, *'Nightmare' Condo Fees After Foreclosure*, PROVIDENCE J., July 6, 2008, at G1 (discussing a Rhode Island foreclosure); Christine Haughney, *Collateral Foreclosure Damage*, N.Y. TIMES, May 15, 2008, at C1 (examining the plight of a Miami woman); Sarah Ryley, *New Manhattan Condos See Rise in Foreclosures*, THEREALDEAL.COM (Mar. 8, 2010, 11:00 AM), http://therealdeal.com/newyork/articles/new-manhattan-condos-see-rise-in-foreclosures--2 (reporting on New York foreclosures); David Sutta, *Condos Demanding Foreclosure On Abandoned Units*, MFI-MIAMI (Apr. 28, 2010), http://www.mfi-miami.com/2010/04/condos-demanding-foreclosure-on-abandoned-units/ (discussing the predicament of a Florida woman).

7. More than 80% of newly built homes across the country are in a CIC. Conlin & Lush, *supra* note 5. The prevalence of condominiums increased markedly over the decade ending in 2005. However, since the housing crisis began, the percentage of occupied housing stock within a condominium has notably declined. *See* JENNIFER COMNEY, CHRIS NARDUCI & PETER TATIAN, URBAN INST., STATE OF WASHINGTON, D.C.'S NEIGHBORHOOD 2010 26–29 (Nov. 2010) (showing how Washington, D.C.'s housing stock has followed the national trend).

8. "Common interest community" is defined by the Restatement (Third) of Property to be a "development or neighborhood in which individually owned lots or units are burdened by a servitude" that cannot be avoided by nonuse or withdrawal. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 6.2 (2000). Common interest communities include condominiums and homeowner associations—also known as planned unit developments ("P.U.D.s"). Data regarding the number of U.S. common interest communities and their residents is tracked by the Community Associations Institute ("CAI"). *Industry Data*, CMTY. ASS'NS INST., http://www.caiouline.org/info/research/Pages/default.aspx (last visited Aug. 16, 2011) [hereinafter CAI Industry Data]. CAI's data indicate that the number of residents of common interest communities has increased from 2.1 million in 1970 to 62.0 million in 2010. This figure represents 20.2% of the population of the United States, estimated by the U.S. Census Bureau to be 307 million in 2009. *Population Finder*, U.S. CENSUS BUREAU, http://factfinder.census.gov/servlet/SAFFPopulation (last visited Aug. 16, 2011).

9. Based on figures provided by Lender Processing Services, as reported at PR Newswire, Press Release, Lending Process Services, Inc., LPS September 'First Look' Mortgage Report: August Month-End Data Shows More Delinquent Loans Entering Foreclosure Process (Sept. 15, 2010), *available at* www.reuters.com/article/idUS224331+15-Sep-2010+PRN20100915. Another article reporting these figures calculates that this rate indicates more than 7.2 million mortgage loans are behind on their payments. Carrie Bay, *Residential Mortgage Delinquency Rate Surpasses 10%: LPS*, DSNEWS.COM (Feb. 4, 2010), http://www.dsnews.com/articles/mortgage-delinquency-rate-surpasses-10-lps-2010-02-04. The foreclosure rate is ten times pre-crisis levels, and the aggregate number of foreclosure sales in one month (around 100,000 nationwide) is now similar to the number of pre-crisis foreclosure sales for an entire year. Alex Viega, *Foreclosure Rate: Americans on Pace for 1 Million Foreclosures in 2010*, HUFFINGTON POST (July 15, 2010, 5:07 PM), http://www.huffingtonpost.com/2010/07/15/foreclosure-rate-american_n_647130.html.

those areas is much higher.[10] The states with recent growth booms are the ones dealing with the steepest mortgage default rate.[11] Notably, these states also have the highest percentage of citizens residing in privately governed CICs.[12] People who have stopped paying their mortgages have, almost invariably, previously stopped paying their community association assessments.[13] The precipitous rise in mortgage

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10. *See* Shayna M. Olesiuk & Kathy R. Kalser, *The 2009 Economic Landscape, The Sand States: Anatomy of a Perfect Housing-Market Storm*, 3 FDIC Q., no. 3, 2009 at 26, *available at* http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_1/Quarterly_Vol3No1_entire_issue_FINAL.pdf (discussing the acute nature of the housing downturn in Arizona, California, Nevada, and Florida); *see also* Dina ElBoghdady, *Foreclosure Activity Rises In Most Major Metropolitan Areas*, WASH. POST, July 30, 2010, at A14 ("The 20 regions with the worst foreclosure rates were in the four states—Florida, California, Nevada and Arizona."); Brad Heath, *Most Foreclosures Pack into Few Counties*, USA TODAY (Mar. 6, 2009, 7:13 PM), http://www.usatoday.com/money/economy/housing/2009-03-05-foreclosure_N.htm (explaining that properties concentrated in a mere thirty-five counties accounted for half of the country's foreclosure actions, and eight counties in Arizona, California, Florida, and Nevada were the source of a quarter of the nation's foreclosures in 2008). As of July 2010, 1 in 200 households in California were in foreclosure; 1 in 171 households in Florida were in foreclosure; 1 in 167 households in Arizona were in foreclosure; and 1 in 82 households in Nevada were in foreclosure. *States with Highest Foreclosure Rates*, CNBC.COM, http://www.cnbc.com/id/29655038/States_with_the_Highest_Foreclosure_Rates (last visited Aug. 16, 2011) (citing data from RealtyTrac's U.S. Foreclosure Market Report).

11. In the last decade, many cities in Arizona, California, Florida, and Nevada have experienced both a double-digit rise in prices as well as a double-digit decline in prices. *See House Price Index*, FED. HOUS. FIN. AGENCY, http://www.fhfa.gov/Default.aspx?Page=87 (last visited Aug. 16, 2011) (providing an index of housing transactions by state); S&P/CASE-SHILLER, HOME PRICE INDICES 2009, A YEAR IN REVIEW 5 (Jan. 2010), *available at* http://www.standardandpoors.com/ (follow "S&P/Case-Shiller Home Price Indices" hyperlink; then follow "S&P/Case-Shiller Home Price Indices: 2009 A Year In Review" hyperlink) (reporting on 2009). Conversely, cities such as Boston, Charlotte, Cleveland, Dallas, and Denver never experienced double-digit price rises nor have they experienced double-digit declines. *See* Heath, *supra* note 10 (explaining that in some parts of the country, "the foreclosure wave was barely a ripple").

12. For example, an estimated 25% or more of Californians reside in a condominium or homeowner association. *See* Carol Lloyd, *Condominium Homeowners Face Rising Condo Fees and Special Assessments*, SFGATE.COM (Aug. 3, 2007), http://articles.sfgate.com/2007-08-03/entertainment/17255445_1_affordable-housing-new-homeownership-inclusionary (reporting on increases in special assessments). Tomas Musil, director of the Shenehon Center for Real Estate at the Opus College of Business at the University of St. Thomas in St. Paul, Minnesota, explains that while "the problem is national in scope, it is more pronounced in Florida, California, Texas, and Colorado," where CIC developments were more popular. Tom Bayles, *After Foreclosure, It's Time for Neighbors to Pay*, HERALD TRIB. (Sept. 23, 2008, 1:26 AM), http://www.heraldtribune.com/article/20080923/ARTICLE/809230372/2055/NEWS?Title=When_foreclosure_is_finished__it_s_time_for_neighbors_to_pay (quoting Musil). The Policy Institute of California asserts that 38% of the housing units in California's "Inland Empire" exist in homeowner association communities. Jim Wasserman, *HOAs Struggle with Gotchas*, ASSOCIATED PRESS, http://www.calhomelaw.org/doc.asp?id=463 (last visited Aug. 16, 2011). Wasserman also points out that more than half of the nation's CIC housing is in five states (California, Florida, Texas, Arizona, and Nevada). Jim Wasserman, *California Eyes HOA Changes*, ASSOCIATED PRESS, (July 8, 2004), *available at* http://www.democraticunderground.com/discuss/duboard.php?az=view_all&address=141x2045calhomelaw.org/doc.asp?id=646.

13. Trevor G. Pinkerton, *Escaping the Death Spiral of Dues and Debt: Bankruptcy and*

default rates therefore indicates an even steeper rise in assessment delinquencies, which will continue until solvent owners replace delinquent owners.[14]

All types of CICs, from high-rise residential condominiums to multiple-zip-code single-home developments, share the same essential service and payment structure: homeowner-elected directors manage common upkeep, and all homeowners contribute their pro rata portion of the common costs.[15] The CIC structure enables more community amenities and upkeep, permitting neighborhoods to self-fund and allowing local governments to avoid raising taxes in response to more housing developments.[16]

Owners in condominiums and homeowner associations expect to be financially independent of their neighbors.[17] Architects of CIC-enabling legislation did not intend to create financial co-dependence nor cause significant financial entanglement because default in a well-functioning market would lead expeditiously to foreclosure and title transfer to a successive solvent homeowner. If a credit-worthy party quickly takes over a defaulting owner's share of upkeep obligations and begins to pay allocated assessments, the community would suffer only limited financial loss due to a member's mortgage default. But it often does not work that way in today's market. Now, contrary to original

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Condominium Association Debtors, 26 EMORY BANKR. DEV. J. 125, 142–43 (2009); Monica Hatcher, *Mediators Foresee Gloom. Doom in Condo Industry*, MIAMI HERALD, Jan. 4, 2009, at 1H; Press Release, PR.com, Concerned Homeowners Association Members Coalition Forms (Feb. 18, 2011), *available at* http://www.pr.com/press-release/299084; Donna Gehrke-White, *Homeowner Associations Step Up Foreclosure Filings*, MIAMI HERALD (Feb. 20, 2011), http://www.miamiherald.com/2011/02/20/2062656/homeowner-associations-step-up.html; Daniel Vasquez, *Should Delinquent Condo Owners Lose Internet, TV Service?*, SUN SENTINEL, Mar. 1, 2011, http://articles.sun-sentinel.com/2011-03-01/business/fl-cable-tv-condocol-20110301_1_delinquent-condo-owners-associations-maintenance-fees.

14. *See Infra* notes 80–84 and accompanying text (illustrating that because assessments are the primary source of funding for community associations, delinquent payments usually cause increases in the assessments of all other homeowners to offset this financial imbalance).

15. *See* WAYNE S. HYATT & SUSAN F. FRENCH, COMMUNITY ASSOCIATION LAW: CASES AND MATERIALS ON COMMON INTEREST COMMUNITIES 11 (2d ed. 2008) (discussing the power of an elected board of directors); WAYNE S. HYATT, CONDOMINIUM AND HOMEOWNER ASSOCIATION PRACTICE: COMMUNITY ASSOCIATION LAW 105, 121 (3d ed. 2000) (discussing assessments and other collection devices).

16. *See generally* CLIFFORD TREESE, ROBERT DIAMOND & KATHERINE ROSENBERRY, RESEARCH INST. FOR HOUS. AM., CHANGING PERSPECTIVES ON COMMUNITY ASSOCIATION MORTGAGE UNDERWRITING AND CREDIT ANALYSIS 3 (Nov. 2001), *available at* http://www.housingamerica.org/RIHA/RIHA/Publications/48502_ChangingPerspectivesonCommunityAssociationMortgageUnderwriting.pdf (discussing methods that communities utilize to minimize taxes); CAI Industry Data, *supra* note 8 (indicating the number of residents of common interest communities).

17. *See Infra* notes 97–100 and accompanying text (discussing the negative aspects of economic entanglement).

intent and expectations, foreclosure is slow in coming and sometimes deliberately or negligently delayed, and community assessments can accrue and remain unpaid for months or years.[18] Furthermore, the sheer number of owners who are currently in default on their payment obligations—some ten times higher than pre-crisis—means that an association could be suffering from widespread assessment delinquency, both increasing its budgetary shortfall and decreasing the number of owners shouldering the burden of bridging that gap.[19] Paying additional upkeep costs harms homeowners. Furthermore, uncertainty in association funding threatens the viability of the community itself.

In the context of today's lengthy mortgage foreclosure timelines, neighbors in CICs have become truly financially interdependent, and the failure of some owners to pay their fair share of common costs requires a greater financial contribution by the others.[20] During the months or years that mortgage foreclosure on a unit is threateued or pending, the association still must pay for upkeep, utilities and necessary repairs; its only source of revenue is increased assessment payments by those owners who are still able to pay.[21] Increased assessments, triggered by chronic non-payments, essentially result in forced inter-neighbor loans. Because foreclosure of the first mortgage wipes away the association's junior lien for assessments,[22] these forced loans typically end up being forced inter-neighbor permaneut subsidies.

Requiring owners to pay their neighbors' debts is wrong, inefficient, and destabilizing for the hundreds of thousands of CICs in the United

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18. Shuang Zhu & R. Kelley Pace, The Influence of Foreclosure Delays on Borrower's Default Behavior 3 (Apr. 19, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=1717127; see *also* Brent Ambrose, Richard Buttimer, Jr. & Charles Capone, *Pricing Mortgage Default and Foreclosure Delay*, 29 J. OF MONEY, CREDIT & BANKING 314, 319–20 (1997) (providing an overview of foreclosure delay).

19. RealtyTrac's Year-End 2010 U.S. Foreclosure Market Report shows a total of 3,825,637 foreclosure filings (including default notices, scheduled auctions, and bank repossessions) reported on a record 2,871,891 U.S. properties in 2010, an increase of nearly 2% from 2009 and an increase of 23% from 2008. Press Release, RealtyTrac, Record 2.9 Million U.S. Properties Receive Foreclosure Filings in 2010 Despite 30-Month Low in December (Jan. 12, 2011), *available at* http://www.realtytrac.com/content/press-releases/2010-year-end-foreclosure-report-6309. The report also shows that nearly 2.23% of all U.S. housing units (1 in 45) received at least one foreclosure filing during the year, up from 2.21% in 2009, 1.84% in 2008, 1.03% in 2007, and 0.58% in 2006. *Id.* Today, at least 8 million Americans are behind on their mortgage payments, and the threat of further housing price decline (the so-called "double dip") has been called the "greatest strategic threat to the recovery of the economy." Zuckerman, *supra* note 4.

20. *See infra* Part I.B.2 (discussing the communal burden of assessment default in a CIC).

21. *See infra* notes 80–84 and accompanying text (discussing the importance of assessment payments to meet an association's budgetary needs).

22. *See infra* notes 187–97 and accompanying text (explaining the treatment of an assessment lien during first mortgage foreclosure).

States and the millions of homeowners who live in them.[23] The current system forces people who completely lacked the ability to foresee, control, or avoid their neighbors' defaults to bear increasing costs due to irresponsible mortgage lending. These same owners end up effectively subsidizing their neighbors' mortgage lenders whose collateral they pay to maintain, insure, and protect through association expenditures. Current laws fail to protect innocent, non-defaulting owners from being forced to provide their own private mortgage lender and neighbor bailouts. These bailouts are not ultimately reimbursed by the federal government or paid back by the home's foreclosing lender or foreclosure buyer. If neighbors refuse to privately fund deficiencies, lack of association funding for maintenance, insurance, and management of common property will eventually lead to a deterioration of the housing stock.[24]

Several states have responded to the dual problem of under-funded associations and inequitable cost allocation by providing for a capped amount of assessment deficiency (typically six months of unpaid assessments) to be repaid at or after foreclosure of the first mortgage on defaulting homes.[25] Often, this is not enough. Such limited obligations fail to adequately protect associations and their paying members from the costs of neighbor delinquency, in terms of both short-term uncertainty and ultimate association recoveries.[26] Changing the lien priority regime—to allow the first mortgagee's priority to decrease as foreclosure is delayed—is a better solution. Freeing post-foreclosure assessment claims from a dollar-capped limit would permit an association to ultimately recover the lenders' share of upkeep costs.

Decreasing a lender's priority based on the interval between mortgage default and foreclosure would likely incentivize more expeditious foreclosure sales. At first glance, this seems to run against conventional wisdom and current politics. Although lenders could choose to delay foreclosure and pay collateral carrying costs, increased lender costs pre-foreclosure could lead to faster foreclosures and faster home loss for defaulting borrowers. Even so, making lenders bear the costs of maintaining their collateral and encouraging transfer of title to

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23. Hart, *supra* note 5, at 185–86; CAI Industry Data, *supra* note 8; *see also infra* Parts I.B & II.B.1 (illustrating how assessement deliquencies can lead to housing devaluation).

24. For example, one Florida CIC was a "dreamy little spot" with affordable amenities before the foreclosure crisis and before "the rats started chewing through the toilet seats in vacant units and sewage started seeping from the ceiling." Conlin & Lush, *supra* note 5; *see also Infra* Parts I.B.2–3 (discussing how some states have adopted the Uniform Common Interest Ownership Act, which gives assessment liens a limited priority upon foreclosure).

25. *See Infra* Part II.A.1.a (describing the six-month limited priority lien).

26. *See infra* Part II.A.1.d (discussing the inadequacy of limited priority liens).

solvent owners is the only way to contain a community's financial distress.[27] Whether foreclosure delays are caused by default volume, inadequate lender documentation, faulty procedure, predictions regarding resale, or the lender's desire to retain the defaulted loans as performing on the balance sheet, equity demands that the procrastination costs be allocated to the mortgagee rather than to the community as a whole. Lender funding of the upkeep of their own collateral avoids unjust enrichment and places costs on the parties who could have reasonably foreseen and prevented the assessment delinquencies in the first place—the lenders who should have been underwriting their potential borrowers.[28] Creating a legal means for ultimate recovery and reimbursement of neighbor-funded budget deficiencies will shore up the finances of communities and non-defaulting homeowners and help stabilize the housing market.

Part I of this Article explains the negative externalities of foreclosures and defaults in the context of CICs, as well as the limited remedies currently available to community associations under disparate state statutes. Part II.A discusses some attempted and proposed solutions to the problem of assessment nonpayment and foreclosure delay, including judicial attempts to resolve the issue through application of equity and legislative efforts to increase limited lien priority coverage. Finally, Part II.B advocates a more nuanced and targeted approach to solving the problem: capping the community's losses by allowing the first mortgage lien's priority to gradually erode during the assessment default period.

While foreclosure procedure must be closely monitored and stringently followed to protect mortgage borrowers, promoting foreclosure sales within such procedural limits helps combat negative externalities created by defaulting community members. Laws that incentivize prompt, procedurally perfect foreclosures and allow for open-ended assessment lien priority would ultimately benefit homeowners, communities, and mortgage lenders. Systematic erosion

27. *See Infra* Part II.B.2 (explaing how a community stands to benefit from an expedited foreclosure process). Furthermore, foreclosure delays result in a "free ride" for mortgagors and their lenders during the time that assessment obligations are not paid on behalf of the defaulted property. *See* Hart, *supra* note 5, at 182 (articulating the idea of "moral property"). While public policy might justify giving defaulting homeowners reasonable time to relocate, economically and philosophically, there is no justification for substantial foreclosure delays that create "collateral damage" on the surrounding community, due to upkeep costs being allocated inequitably. There is no equitable reason to give either cost-free occupancy to borrowers or cost-free collateral preservation to their lenders. In fact, the very definition of "fair allocation" would demand otherwise. *See* RAWLS, *supra* note 5, at 96 (articulating moral principles).

28. *See Infra* notes 378–79 and accompanying text (discussing why shifting the financial burden to the lender would be beneficial to individuals and the economy as a whole).

of mortgage priority during foreclosure delay promotes equitable allocation of upkeep costs and efficient property transfers, and keeps lenders from getting a free ride. Compared to other potential solutions, first mortgage lien priority erosion is the best way to remedy the inequitable and community-destabilizing status quo.

I. THE PROBLEM OF PRIVATE GOVERNANCE AND MEMBER DEFAULTS

A. Negative Externalities of Default

A property owner's failure to meet assessment payment obligations creates significant negative externalities.[29] Widespread payment defaults destabilize communities, depress property values, lower local property tax revenue, and impose additional costs on public agencies that provide municipal services.[30] Although the problem of contagious declines in property values and neighborhood upkeep is often couched in terms of the spillover effect of foreclosures,[31] the most significant external harm arises not from the foreclosure sale itself, but from the default in homeowner payment obligations that preceded it.[32] Below-market foreclosure sales may temporarily reduce real estate market pricing of real estate in the immediate vicinity of the foreclosed parcel.[33] But the adverse neighborhood effect of a property in limbo (foreclosure is pending while upkeep is lacking) is both more tangible and longer-lasting.[34] The true risk of contagion, therefore, comes from default and delay rather than from the ultimate property transfer.

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29. *See, e.g.*, ALLAN MALLACH, BROOKINGS INST., METRO. POL'Y PROGRAM, ADDRESSING OHIO'S FORECLOSURE CRISIS: TAKING THE NEXT STEPS 35 (June 2009), *available at* http://www2.safeguardproperties.com/pub/Alan_Mallach.pdf (reporting on the consequences of Ohio foreclosures).

30. *See* City of Cleveland v. Ameriquest Mortg. Sec., Inc., 621 F. Supp. 2d 513, 536 (N.D. Ohio 2009) (involving a lawsuit brought by the City of Cleveland against several lending institutions), *aff'd en banc*, 615 F.3d 496 (6th Cir. 2010), *cert. denied*, 131 S. Ct. 1685 (2011); *see also* JOINT CTR. FOR HOUS. STUDIES HARV. U., AMERICA'S RENTAL HOUSING: THE KEY TO A BALANCED NATIONAL POLICY 3 (2008), *available at* http://www.jchs.harvard.edu/publications/rental/rh08_americas_rental_housing/rh08_americas_rental_housing.pdf (describing the destabilization of certain communities).

31. In a May 5, 2008 speech, for example, Chairman of the Federal Reserve Ben Bernanke warned that "high rates of delinquency and foreclosure can have substantial spillover effects on the housing market, the financial markets, and the broader economy." Ben S. Bernanke, Chairman, Fed. Reserve, Speech at Columbia Business School 32nd Annual Dinner (May 5, 2008) (transcript available at http://www.federalreserve.gov/newsevents/speech/Bernanke20080505a.htm).

32. *See infra* Part I.A.2 (discussing constructive abandonment).

33. *See infra* notes 38–39 and accompanying text.

34. *See infra* Part II.A.2 (describing the effects of a prolonged foreclosure).

1. Lower Comparable Sales Valuation

In general, property sells at foreclosure for a significant amount below an arm's-length market transaction.[35] Because the market traditionally prices homes based on comparable sales within the same community, any below-market sale creates a drag on neighboring values and sale prices.[36] In addition, mortgage default and foreclosure increases the supply of homes for sale in the given neighborhood, and increasing supply with static demand lowers market prices as well. Research published by Fannie Mae in 2006, focusing on the effect of subprime foreclosures, estimated that 41 million properties in the United States faced declining property values due to foreclosure of nearby parcels, resulting in an aggregate loss of $200 billion in value.[37] The study found that homes within one-eighth of a mile of a foreclosed property experience a 0.9% decline in value after the foreclosure sale.[38] More recent empirical studies have questioned this figure—particularly in terms of the geographic scope and duration of the foreclosure effect—arguing that the depreciation is closer to 0.5%, can quickly rebound, and that the farther away a "good standing" home resides from a foreclosed home, the smaller the psychological and market pricing impact of the foreclosure sale.[39]

Interestingly, while neighboring homeowners may decry falling property values, the downward price pressure of foreclosure sales may actually help rather than hurt the housing market as a whole. Housing prices in this country are likely still inflated above market

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35. *See* John Y. Campbell, Stefano Giglio & Parag Pathak, *Forced Sales and House Prices* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 14866, 2009), *available at* http://econ-www.mit.edu/files/3914 (showing that foreclosure sales prices averaged 27% lower than the appraised value for the home). The depressed purchase price at foreclosure, however, is almost never cause to avoid the sale. *See, e.g.*, B.F.P. v. Resolution Trust, 511 U.S. 531, 545 (1994) ("We deem, as the law has always deemed, that a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with.").

36. *See* John Harding, Eric Rosenblatt & Vincent Yao, *The Contagion Effect of Foreclosed Properties*, 66 J. URB. ECON. 164, 172 (2009) (providing statistics). For a description of comparative sales methodology, see James Kimmons, *The Sales Comparison Method of Real Estate Appraisal and Valuation*, ABOUT.COM, http://realestate.about.com/od/appraisaland valuation/p/compare_method.htm (last visited Aug. 16, 2011) (discussing factors to consider in comparing properties).

37. Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single Family Mortgage Foreclosures on Property Values*, 17 HOUS. POL'Y DEBATE 57, 57 (2006).

38. *Id.*; *see also Chart of the Day: Foreclosure Contagion*, PORTFOLIO.COM (Jul. 18, 2008, 12:00 AM), http://www.portfolio.com/views/blogs/odd-numbers/2008/07/18/chart-of-the-day-foreclosure-contagion/#ixzz10I33 (discussing the effects of foreclosure on neighboring property values).

39. Harding et al., *supra* note 36, at 164–65.

"equilibrium"—meaning that the ratio of a home's value based on rental income is well below the comparable sale value of a given home.[40] Even though rents have gone up and prices have gone down, in many cases rents still cannot cover purchase-money mortgage payments, suggesting that real property prices have not yet decreased sufficiently to reach a stable, rent-neutral level.[41] There is, therefore, a systemic (market stability-based) upside to this particular aspect of foreclosure "contagion."

2. Constructive Abandonment

Comparable sales values of homes are notoriously finicky and fragile, and the foreclosure-related value losses likely represent unsustainable prior gains due to housing speculation.[42] Far more long-lasting and tangible costs arise from homeowners defaulting on their property upkeep obligations. Our system of homeownership involves both rights and responsibilities of homeowners,[43] and when owners abandon their homes, either literally, by ceasing to reside there, or figuratively, by ceasing to maintain the property, the community suffers tangible and permanent losses in value,[44] homes and neighborhoods deteriorate, and

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40. *See* Suzanne Stewart & Ike Brannon, *A Collapsing Housing Bubble?*, 29 REG. 15, 16 (2006) ("A reading well below or above 100 indicates a market that is out of equilibrium: if the reading is below 100, renting is a bargain."). In 2005, the average rental value of homes was only 70% of the purchase price nationwide and was the lowest since the Office of Federal Housing Enterprise Oversight ("OFHEO") began the index in 1985—with the next-lowest annual ratio (1989) being roughly 91%. *Id.* The rental-sale price disequilibrium was far more pronounced in certain areas of the country, such as California, Nevada, Arizona, and Florida, where home prices in the prior decade had increased by over 99%. *See* OLESIUK & KALSER, *supra* note 10 (providing statistics); *see also* Anthony Sanders, *The Subprime Crisis and its Role in the Financial Crisis*, 17 J. HOUS. ECON. 254, 254 (2008) (providing statistics).

41. *See, e.g.*, Emma L. Carew, *To Woo A Renter: Homeowners Who Punt on Selling Face Challenge as Tenants Get Choosier*, WASH. POST, Aug. 15, 2009, at E1 (providing an example from the Washington, D.C. area); *see also* Stewart & Brannon, *supra* note 40, at 16.

42. *See* Andrea J. Boyack, *Lessons in Price Stability from the U.S. Real Estate Market Collapse*, 2010 MICH. ST. L. REV. 925, 933–34 (2010) (discussing speculation and overpricing).

43. Owners of real property are obligated to pay property taxes, are required to protect against hazards and nuisance on their properties, and face liabilities related to environmental hazards thereon. Real property cannot be abandoned. *See* RESTATEMENT (FIRST) OF PROP. § 504 cmt. a (1944) (explaining why easements may be abandoned more easily than other land interests); *see also, e.g.*, Pocono Springs Civic Ass'n v. MacKenzie, 667 A.2d 233, 235 (Pa. Super. Ct. 1995) (discussing the law of abandonment in Pennsylvania). Property law requires that some entity always hold seisin, because the holder of seisin is the gatekeeper, or responsible party, with respect to that parcel of realty. *See* THOMAS W. MERRILL & HENRY E. SMITH, PROPERTY: PRINCIPLES AND POLICIES 201 (2007) (discussing the role of gatekeeper as it relates to adverse possession).

44. *See* Ivana Kottasova, *A House Dies and a Block Sinks*, BROOK. INK (Mar. 9, 2011), http://thebrooklynink.com/2011/03/09/23899-a-house-dies-and-a-block-sinks/ ("Vacant properties are often not maintained properly and show signs of physical distress . . . . That itself causes property values to go down—and then the area becomes less attractive for residents." (quoting Josiah

the absence of a vigilant gatekeeper for the property allows vandalism and other crime to increase.[45] A defaulting homeowner facing imminent or even eventual mortgage foreclosure has little incentive to invest anything in the home and, thus, will forego many socially desirable activities: painting shutters, cleaning gutters, mowing the lawn, or fixing broken appliances or cabinets.[46]

The mere drop in home value itself can start the trend toward owner constructive abandonment because once a property is "upside-down" or "underwater" (more is owed on a mortgage loan than the property is worth), any improvements or maintenance made on a home effectively becomes "sweat debt" (value created for the lender) rather than "sweat equity" (value created for the owner). Some commentators have suggested that a typical borrower will consider walking away from a mortgage when the home value falls below 75% of the amount owed on the mortgage.[47] More than 5 million homeowners in the United States

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Madar)). The negative externalities caused by failure of an owner to exercise adequate property oversight are among the many justifications for the doctrine of adverse possession. *See* John G. Sprankling, *An Environmental Critique of Adverse Possession*, 79 CORNELL L. REV. 816, 816 (1994) (advocating an environmental reform of the adverse possession doctrine).

45. *See, e.g.*, John Cutts, *Neighborhood Cleanup Might Improve Cheap Houses for Sale Numbers*, REAL ESTATE PRO ARTICLES (July 7, 2010, 10:15 AM), http://www.realestateproarticles.com/Art/19024/278/Neighborhood-Cleanup-Might-Improve-Cheap-Houses-for-Sale-Numbers.html (discussing foreclosures in San Antonio); Seth Slabaugh, *High Vacancy Rates in Inner-City Muncie*, STAR PRESS (Feb. 26, 2011), http://pqasb.pqarchiver.com/thestarpress/access/2276988201.html?FMT=ABS&FMTS=ABS:FT&date=Feb+26%2C+2011 (reporting on the numerous vacancies in Muncie, Indiana); Yepoka Yeebo, *Coping With Chicago's Foreclosure 'War Zones,'* HUFFINGTONPOST.COM (Mar. 2, 2011, 9:49 AM), http://www.huffingtonpost.com/2011/03/02/chicago-vacant-reo-property_n_829343.html (lamenting vacancies in Chicago).

46. *See* Steve Vitali, *HOA's are Important to Our Valley Communities*, LAS VEGAS REV. J. (Mar. 12, 2011), http://www.lvrj.com/real_estate/hoas-are-important-to-our-valley-communities-117848853.html?ref=853 (describing efforts by the Nevada legislature); Tammy Leonard, Home Appreciation, Default Risk and Neighborhood Upkeep 3 (June 10, 2009) (unpublished manuscript), *available at* http://www.utdallas.edu/~auurdoch/NeighborhoodChange/Tammy/Appreciation_Default_Upkeep_v11.pdf (examining the relationship between houshold maintenance expenditures and default risk). Some homeowners who have defaulted on their mortgages and know that they will ultimately lose their home in foreclosure affirmatively and permissively create waste—some homeowners rip out fixtures and actively destroy improvements on the real property. *See Report: Owners of Foreclosed Homes Steal Appliances, Leave Houses In Disarray*, FOXNEWS.COM (Feb. 4, 2009), http://www.foxnews.com/story/0,2933,487884,00.html (reporting that some homeowners retaliate against lenders by damaging and looting their homes prior to foreclosure sales); James Thorner, *In home foreclosure, if it's not nailed down...*, ST. PETERSBURG TIMES (Feb. 19, 2008), http://www.sptimes.com/2008/02/19/Business/In_home_foreclosure__.shtml (reporting that, in Florida, 20% of owners strip their houses prior to foreclosure); James Walsh, *Monsey, NY—House Demolished Just Before Auction for Mortgage Default*, VOS IZ NEIAS? (Feb. 4, 2009, 8:41 AM), http://www.vosizneias.com/26875/2009/02/04/monsey-ny-house-demolished-just-before-auction-for-mortgage-default/ (reporting a situation where homeowners destroyed their entire house before a foreclosure sale).

47. David Streitfeld, *No Aid or Rebound In Sight: More Homeowners Just Walk Away*, N.Y.

reached this "tipping point" of underwater valuation by the third quarter of 2009.[48]

According to the Rassmussen Report, 31% of U.S. homeowners with a mortgage owed more on their homes than their homes were worth as of the end of 2010.[49] Deutsche Bank predicted that 48% of American homes could have negative equity by the end of 2011.[50] Along with the numerous defaults on home mortgages caused by the inability to pay, more and more borrowers who are financially able to pay are strategically defaulting on their mortgages.[51] When the lender holds 100% (or more) of the current value of a home, many homeowners feel that there is no financial incentive to continue to pay the mortgage or, for that matter, the community association assessments.[52]

3. Government Rescue Efforts

The negative externalities of homeowner constructive abandonment have been cited to justify policies and programs aimed at helping homeowners facing foreclosure.[53] Many of these programs create additional incentives for lenders to pursue loan modifications or permit

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TIMES, Feb. 3, 2010, at A1.

48. *Id.*; *see also* Thompson, *supra* note 1, at 55 ("Housing prices peaked in the United States in early 2005 and began declining in 2007. Foreclosures then increased in the United States at record levels throughout 2006, continuing throughout 2008."); *Negative Equity Report for Q3*, CALCULATED RISK (Nov. 24, 2009, 4:00 PM), http://www.calculatedriskblog.com/2009/11/negative-equity-report-for-q3.html ("Nearly 10.7 million, or 23 percent, of all residential properties with mortgages were in negative equity as of September, 2009.").

49. Peter Schroeder, *Poll: Nearly One-Third of Homeowners Underwater on Mortgage*, THE HILL (Mar. 21, 2011, 1:29 PM), http://thehill.com/blogs/on-the-money/801-economy/151039-poll-nearly-one-third-of-homeowners-underwater-on-mortgages. Previously, in the first quarter of 2010, Zillow.com had estimated that 23% of homes in the United States were worth less than mortgage loan amounts secured by the property. Brian Louis, *U.S. Mortgage Holders Owing More Than Homes Are Worth Rise to 23% of Total*, BLOOMBERG (May 10, 2010, 3:31 AM), http://www.bloomberg.com/news/2010-05-10/u-s-mortgage-holders-owing-more-than-homes-are-worth-rise-to-23-of-total.html.

50. Zuckerman, *supra* note 4.

51. *See* Gail Marks-Jarvis, *Ethics of Strategic Default are Really Hitting Home*, CHI. TRIB., Oct. 7, 2010, at 7.1 ("Morgan Stanley recently estimated that about 18 percent of defaults will be strategic.").

52. Underwater homeowners have no incentive to pay property taxes either, but counties are always first in line to collect unpaid tax amounts from foreclosure proceeds. There is no cap on the amount of unpaid property taxes that a county can collect from the purchase price at a foreclosure sale.

53. *See* CONGRESSIONAL OVERSIGHT PANEL, EVALUATING PROGRESS ON TARP FORECLOSURE MITIGATION PROGRAMS, APRIL OVERSIGHT REPORT (2010) [hereinafter APRIL OVERSIGHT REPORT] (discussing the Home Affordable Modification Program ("HAMP") and its successes and failures over the first year); *see also* David Streitfeld, *Program to Pay Homeowners to Sell at a Loss*, N.Y. TIMES, Mar. 7, 2010, at A1 (stating that the Obama Administration's latest program "will allow owners to sell for less than they owe and will give them a little cash to speed them on their way").

short sales in lieu of foreclosure.[54] To the extent that loan modifications create true incentives for owners to remain invested in their property by reassuming the gatekeeper role and paying upkeep costs and the like, such modifications would help eliminate the property value losses discussed above and should be promoted as sound policy. To the extent that short sales would streamline the process of replacing insolvent owners with financially capable "gatekeepers," short sale incentives would also benefit the community and deserve to be encouraged.[55] Unfortunately, however, these government efforts have mostly failed to create viable mortgages and ensure homes are held by owners able to meet their assessment obligations. Even with payment reductions and government assistance, more than three-quarters of the mortgage loans that were modified under the Home Affordable Modification Program ("HAMP") remained underwater in April 2010.[56] The initiative for expedited short sales likewise has been mostly unsuccessful.[57]

One obstacle to greater success through loan modifications and/or short sales is the problem of junior liens.[58] Not only do many financially imperiled homes today have subordinate liens from second mortgages and home equity lines, but the community association in any CIC will have a lien securing its rights to recover unpaid assessments.[59] Junior lienors, including community associations, can stymie modification plans by withholding consent to proposed changes to the senior loan.[60] A community association's board might lack the

54. Short sales are tri-party agreements amongst a defaulting mortgage borrower, the mortgage lender, and a third-party purchaser, whereby the purchaser agrees to buy the property for less than the outstanding loan amount, and the lender agrees to accept payment of the buyer's purchase price in full satisfaction of the borrower's mortgage loan.

55. Streitfeld, *supra* note 53, at A1.

56. APRIL OVERSIGHT REPORT, *supra* note 53, at 39.

57. Andrew Jeffrey, *Housing Market: Foreclosure Relief Programs Under Fire*, MINYANVILLE (Mar. 14, 2011, 10:00 AM), http://www.minyanville.com/businessmarkets/articles/foreclosure-forelcosure-relief-program-homeowners-loan/3/14/2011/id/33322.

58. Loan modifications without junior lienor consent can result in a complete loss of priority for the senior lienholder. Short sales are made subject to all junior liens, if these are not paid off or voluntarily released, as part of the sale. *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 871–76 (5th ed. 2007) (discussing the relationship between junior and senior liens); *see also* Robert Kratovil & Raymond J. Werner, *Mortgage Extensions & Modifications*, 8 CREIGHTON L. REV. 595, 610 (1975) (stating that an original clause in the record granting the senior lienor the ability to increase the interest rate on the giving of any extension will not be sufficient for priority for that increased interest over junior lienors, due to prejudice).

59. Many properties in default have other junior lienors as well, including second purchase money mortgages or home equity lines of credit. In many, but not all, states, second mortgages are junior in priority to the association's lien.

60. Loan modifications occurring without the consent of junior lienors are vulnerable to priority loss should a court determine that the modification adversely impacts the secured position of the junior lienor. Many loan modifications, however, have been upheld as non-prejudicial to a

authority to engage in debt forgiveness with respect to delinquent assessments, since this effectively imposes more costs on the remainder of the community and violates the payment allocation provisions of the CIC's governing documents.[61] The argument that in a bad mortgage debt situation, both a borrower and a lender should compromise by giving up value (in terms of lost equity and lost loan proceeds) is compelling.[62] But no similar logic supports a claim that non-party neighbors should be forced to bear losses due to other people's poorly conceived loans. This is one reason the "Helping Families Save their Homes Act of 2009" was voted down in the U.S. Senate: the proposed law would have given bankruptcy judges the ability to mandate massive write-downs on unpaid assessment liens, essentially blocking the already limited ability of associations to collect delinquent assessments and continue to perform their essential functions.[63] If the government truly wants to encourage short sales or modifications in privately governed communities, it must ensure that the workout (a) ultimately stabilizes the community and (b) is not forcibly financed by the non-delinquent neighbors.

Government programs that encourage property to be efficiently conveyed to solvent and responsible owners ameliorate the harm caused

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community association. *See, e.g.*, Dime Sav. Bank of N.Y., F.S.B. v. Levy, 615 N.Y.S.2d 218, 220 (Sup. Ct. 1994) (holding that a modification extending the first mortgage loan term remained a first priority lien, and short sales required cooperation of junior lienors (or full repayment of such obligations) to transfer unencumbered title to the proposed buyer).

61. *See* ROBERT G. NATELSON, LAW OF PROPERTY OWNERS ASSOCIATIONS 437 (1989) (discussing the impact of association conduct on the value individual condominium units); *see also* HYATT & FRENCH, *supra* note 15, at 319, 567–68 (stating that homemakers of a community generally rely on uniform enforcement of covenants that are in furtherance of the original developmental scheme).

62. This argument is often used to promote modifications and short sales. *See* David Benoit, *Bank Of America Begins Mortgage Principal Reduction Program in Arizona*, FOX BUS. (Mar. 2, 2011), http://www.foxbusiness.com/industries/2011/03/02/bank-america-begins-mortgage principal-reduction-program-arizona/ (discussing Arizona's program "using federal money to get Bank of America to lower the amount borrowers owe on their mortgages"); Dave Clarke, *U.S. Regulators Strike Deal on Mortgage Risk Rule*, REUTERS, Mar. 1, 2011, *available at* http://www.reuters.com/article/2011/03/01/financial-regulation-qrm-idUSN0113980220110301 (examining banking regulator's provision forcing services to modify loans if it would save the lenders and borrowers money); Abigail Field, *What the Mortgage Mess Settlement Proposal Really Means*, DAILY FIN. (Mar. 9, 2011, 12:20 AM), http://www.dailyfinance.com/story/credit/what-the-mortgage-mess-settlement-proposal-really-means/19872233/ ("Servicers have to show their math when announcing if a modification is denied."); David McLaughlin & Lorraine Woellert, *Attorney Generals Push for Loan Reductions, Seek Bank Accord*, BLOOMBERG (Mar. 8, 2011, 12:01 AM), http://www.bloomberg.com/news/2011-03-07/foreclosure-settlement-said-to-be-sought-by-states-u-s-within-two-months.html (discussing how state attorneys general are pushing for reduced balance settlements between lenders and borrowers).

63. H.R. 1106, 111th Cong. §§ 202–03, 532 (2009) (defeated in a Senate vote on April 30, 2009).

by owner payment defaults.[64] But most government attempts to mitigate the damage caused by mortgage defaults have failed to adequately address the problems caused by upkeep reduction, and, in fact, some have exacerbated the spillover effects of default. For example, although purporting to help homeowners, foreclosure moratoriums can perpetuate the constructive abandonment maintenance problem.[65] Forced loan modifications—to the extent they merely postpone the inevitable and leave a borrower unable (or unwilling) to pay assessments—do the same.[66] Any government interference that slows foreclosure may (at least in the short-run) help an individual defaulting mortgagor and might, in a temporarily "down" market, even help the mortgage holder ultimately recover more on its loan, but in CICs, these benefits are funded by the neighbors. Keeping an ultimately doomed mortgage loan on this sort of life support increases current and carrying costs borne by neighboring owners, increases CIC assessment levels, and drives down property values.

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64. Unlike HAMP and the initiative promoting short sales, the Neighborhood Stabilization Program of the Department of Housing and Urban Development ("HUD") has focused on infusing money into communities directly, buying abandoned homes, renovating them, and contributing to the community's upkeep and property values. This HUD program is effectively the antithesis of foreclosure moratoriums: it encourages sales of constructively abandoned properties to prevent communities from hearing the negative externalities such properties cause. HUD provided $6 billion in two rounds of Neighborhood Stabilization Program funding, some of which was supplemented by state funds to create successful and effective localized programs. For example, $5.6 million in federal funds combined with $30 million in resources from the Twin Cities Community Land Bank created an entity able to buy up 250 blighted and defaulting properties in targeted neighborhoods. These properties were rehabilitated (updated to green standards) and sold to "responsible homeowners." Shaun Donovan, *Fighting Foreclosures and Strengthening Neighborhoods*, U.S. DEP'T OF HOUS. AND URBAN DEV. BLOG (Sept. 3, 2010), http://portal.Hud.gov/portal/page/portal/HUD/press/blog/ (discussing the effectiveness of The Neighborhood Stabilization Program as an example of a fairer and more forward-looking approach to the contagion effects of mortgage defaults in communities).

65. Moratoriums can perpetuate the tenure of owners who are unwilling or unable to bear the costs of ownership, including paying community assessments, property taxes, and basic property upkeep costs, delaying the conveyance of property owning responsibilities to an owner willing to assume such responsibilities. *See, e.g.*, Jennifer Slosar, *Chicago Coupe Deals with Toxic Mold, Unresponsive Bank*, CHI. J. (Oct. 6, 2010), http://www.chicagojournal.com/News/10-06-2010/Chicago_couple_deals_with_toxic_mold,_unresponsive_bank ("As the foreclosure process stretches past the two-year mark, they are struggling to maintain the empty unit and stanch the bleeding in their homeowners association fund from lost assessments."); *see also* Zhu & Pace, *supra* note 18, at 12–17 (stating that foreclosure delays encourage mortgage default and lack of owner upkeep and investment in the property, all of which drives down the value of homes and drives up costs of financing and "may impede the recovery of the housing market").

66. This is because the longer a non-payment problem persists in a community, the more costs are inequitably borne by paying neighbors. If a modification merely delays an ultimate, inevitable foreclosure, it is unlikely that a neighbor will bring his or her association assessments current in the interim, and the threat of permissive and affirmative waste remains.

Foreclosure rescue efforts have mostly failed to create viable long-term mortgage loans, and the most worrisome contagious effects of homeowner defaults remain, since true losses arise not from foreclosure sales themselves, but from a chronic reduction in neighborhood upkeep and inequitable upkeep costs.[67] This fact reinforces the main contention of this Article: delaying foreclosure and allowing property to deteriorate is a lose-lose scenario, avoidable only by ensuring that properties are owned by people who are able and willing to maintain the property and pay association assessments. This is particularly true in CICs where there are additional, direct and compelling cost externalities with respect to payment defaults, so the contagion effect is more pronounced.[68]

B. Financial Entanglement

1. The CIC Ownership, Assessment, and Services Model

The CIC structure is a privatized governance solution to the collective action and free-rider problems often termed the "tragedy of the commons."[69] Widespread private property ownership in the United States has minimized the number of publicly maintained "commons,"[70] and until recently, federal, state, or local governments maintained most of those areas that could not be divided and privatized.[71] In the past

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67. Harding et al., *supra* note 36, at 165, 172, 178; *see also supra* Part I.A.2 (discussing the notion of constructive abandonment).

68. *See Infra notes* 83–88 and accompanying text (describing why delayed foreclosure is particularly harmful in CICs).

69. Garret Hardin, *The Tragedy of the Commons*, 162 SCI. 1243, 1244–45 (1968); *see also* Thrainn Eggertsson, *Open Access versus Common Property*, in TERRY L. ANDERSON & FRED S. MCCHESNEY, PROPERTY RIGHTS: COOPERATION, CONFLICT AND LAW, 74–82, 84–85 (2003) (discussing the tragedy of subsequent empirical studies as a result of Garret Hardin's *The Tragedy of the Commons*); James E. Krier, *The Tragedy of the Commons, Part II*, 15 HARV. J.L. & PUB. POL'Y 325, 325 (1992) (acknowledging Garret Hardin as having addressed the problem of coordinating human behavior as it affects environmental quality); Mark A. Lemley, *Property, Intellectual Property and Free Riding*, 83 TEX. L. REV. 1031, 1037 (2005) ("The tragedy of the commons is a specific example of the more general preoccupation of the economic literature on real property with the internalization of externalities and with the use of property law to achieve that end.").

70. Throughout U.S. history, the government has aggressively sought to sell land to private owners. This was the impetus behind Thomas Jefferson's Land Ordinance Act, for example. *Land Ordinance of 1785*, *in* DOCUMENTS OF AMERICAN HISTORY 123–24 (Henry S. Commager ed., 1940); *see* Richard P. McCormick, *The "Ordinance" of 1784?*, 50 WM. & MARY Q. 112, 116–17 (1993) (discussing the scheme for selling and disposing of land acquired under the Ordinance as a reason why it was not adopted in its original form).

71. *See, e.g.*, 39 AM. JUR. 2D *Highways, Streets, and Bridges* § 212 (2011) (discussing usage rights for public property adjacent to private property); 59 AM. JUR. 2D *Parks, Squares, and Playgrounds* § 23 (2011) (discussing the proper use of property such as parks and squares); *see also* Lemley, *supra* note 69, at 1038 (discussing government regulation of property rights due to

century, courts began to routinely hold that community covenants creating payment obligations for common area upkeep were servitudes running with the land.[72] This judicial interpretation enabled the rise of private governance and assessment systems across the United States. In privately governed neighborhoods, common space and amenities are maintained by an association, which assesses each owner a share of the upkeep costs.[73] The association provides sufficient governance to solve the tragedy of the commons by controlling overuse and creating a mechanism for maintenance and shared costs,[74] which in turn permits communities to avoid the economic downside of public goods, meaning that a neighborhood can enjoy better amenities at lower prices.[75] The association is essentially a mini-government, performing public functions: upkeep of common areas and amenities, rule-making, and dispute resolution.[76] Association assessments are therefore, to some extent, the equivalent of property taxes, a mechanism to fund common

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negative externalities).

72. Neponsit Prop. Owners Ass'n, Inc. v. Emigrant Indus. Sav. Bank, 15 N.E.2d 793, 797 (N.Y. 1938). Prior to *Neponsit*, covenants to pay money were viewed as personal, not running with the land because they did not adequately "touch and concern" real property. The *Neponsit* characterization of this covenant as creating a real property servitude, however, spurred the growth of suburban communities across the country. Enforcing payment obligations as servitudes on real property is now *de rigueur*. *See, e.g.*, Regency Homes Ass'n v. Egermayer, 498 N.W.2d 783, 788–93 (Neb. 1993) (holding that a covenant to pay dues to a community association to maintain recreational facilities is a real covenant that runs with the land).

73. Most associations' governing documents explicitly provide for assessment funding of association obligations. HYATT, *supra* note 15, at 108 ("Generally, covenants in the declaration provide authority for the association to collect assessments from each owner."). Even in situations where governing documents for community associations have failed to provide for assessments, courts find the power to assess implicit in the structure of a CIC. *See, e.g.*, Fogarty v. Hemlock Farms Cmty. Ass'n, 685 A.2d 241, 244 (Pa. Commw. Ct. 1996) ("[A]bsent language in the deed covenant prohibiting HFCA from levying special assessments for capital improvements, the [property owners] may be assessed their proportionate costs to construct the new improvements."); Meadow Run & Mountain Lane Park Ass'n v. Berkel, 598 A.2d 1024, 1027 (Pa. Super. Ct. 1991) (finding that inherent in the duty to provide maintenance is the power to assess costs to property owners). *But see, e.g.*, Bd. of Dirs. of Carriage Way Prop. Owners Ass'n v. W. Nat'l Bank of Cicero, 487 N.E.2d 974, 978–79 (Ill. App. Ct. 1985) ("[T]he [association] cho[o]s[ing] to continue to maintain the common areas does not render the [property owners] unjustly enriched."); Wendover Road Prop. Owners Ass'n v. Kornicks, 502 N.E.2d 226, 231 (Ohio Ct. App. 1985) (declining to apply quasi-contract or unjust enrichment theories to require a property owner to pay assessments when the deed conveying the property did not provide for such an assessment).

74. *See* HYATT, *supra* note 15, at 29–32 ("The community association allows innovation, provides for responsibility and obligation, and provides the necessary power to meet these responsibilities.").

75. CAI INDUSTRY DATA, *supra* note 7; *see* TREESE ET AL., *supra* note 16, at 6 (noting that common upkeep also allows a community to take advantage of cost savings from economies of scale).

76. *See* TREESE ET AL., *supra* note 16, at 6 (discussing the municipal responsibilities the associations now assume).

costs, and are treated as such by the income tax laws of at least two states.[77]

For condominiums, a private governance and assessment system is not only beneficial, it is essential. Once states passed statutes allowing fee simple ownership of a three-dimensional "box" of space,[78] multiple individuals could become owners of distinct units within one building. But having many owners within one building mandates certain jointly-held property: the roof, lobby, elevators, hallways, laundry rooms and, in some buildings, water, sewer, trash, electricity, and gas, as well as hazard insurance on the building itself. The mechanism of private community governance provides and pays for all such commons equitably and efficiently.[79]

Typically, CIC governing documents explicitly vest the association with broad authority to assess members according to budgetary needs,[80] and courts have found that even when an association's documents lack explicit authorization, assessment power is implied.[81] As long as the assessments are authorized, it is clear that the obligation to pay assessments is both an *in personam* obligation of a homeowner and an *in rem* affirmative covenant that runs with the land and is binding on all successor owners of the property.[82] The obligation to pay assessments is the most vital obligation in a privately governed community because

77. In New Jersey, the correlation of community assessments and property taxes has been acknowledged by the legislature, which now permits a portion of community assessment payments to offset local property tax assessments. N.J. STAT. ANN. §§ 40:67-23.2-23.3 (West 1993); *see also* K. Kennedy & B. Lambert, *New Developments in Municipal Services Equalization*, 3 J. CMTY. ASS'N L. 1 (2000) (illustrating that the New Jersey Municipal Services Act, which requires a municipality to provide certain public services to private communities, provides a framework for the eradication of the double taxation of these communities). Recently, Pennsylvania's legislature followed suit, passing a law that allows a unit owner in a CIC to deduct 75% of association assessments from state income taxes. H.R. 675, 2009 Gen. Assemb. Reg. Sess. (Pa. 2009). On the other hand, many of the community-provided services supplement local governmental functions rather than replace them and instead operate to replace individual upkeep costs. The trend toward municipal services equalization legislation—refunding members of a CIC local government taxes for items paid for by the association—is discussed in TREESE ET AL., *supra* note 16, at 3.

78. Under the common law, real property is owned in a column of space defined with respect to a two-dimensional real property mapping description, indicating a closed figure on the face of the earth.

79. *See* Robert C. Ellickson, *Cities and Homeowner Associations*, 130 U. PA. L. REV. 1519, 1522–23 (1982) (discussing the method of assessments and distribution of costs amongst property owners).

80. Associations meet their budget requirements through a combination of regular assessments, special assessments, and transfer fees.

81. HYATT, *supra* note 15, at 105–09. *See, e.g.*, *supra* note 73 (discussing whether an association has the authority to demand assessments from its members).

82. HYATT, *supra* note 15, at 105–17.

assessments are a community's "lifeblood" and its primary (and sometimes only) funding source.[83] As Wayne Hyatt, author of the seminal treatise on CICs, explains, "when one member of the community chooses not to pay the assessments, everyone in the community pays the price through increased assessments, decreased services, and declining community appearance and quality of living."[84]

Two aspects of association assessments are important for purposes of this discussion: their collectability and their durability. The ability to collect delinquent assessments is of crucial importance in a context—such as today—where increasing mortgage defaults indicate an even steeper increase in assessment delinquency.[85] In addition to the ability to assess charges, associations have the power to place a lien on a member's real property to secure the assessment payment obligation.[86] In some states, such liens arise and are perfected on the date the association's documents are recorded in the land records.[87] In other states, the lien arises and is perfected automatically at the time an assessment comes due.[88] Still, in other states, perfection of an assessment lien requires filing a notice of the lien in the appropriate land records.[89] Whether this lien has payment priority over a first mortgage can determine whether an association will be able to ultimately collect. Assessment liens are generally junior in priority to first mortgage liens on the units,[90] and junior interests are extinguished upon the foreclosure of a senior priority lien.[91]

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83. *Id.* at 105, 121.

84. *Id.* at 121.

85. Association assessment defaults are usually well in advance of loan payment delinquencies. *See* Pinkerton, *supra* note 12, at 142–43 (discussing how dues and debts create a "death spiral").

86. HYATT, *supra* note 15, at 120–21.

87. For example, in Colorado, a perfected association lien exists as of the date of filing the declaration. COLO. REV. STAT. § 38-33.3-316 (2009). Although this perfected lien could be essentially an "empty bucket" securing no indebtedness, it has statutory priority relating back to the date the community was created. First mortgages on units in such states, however, enjoy a special statutory super-priority over the pre-existing association lien.

88. Under the Uniform Common Interest Ownership Act § 3-116 (1994) (amended 2008), recording of the declaration creating a common interest community constitutes record notice and perfection of the lien for all future assessments. *See also infra* note 190 and accompanying text (explaining that the Uniform Common Interest Ownership Act takes the position that assessment liens are considered automatically perfected with the date of perfection relating back to the date the association was formed).

89. *See, e.g.*, F.N. Realty Servs., Inc. v. Or. Shores Recreational Club, Inc., 891 P.2d 671, 674 (Or. Ct. App. 1995) (finding that an association lien arises only upon recordation of notice of lien).

90. *See infra* Part I.C.2 (noting that liens on real property enjoy a priority based on the order in which they were perfected).

91. NELSON & WHITMAN, *supra* note 58, at 872–73 ("[I]f a junior lienor is forced to satisfy

CICs are contractually bound to maintain the property and provide other services mandated by the documents creating the servitude regime.[92] State and local laws may mandate the provision of other services and/or a certain level of association reserves, in addition to document-based requirements.[93] The FHA will only insure loans secured by units in communities with sufficient reserve funding.[94] Although reserve requirements support an association's future financial health, increasing the required reserves means that the association must collect additional funds today. Raising the reserve requirement can exacerbate the problem of increasing assessments for paying members in an environment of widespread payment defaults.[95] The upkeep and reserve funding obligations of the association are not contingent on the condition of the economy or the payment participation of all members, and assessments are the association's sole source of income.[96]

2. Tragedy of the Financial Commons

The legal structure of CICs was an attempt to solve the tragedy of the commons by establishing a government that could manage common resources, preventing overuse and under-maintenance.[97] Such a private consortium democracy with governance obligations and powers theoretically can create a better neighborhood for all. But since the homeowners in CICs jointly bear funding responsibilities for essential

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the senior mortgage in order to protect his or her position, the amount required for such satisfaction will be more than could have been contemplated at the time the junior interest was acquired.").

92. HYATT, *supra* note 14, at 43.

93. States require reserve studies by condominiums and homeowner associations to ensure adequate reserves are collected. *See, e.g.*, VA. CODE ANN. § 55-514.1 (2002) and § 55-79.83.1 (1993) (requiring a condominium's executive organ or a homeowner association's board of directors to conduct a study to determine the necessity and amount of reserves required at least once every five years and review the results of that study at least annually).

94. Reserve requirements are 60% of the annual budget for established condominiums and 100% of the budget for new projects. Letter from Brian D. Montgomery, Assistant Sec'y for Hous., Fed. Hous. Comm'r, to All Appr. Mortgagees and All FHA Roster Appraisers (June 12, 2009) (on file with author).

95. *See, e.g.*, Josh Brown, *Condo Assessments are the Breaking Point for Some*, VA. PILOT (Sept. 20, 2009), http://hamptonroads.com/2009/09/condo-assessments-are-breaking-point-some (explaining that a homeowner faced loss of home through association foreclosure because of an inability to pay an assessment increase to fund the increased reserve requirement mandated by statute).

96. Some associations charge user fees, but most association costs are covered exclusively by assessments paid by unit owners. *See* HYATT & FRENCH, *supra* note 14, at 319 (stating that the most common approach to financing the operations of community associations is the assessment of a share of common expense); HYATT, *supra* note 14, at 121 (noting that assessments are generally the primary funding source).

97. MERRILL & SMITH, *supra* note 43, at 772.

commons upkeep, the fiscal fortunes of the members of a community are intertwined. A change in the economic fortunes of one owner can therefore impact the other owners. Defaults of members on payment obligations cause a direct and devastating impact on the other members of the community who must fund the difference. Sam Chandan, chief economist at the real estate research firm Reis, explained the connection between the upside of joint maintenance and the downside of economic entanglement:

> What motivated people to go into the condo market in a way that led to overbuilding was the expectation that it would be easier than owning a home on a maintenance basis. The downside is that your fate is tied to 50 to 100 other people who may stop making their condo payments.[98]

Although the possibility of member assessment default had long been understood, before 2006, no one anticipated that so many highly leveraged mortgages taking so long to foreclose would eventually put a huge strain on community associations.[99] But today's delinquency rate for assessments has caused many of these associations to fail.[100] Their failure leaves the community without its expected amenities and upkeep and leaves the commons to its natural economic "tragedy" because local municipalities need not provide public services that were previously left to private associations to fund and provide.

Most courts have held that CIC associations cannot declare bankruptcy as long as they retain the power to assess for budgetary shortfalls.[101] Thus, solvent owners must fund their delinquent neighbors' deficiencies. Delinquency levels in some parts of the country have seen astronomical increases since 2005. One management firm in the Boston area reported a 150% increase in delinquent assessments from 2006 to 2007.[102] Vulnerability to increased assessments to fund neighbor shortfalls and the inability of an

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98. Haughney, *supra* note 6, at C1 (quoting Chandan).

99. The closest precedent is New England in the late 1980s and early 1990s when many associations were left with debilitating budgetary shortfalls as many owners defaulted on their mortgages and other payment obligations. It was this regional crisis among CICs that led Massachusetts to adopt a six-month lien priority for CIC association liens. *See infra* note 213 (explaining that the six-month super priority in UCIOA was meant to solve this same issue, but the authors of that model legislation did not foresee that in today's climate of extensive and long-delayed foreclosure, six months would generally be inadequate).

100. *See* Pinkerton, *supra* note 12, at 125 (discussing the "crushing" nature of association debt).

101. *See infra* Part I.B.4 (explaining why it is unfeasible for condominium associations to file for bankruptcy).

102. Sacha Pfeiffer, *Delinquencies at Condos Can Cost Neighbors*, BOS. GLOBE, Oct. 16, 2007, at C1.

association to perform contractually required maintenance in the face of member default causes a significant adverse impact on the value of properties within a CIC.[103]

Where available, statistics regarding the problem of assessment delinquencies underscore the magnitude of the problem. According to a study cited by *The Miami Herald*, more than 60% of Florida condominiums and homeowner associations reported in March 2010 that at least half of their units were at least two months behind in paying their assessments.[104] Losing half of the required revenue completely hamstrings the operation of these associations. For example, Parkview Point Condominium in Miami Beach suffered a large enough loss of assessment revenue that it was unable to pay water bills for the building, and the unit owners nearly had their water cut off before solvent owners were able to raise funds to pay the arrearage.[105] The lobby ceiling repairs, however, were stopped mid-repair, leaving wiring and ducts exposed.[106] On the nation's other coast, Gas Lamp City Square in downtown San Diego awaits pending foreclosure sales on multiple units in the building while the association struggles with a $115,000 budgetary shortfall because of unpaid dues.[107] In Union City, California, a special assessment for roof repairs in Alvarado Village ended up costing each paying owner $18,494.27.[108] A couple in San Francisco reports that over the past three years, their special assessments have exceeded $100,000.[109]

Pervasive assessment default unfairly impacts the paying neighbors financially and psychologically, and anecdotal evidence underscores the reality behind the troubling statistics of unpaid community dues. Ana Martinez, for example, reported that she no longer felt safe living in her own home—a unit within a South Florida condominium that was deteriorating in the face of the association's inability to pay for

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103. *See, e.g.*, Bd. of Dirs v. Wachovia Bank, N.A., 581 S.E.2d 201, 206 (Va. 2003) (Lacy, J., dissenting) ("Part of the value of a condominium unit comes from the ability of the condominium association to maintain the common areas of the development . . . . The ability to maintain these elements is directly related to the association's ability to secure payment of assessments from the individual unit owners.").

104. Rachael Lee Coleman, *Desperate Condos Thrown a Lifeline*, MIAMI HERALD, Mar. 7, 2010, at 1A.

105. Haughney, *supra* note 6, at C8.

106. *Id.*

107. *Id.*

108. James Temple, *Neighborhood Fees Go Through the Roof*, CONTRA COSTA TIMES (May 29, 2006), http://www.calhomelaw.org/doc.asp?id=487. The Alvarado Village association also blamed the large special assessment on the property developer who they claim failed to adequately fund reserves. *Id.*

109. Lloyd, *supra* note 11.

maintenance.[110] Some of Ana's neighbors had literally abandoned their units, leaving behind not only unpaid and underwater mortgage loans, but also months of unpaid condominium assessments.[111] Ana's monthly assessment tripled in response to the condominium's budget shortfall, and her property's value fell and continues to plummet in the face of lower occupancy, higher crime, and substandard common area maintenance.[112]

In a modest, low-income area of Providence, Rhode Island, Debra McGarry was forced to take out a $4800 personal credit card loan to keep water, gas, and electricity from being cut off in the eight-unit condominium building in which she lives.[113] Two of the owners in the building stopped paying dues and abandoned their homes, nearly bankrupting the small condominium.[114] Even doubling the condominium fees that the remaining six paying owners were assessed failed to generate enough capital to keep the building afloat.[115] The "affordable" unit Debra and her husband Bernard, a disabled veteran, bought in 2006 ended up being their financial "nightmare" since Debra and her solvent neighbors were left to personally pick up the tab left by lenders who failed to foreclose on strategically defaulted mortgages.[116]

The problem of assessment delinquencies is not confined to lower income owners. Many owners of ritzy Manhattan condominiums that come with top-flight amenities (gym membership, butler and maid service, billiards room, and library) can no longer afford the cost of such services because of a rash of unit owner assessment defaults.[117] In the past year, foreclosure filings for Manhattan condominiums doubled, and now, one in every thirteen units are in some stage of foreclosure.[118] Foreclosures in New York take longer than in any other state, and at the current pace, it would take lenders sixty-two years to complete foreclosure on the 213,000 homes now in severe default.[119] During the

110. Sutta, *supra* note 6.
111. *Id.*
112. *Id.*
113. Dunn, *supra* note 6, at G1.
114. *Id.*
115. *Id.*
116. *Id.*
117. Ryley, *supra* note 6.
118. *Id.*
119. David Streitfeld, *Backlog of Cases Gives a Reprieve on Foreclosures*, N.Y. TIMES, June 19, 2011, at A1 (citing calculations by LPS Applied Analytics, a real estate data firm). Even before the housing crisis, it took up to two years for property to be sold at a foreclosure sale under New York law. In the first half of 2011, the average time to complete a foreclosure in New York was 966 days, and the average time to foreclose in Florida was 676 days. While the number of foreclosure sales dropped dramatically in the first half of 2011, this does not indicate a market

several years foreclosure is pending in the current market, the non-defaulting owners in these glamorous buildings will see their own assessments increase to close the association's budgetary gap while the building services and amenities simultaneously disappear. In one Manhattan condominium, the nonpayment of just one investor—who held title to a dozen units in the building—caused the remaining members' monthly charges to jump by 15%.[120]

3. Barriers to Market Recovery

The housing market continues to implode in many localities. Sustainable home pricing and the expeditious placement of owners willing and able to meet a property's upkeep obligations are the only way out.[121] But predictable credit costs and upkeep charges are a prerequisite to stable home pricing and residential real estate investment.[122] Volatile CIC assessments stymie economic recovery. Would-be buyers, faced with uncertain future assessment increases due to financial entanglement in a CIC, are unwilling and unable to manage certain risks. Loan modifications for overburdened borrowers do not

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recovery, but is rather further testament to rampant processing delays and lender strategic delays. Les Christie, *Foreclosures Plunge in First Half of 2011*, CNN MONEY (July 14, 2011), http://money.cnn.com/2011/07/14/real_estate/housing_market_foreclosures/index.htm.

120. Ryley, *supra* note 6. The situation is different for cooperative buildings because assessment payments are characterized as rent. Thus, the cooperative can evict a defaulting owner and need not wait for the owner's lender to foreclose. In condominiums, however, the association lien is subordinate to the first mortgage lien, and typically, the association's assessment will not be paid upon foreclosure.

121. *See* BEN BERNANKE, CHAIRMAN, U.S. FED. RESERVE, SEMIANNUAL MONETARY POLICY REPORT TO THE CONGRESS 2 (July 13, 2011), *available at* http://www.federalreserve.gov/newsevents/testimony/bernanke20110713a1.pdf (opining that one key roadblock to economic recovery is "the continuing depressed condition of the housing sector"); Steven Pearlstein, *To Sort this Mess, Both Banks and Borrowers Must Own Their Mistakes*, WASH. POST, Oct. 10, 2010, at A09 (explaining that "the longer the foreclosure process goes on, the longer it will take for the excess supply of houses to be absorbed, for prices to stabilize and for the real estate market to return to something closer to a normal equilibrium"); Alexander Eichler, *Foreclosure Processing Time Has Doubled Since 2007, Backlogging Housing Market*, HUFFINGTON POST (July 1, 2011), http://www.huffingtonpost.com/2011/07/01/home-foreclosure-backlog_n_888655.html (citing *The Atlantic*'s Daniel Indiviglio's opinion that "the more foreclosures pile up, the longer it will take for the housing market to hit bottom and begin recovering").

122. While the costs of real estate investment are usually cited as high transaction costs and illiquidity, predictability of future costs and returns is often cited as one of the benefits of real estate investment. It therefore stands to reason that eroding this benefit will decrease the attractiveness of investment in the real property sector. *See* Christian Rehring, *Real Estate in a Mixed-Asset Portfolio: The Role of the Investment Horizon*, REAL ESTATE ECON., June 30, 2011, at 22 (finding that return predictability is very important to attracting real estate investors); *cf.* JOINT CTR. FOR HOUS. STUDIES HARV. U., THE STATE OF THE NATION'S HOUSING 4–5 (2011) (chronicling the declining confidence and investment in the housing sector of the economy as prices remain uncertain).

work when assessments rise so quickly that borrowers still cannot meet their reduced mortgage debt obligations while also paying association assessments. Lenders resist financing and refinancing in communities where assessment levels and the fiscal health of the association are both uncertain.[123] The possibility (or reality) of steeply rising assessments makes investors hesitant to purchase a unit when rents may not cover additional increases. As one example: the common charge for a 601 square foot studio in one Manhattan CIC is now $1095 per month, and this substantial cost has discouraged investor purchasers and financiers, even when the purchase price for the unit is set at a tremendous discount.[124] When rents will not cover assessments, ownership of a unit generates a monthly financial loss.

Lenders are as wary of the uncertain financial future of CIC properties as are would-be buyers. Mortgage financing or refinancing of a unit in a condominium or a house in a privately governed community has become vastly more difficult as banks seek information not only about the creditworthiness of their borrower, but the credit of the other members of the financially linked community.[125] Lenders have started to scrutinize a community's reserve amounts and assessment delinquency levels in an attempt to quantify the risk of assessments materially increasing.[126] A buyer of a new condominium unit in New York reported that Bank of America denied her application to refinance because the condominium association's reserve account was depleted, and 17% of the owners in her building were delinquent in paying their assessments.[127] Most lenders require that reserves be sufficiently funded and that no more than 15% of homeowners be more than thirty days delinquent on homeowner assessments before they will agree to lend on any property located in the community.[128]

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123. *See* Dina ElBoghdady, *New Condo Loan Rules Put More Scrutiny on Neighbors*, WASH. POST, Apr. 25, 2009, at A01 (noting that financing availability depends on the credit of neighboring owners in a condominium); *Infra* Part II.A.1.b (discussing lending policies and risk assessment).

124. Ryley, *supra* note 6. Ryley also gives the example of a Manhattan studio that rents for $3000 a month costing $5750 a month in mortgage payments, taxes, and common charges.

125. *See, e.g.*, Lorraine Ash, *People Facing Foreclosure Should Seek Help Early*, DAILY RECORD (Mar. 19, 2011, 6:35 PM), http://www.dailyrecord.com/article/CN/20110319/NJNEWS/103190343/People-facing-foreclosure-should-seek-help-early (noting that banks look at the association finances); Matt Tomsic, *Homeowners Associations Stepping Up Legal Pressures with Foreclosures*, STARNEWS (Mar. 5, 2011, 5:01 PM), http://www.starnewsonline.com/article/20110305/ARTICLES/110309754 (noting that lenders look at the financial help of associations).

126. Ryley, *supra* note 6.

127. *Id.*

128. *HOA Delinquinces In Condos*, FREE ADVICE (Apr. 14, 2010), http://forum.freeadvice.com/buying-selling-home-40/hoa-delinquencies-condos-512763.html. *See also Infra* notes 129–32 and accompanying text.

The two giants of the secondary residential mortgage market—the government-sponsored enterprises ("GSEs") Fannie Mae and Freddie Mac—likewise demand certain thresholds of reserves and non-delinquencies for CICs in which their prospective mortgage loan purchases are located.[129] For example, Freddie Mac's Condominium Unit Mortgages Project Analysis requires a budget and certification of a working capital fund, appropriate assessments levied with a minimum of 10% of the budget designated for replacement reserves and deferred maintenance, a working capital fund in an amount consistent with the remaining life of the common elements, and no more than 15% of assessments delinquent more than thirty days.[130] Freddie Mac also mandates that common elements be consistent with the nature of the project and competitive with the local market, and it requires the community to be in good financial and physical condition.[131]

The lack of financing alternatives and the threat of instability that would result if assessment delinquencies reach 15% have chilled investment in condominium properties.[132] Some investors report that they will pay only cents on the dollar because of the possibility that neighboring owners will default in paying their pro rata share of maintenance costs, rendering all units in the CIC unfinanceable.[133] Before he would agree to buy, one investor from Italy reportedly demanded a "written guarantee" from the association that he would not

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129. Fannie Mae (formerly the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation) were chartered by Congress and regulated by federal agencies. Although technically still owned by private shareholders, in September 2008, the Treasury Department placed Fannie Mae and Freddie Mac into conservatorship, reorganizing the enterprises and infusing them with new capital. At the time, this was the largest state rescue in history, to the tune of $100 billion. *See* Herbert M. Allison, Jr., President and CEO, Fannie Mae, Oversight Hearing to Examine Recent Treasury and FHFA Actions Regarding the GSEs (Sept. 25, 2008) (addressing how Freddie Mac pursued its mission to support the mortgage market, provide liquidity, and prevent foreclosures since the conservatorship began); James Lockhardt, Acting Dir., Office of Fed. Hous. Enter. Oversight (OFHEO), Testimony Before the Financial Crisis Inquiry Commission (Apr. 9, 2010), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0409-Lockhart.pdf (explaining the Freddie Mac remediation process). *See generally* Press Release, Fed. Hous. Fin. Agency, Questions and Answers on Conservatorship, http://www.fhfa.gov/webfiles/35/FHFACONSERVQA.pdf (explaining conservatorship and how it will affect the Federal Housing Finance Agency).

130. FREDDIE MAC, FREDDIE MAC CONDOMINIUM UNIT MORTGAGES 1, 3 (Apr. 2011), *available at* http://www.freddiemac.com/learn/pdfs/uw/condo.pdf.

131. *Id.*

132. Some areas of the country—New England and Manhattan in particular—faced a breakdown in the early 1990s. There is anecdotal evidence of New Yorkers during that crisis "handing over their Fifth Avenue apartments for $1 because they could not afford the maintenance fees." Haughney, *supra* note 6, at C1.

133. *Id.*

have to pay larger fees in the future (although such a guarantee is likely not enforceable against the association).[134] The fact that no one—neither banks nor buyers—willingly takes on this uncontrollable risk is more evidence that the current system is broken.[135]

Some associations have responded to their community's budgetary crisis by in-sourcing all possible costs.[136] For example, homeowners may be required to take turns mowing common area lawns, caring for common area maintenance, or even staying up all night to serve as a doorman or security guard. While these efforts may reduce the dollar contributions associations need to function, in-sourced upkeep actually replicates the very same collective action and free-rider problems that community governance was designed to eliminate: some people will contribute more than others, and others will be unjustly enriched by their efforts. In-sourcing just replaces the problem of increased assessments of money with the problem of increased "assessments" made in kind, and it is equally inequitable. Either way, the non-defaulting homeowners pick up the costs of the defaulting owners mortgage lenders' free ride.[137]

As an alternative to increasing assessments, associations may reduce the level of services offered to members of the community by decreasing maintenance, closing amenities, or starting to charge amenity user fees. In 2008, the Community Associations Institute conducted an informal poll and found that nearly 40% of the associations nationwide had delayed capital expenditures, and nearly 35% had raised assessments—in each case because of an increase in delinquent assessments.[138] Three years later, these numbers are likely even higher. The end result of the efforts to cut services and impose

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134. *Id.* Associations cannot guarantee limitations on future assessments unless the documents so permit because any limitation to one unit owner's obligations necessarily burdens other owners with greater costs should the association's revenue requirements increase.

135. Condominiums as a real estate product type have incurred the biggest losses in terms of market value and transactional volume. CLIFFORD TREESE, METRICS FOR THE DEPRESSED (May 2011), *available at* https://spreadsheets.google.com/spreadsheet/pub?hl=en_US&hl=en_US&key=0Apv0sov_B8cSdGpwVTd4TEwybGJFd2J3QUQ2ZnRFbXc&output=html. According to statistics compiled by LM Funding from the Hillsborough Property Appraiser's Office and Zillow.com, average values for condominiums have dropped 34% from the peak in 2005 to 2009. *Id.*

136. *Housing Associations*, DUE NORTH, http://www.due-north.com/Industries/housing-associations.aspx (last visited Mar. 21, 2011); Michelle Rindels, *Nevada Legislators Considering Reform for HOAs*, ASSOCIATED PRESS, Feb. 25, 2011, *available at* http://www.kolotv.com/home/headlines/Nevada_Legislators_Considering_Reform_for_HOAs_116980213.html; Vitali, *supra* note 46.

137. *See* Lemley, *supra* note 69, at 1057 (discussing the consequences of free riding); *infra* Part II.B.1 (discussing how lenders benefit from upkeep pre-foreclosure).

138. Bayles, *supra* note 11.

more costs on owners is the same: significant decline in a community's property values and a community government that ceases to function effectively.[139]

4. Association Bankruptcy

Community associations cannot seek relief from their financial obligations in bankruptcy, even if their obligations outpace their revenues. Condominium associations typically have no assets of their own,[140] and homeowner associations are prohibited by their governing documents from selling their assets or otherwise seeking to raise revenues in ways not foreseen and explicitly authorized in their covenants.[141] These entities perform primarily (or exclusively) governance and maintenance roles. Although it is nearly impossible to file bankruptcy as a pass-through entity, it is also practically impossible for an association to function if a significant amount of the units are in arrears. Once more than 15% of unit owners are delinquent in their assessment payments, FHA insurance and Fannie Mae loan qualification becomes unavailable for purchaser mortgages on units in that community.[142] At that level of delinquency, neither associations nor their member owners can obtain financing.

Bankruptcy law currently offers no good solution.[143] Courts generally disallow bankruptcy filings by community associations

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139. *See* HYATT, *supra* note 14, at 121 (stating that cutting services and charging user fees for amenities may cause disrepair of the common and recreational facilities, resulting in a decline in property values within the community). A similar fate befell Alaskan condominiums when workers abandoned their units and moved away after the completion of the Alaska pipeline. *See* MIN DIXON, WHAT HAPPENED TO FAIRBANKS? THE EFFECTS OF THE TRANS-ALASKA OIL PIPELINE ON THE COMMUNITY OF FAIRBANKS, ALASKA 295–96 (1980) (explaining that a housing shortage resulted from a lack of certainty regarding the housing that an industry was to supply its employees and the disposition of that housing after the construction period had terminated).

140. In condominium ownership, the unit owners hold title to all common areas as tenants-in-common, and the association's role is purely one of governance.

141. HYATT, *supra* note 14, at 109–12.

142. U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-19, CONDOMINIUM APPROVAL PROCESSS—SINGLE FAMILY HOUSING (June 12, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-19ml.doc; U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-46 A, TEMPORARY GUIDANCE FOR CONDOMINIUM POLICY (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46aml.pdf; U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-46 B, CONDOMINIUM APPROVAL PROCESS FOR SINGLE FAMILY HOUSING (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46bml.pdf.

143. Professor Evan McKenzie calls association bankruptcy attempts "disaster[s]" that accomplish nothing. Joseph Dobrian, *Condominium Associations Hard Hit by Foreclosures Consider Bankruptcy*, J. PROP. MGMT., May/June 2010, at 32 (quoting McKenzie). Recently, scholars have called for reformation of the Bankruptcy Code to offer some relief to beleaguered condominium associations. Pinkerton, *supra* note 13, at 142–46 (citing the inescapable "death

because the associations have assessment powers, and courts can force associations to levy assessments on unit owners to pay for association debt.[144] Because an association can theoretically make special assessments to make up any budgetary shortfall, an association's inability to pay its obligations is seen as a revenue problem rather than as a debt or asset problem. Only if all the members of the association are themselves insolvent does the actual ability of an association to meet its debts become imperiled.[145]

There have been very few exceptions to this general rule, and each has presented an atypical case. For example, in the recent bankruptcy case filed in Florida by Maison Grande Condominium, the association entered into a long-term recreation lease with an escalation clause and faced inability to meet this obligation when 25% of its units became delinquent while lease fees rose astronomically.[146] The association filed a petition for Chapter 11 bankruptcy seeking to reject the lease, and the bankruptcy judge in that case permitted the lease rejection.[147] The court noted that the board of directors had concluded that further increases of assessments would be unavailing because unit owners had advised the board that they lacked the ability or willingness to pay.[148]

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spiral" of association unpaid dues and debt).

144. *See* White v. Cox, 95 Cal. Rptr. 259, 263 n.3 (Cal. Ct. App. 1971) (stating that a condomium owner may satisfy his portion of any liability arising from the association by the payment of his proportionate share of the liability); HYATT & FRENCH, *supra* note 14, at 591; NATELSON, *supra* note 61, at 328–31; Donald L. Schreifer, *Judicial Action and Condominium Unit Owner Liability: Public Interest Considerations*, 1986 U. ILL. L. REV. 255, 262–65 (1986) (explaining that at least a share of the debt may be collected from any member who has been named and served in the absence of a statute to the contrary); Jessica Meyers, *HOA Bills Start to Get Spotlight*, DALL. NEWS (Mar. 7, 2011, 10:05 AM), http://trailblazersblog.dallasnews.com/archives/2011/03/hoa-bills-start-to-get-spotlig.html; *cf. In re* Rivera, 256 B.R. 828, 830–36 (Bankr. M.D. Fla. 2000) (denying as moot and unnecessary a homeowner association's "Motion for Reconsideration of Order denying Motion to Compel Debtor to Reaffirm, to Redeem, or to Surrender, and to Withhold Entry of the Discharge Pending Consideration of this Motion or Alternately to Dismiss," because post-petition homeowner association assessments survived a Chapter 7 discharge as a condition of continued ownership of a lot subject to such assessment), *superseded by statute*, 11 U.S.C. § 523(a)(16) (2006).

145. *See* Pinkerton, *supra* note 13, at 147–64 (discussing the insolvency and condominium association debtors).

146. *In re* Maison Grande Condo. Ass'n, 425 B.R. 684, 687–88 (Bankr. S.D. Fla. 2010).

147. *Id.* at 689, 707.

148. *Id.* at 688 ("Some owners advised members of the Board that they lacked the financial resources to pay additional assessments. Others advised the Board that they would refuse to pay additional assessments that were only necessitated by other owners not paying their fair share. The Board also took into consideration the demographics of the unit owners, including the fact that many [were] elderly and on fixed incomes." (citation omitted)). Chapter 11 Bankruptcy offers an association the only hope of bankruptcy relief, but even that avenue is uncertain and perilous. *See* Pinkerton, *supra* note 12, at 155–65 (asserting that Chapter 7 is "not a good option for condominium associations" and that while Chapter 11 "might work," the association faces many problems with that route as well); *see also* Kristen L. Davidson, *Bankruptcy Protection for*

This case, however, is an anomaly and upon closer reading, seems to be predicated on a finding that the subject lease's escalation clause was unenforceable in Florida as against public policy.[149]

More typical is the approach of another Florida bankruptcy case, in which the court adamantly rejected the association's proposed Chapter 7 bankruptcy.[150] In this case, the association sought to dissolve and reform to avoid payment obligations to a roofing vender that it could not meet without significant increases to assessments.[151] The court rejected this plan, calling the association's attempt to avail itself of bankruptcy protection bad faith.[152] Carla Barrow, counsel to the roofing company, noted that at least eight other condominiums had also filed for some sort of bankruptcy protection in South Florida, attempting to avoid paying for roof repairs,[153] but such attempts are unlikely to be successful. In 2010, Florida passed the Distressed Condominium Relief Act, which, among other things, specifically empowers associations to take stronger measures to recover revenues from non-paying owners and permits "bulk assignees" and "bulk buyers" to take over unsold developer condominium inventory, assuming assessment obligations but not other liabilities of the original developer.[154]

Without bankruptcy as a potential escape from financial obligations in excess of collected funds, associations with assessment delinquencies are left with only one alternative: increase assessment amounts and hope the paying members will make up the shortfall. Charging paying members more to make up for neighbor defaults is not only unfair,[155] but it is unlikely to actually save the community from de facto insolvency. As the court in *Maison Grande* noted, increased assessments will likely increase delinquencies.[156] Increased delinquencies lead to increased assessments that can further increase delinquencies, requiring still greater increases of assessments (*ad infinitum*). Barring some ability to actually recover from non-paying

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Community Associations as Debtors, 20 EMORY BANKR. DEV. J. 583, 616–25 (2004) (discussing the difficulty that courts have in applying bankruptcy laws to community associations).

149. *In re Maison Grande*, 425 B.R. at 702.

150. *In re* Boca Village Ass'n, 422 B.R. 318, 327 (Bankr. S.D. Fla. 2009).

151. *Id.* at 325.

152. *Id.* at 321–25.

153. Dobrian, *supra* note 143, at 33.

154. S.B. 1196, 2010 Sess. (Fla. 2010) (adding new Sections 718.701–708 to the Florida Statutes through the "Distressed Condominium Relief Act").

155. *See* Hart, *supra* note 5, at 185 ("[W]hen a number of persons conduct any joint enterprise according to rules and thus restrict their liberty, those who have submitted to these restrictions when required have a right to a similar submission from those who have benefited by their submission.").

156. *In re* Maison Grande Condo. Ass'n, 425 B.R. 684, 688 (Bankr. S.D. Fla. 2010).

owners or properties, the only remaining solution is to have a public (state, local, federal) government step in and bail out communities that are unable to collect sufficient revenues from their members.[157] Private government failure mirrors local government failure (when tax revenues are insufficient to maintain the community), but unlike community associations, municipalities can, in fact, declare bankruptcy.[158]

C. Payment Collection and Lien Priority

1. Association Collection Efforts

Because of the difficulty of enforcing payment obligations in privately governed communities, conventional wisdom holds that an association board should act quickly in response to nonpayment of assessments. An association with delinquent members has the ability to enforce its payment obligation in several ways. Associations may be able to use self-help by denying a delinquent owner the right to use common elements or by suspending the owner's voting rights.[159] For example, a nonpaying unit owner may be barred from using a community amenity such as a swimming pool or health club. The

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157. *See* Dobrian, *supra* note 143, at 34 ("The main burden of dealing with troubled condo associations will fall on local governments, which are seldom experienced in such matters.") (quoting Professor Evan McKenzie).

158. 11 U.S.C. § 109(c)(1) (2006). Chapter 9 of the Bankruptcy Code provides for reorganization of municipalities, which includes cities, towns, villages, counties, taxing districts, municipal utilities, and school districts. *E.g.*, *Municipality Bankruptcy*, U.S. COURTS, http://www.uscourts.gov/federalcourts/bankruptcy/bankruptcybasics/chapter9.aspx (last visited Aug. 16, 2011). It does not, however, cover common interest communities. Municipal bankruptcy legislation has a history of constitutional fragility. *See, e.g.*, Ashton v. Cameron Cnty. Water Improvement Dist. No. 1, 298 U.S. 513, 530–32 (1936) (striking down as incompatible with the Tenth Amendment the initial attempt by Congress to craft bankruptcy protection for local governments). According to the federal government, in the more than sixty years since Congress established a constitutionally viable municipal bankruptcy procedure, there have been less than 500 governmental bankruptcy petitions filed. *Municipality Bankruptcy*, *supra*. Those filings that do occur, however, are typically extreme cases in large municipalities (e.g., Orange County, CA) and can involve many millions of dollars in municipal debt. MARK BALDASSARE, WHEN GOVERNMENT FAILS: THE ORANGE COUNTY BANKRUPTCY 7 (1998).

159. HYATT, *supra* note 14, at 121–22; *see also* How v. Mars, 513 N.W.2d 511, 516 (Neb. 1994) (holding that both the association bylaws and Nebraska's nonprofit corporations code permitted the association to deny delinquent owners the right to vote in the community). *But see* Mountain Home Props. v. Pine Mountain Lake Ass'n, 185 Cal. Rptr. 623, 630 (Cal. Ct. App. 1982) (holding that California law bars a community association from denying membership privileges to a new member because of the unpaid association debts of the new member's predecessors in interest). In most cases, private governments are able to suspend voting rights of members due to non-payment of assessments even though public governments may not suspend the right to vote based on non-payment of taxes. For example, a Florida law passed in July 2010 clarifies the availability of this type of self-help in that state. S.B. 1196, 2010 Sess. (Fla. 2010). For further discussion of how assessments in communities are similar to and yet distinct from taxes, see *infra* Part II.A.3.

extent to which services may be denied, however, depends on state law. For example, a Texas court permitted an association to turn off the utilities of a delinquent owner,[160] but few states permit the discontinuance of essential services, such as heat, water or electricity.[161]

If such efforts fail, an association can commence an action to collect a debt against the non-paying owner. Federal case law is split on the issue of whether association assessments are debts for the purposes of the 1966 Fair Debt Collection Practices Act, 15 U.S.C. § 1692 (2006), which would require certain explicit warnings and notices to be served prior to collection efforts.[162] To the extent an association complies with any such applicable laws, it can thereafter bring lawsuits against delinquent owners personally, claiming breach of contract and seeking damages equal to the unpaid assessment amounts.[163] Collection based on a judgment against the owner can proceed like any other debt collection (garnishing wages, seizing assets, enforcing a judgment lien, etc.).[164] Bringing a lawsuit, however, can be costly to the association in terms of time and attorney fees, and the paying owners—those who are already bearing the costs of their neighbors' delinquencies—will have to foot that bill unless the delinquent owner or responsible party can

160. San Antonio Villa Del Sol Homeowners Ass'n v. Miller, 761 S.W.2d 460, 465 (Tex. App. 1988) ("Clearly, a condominium dweller who does not pay his share of the maintenance fee, admits that the other owners are in essence paying his way, and fails to respond to notice of disconnection is in violation of the meaning and intent of the [by-laws]. The Association took appropriate action to abate this condition.").

161. *See, e.g.*, N.Y. GEN. BUS. LAW § 352-eee(4) (McKinney 2011) (prohibiting a property owner who wishes to convert a building to cooperative or condominium ownership from the "interruption or discontinuance of essential services, which substantially interferes with or disturbs the comfort, repose, peace or quiet of any tenant in his use or occupancy of his dwelling unit or the facilities related thereto."). Among property managers, the belief is that the most efficient way to collect unpaid assessments is to turn off community-provided cable or satellite television services where law permits. *See* Polyana da Costa, *Associations Get Creative In Punishing Delinquencies*, MIAMI DAILY BUS. REV., Nov. 23, 2010, at A1 (discussing legal and prohibited methods of encouraging assessment compliance); *see also* Mark Leen, *Condo Utilities May Be At Mercy of Assessments*, KING CNTY. BAR ASS'N BAR BULLETIN, 2009, *available at* http://www.kcba.org/newseveats/barbulletin/archive/2009/09-07/article18.aspx (discussing why cutting services off to a unit is "particularly effective").

162. *Compare, e.g.*, Bryan v. Clayton, 698 So. 2d 1236, 1237 (Fla. Dist. Ct. App. 1997) (assessments are not covered by the Act) *with* Newman v. Boehm, Pearlstein & Bright, Ltd., 119 F.3d 477, 479 (7th Cir. 1997) (finding that a past due assessment is a "debt" under the Act).

163. *See* HYATT, *supra* note 14, at 119 (discussing a typical collection process for an association against a delinquent owner, including filing a lawsuit against the delinquent owner personally, in addition to filing a lien on the delinquent owner's unit).

164. *See Infra* Part I.C.1 (discussing association collection efforts). The priority of any such judgment lien, however, will be subordinate to any mortgages or other obligations currently secured by the property, and thus, perfecting the association's assessment lien likely offers a better chance for ultimate recovery.

obtain the costs of collection.[165] Nevertheless, these sorts of collection actions are how the bulk of unpaid assessments are eventually collected.[166]

The lien on the defaulting owner's property that association covenants create for delinquent assessments is another tool for delinquency recovery.[167] The lien guarantees that the association will be paid out the proceeds of any resale, after all senior interests are satisfied. Furthermore, a lien for unpaid assessments clouds the owner's title and can be used as leverage to convince an owner who is seeking clear title (for sale or financing) to pay up. A last resort for associations is to foreclose on the property lien securing the assessment obligation.[168]

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165. *See* HYATT, *supra* note 14, at 121 (discussing the substantial amount of time it takes to foreclose on a lien and collect a judgment, the low price a sheriff's sale may generate, and that the availability of wage garnishment is dependent on the delinquent owner having an income).

166. *See, e.g.*, KATZMAN GARFINKEL & BERGER, COMMUNITY ASSOCIATION ASSESSMENT COLLECTION AND FORECLOSURE 14–15 (2011), *available at* http://www.canfl.com/pdfs/KGBcollFAQs_sm.pdf (explaining the benefits of collection actions).

167. *See* Pinkerton, *supra* note 13, at 143 ("Functionally, condominium associations only possess one remedy to recover their expenses from delinquent unit owners. They can obtain a lien on the unit for the amount owed to the association by that unit owner. The association can then foreclose on its lien if the debt remains unpaid. However, this remedy is not very useful in the face of many states' laws concerning the relative priority of mortgages."). The association lien has always been used as a practical means to induce voluntary compliance with assessment obligations rather than as a means to collect from the asset's value directly via foreclosure (although the viable threat of foreclosure can motivate payment). The problem arises in situations where a homeowner is already facing foreclosure (under the mortgage) and the owner's equity is gone. The association in such cases loses its power to motivate compliance. At this point, the only other interest holder of the property who still has a stake in its value is the first mortgagee, which is why eroding that priority position may incentivize a lender to pay, or cause a borrower to pay, assessments. A lender would be motivated to pay to preserve its own collateral value if its claim on the property would diminish should assessments remain delinquent.

168. *See, e.g.*, UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (amended 2008) (outlining enforcement of lien for sums due the association, including foreclosure); Societe Generale v. Charles & Co. Acquisition, Inc., 597 N.Y.S.2d 1004, 1009 (N.Y. Sup. Ct. 1993) ("[A] condominium's lien for unpaid common charges may be foreclosed in the same manner as a mortgage on real property . . . ."). Some state laws limit recovery for debt repayment from foreclosure of a homestead. Homestead exemptions protect a certain amount of equity from sale to satisfy a debt. In Missouri, for example, the first $15,000 of debt is exempted as the owner's homestead. MO. REV. STAT. § 513.475 (2002). Florida, Texas, Oklahoma and Colorado have virtually unlimited homestead exemptions. *See, e.g.*, TEX. PROP. CODE ANN. § 41.001 (West 2010) (providing that a homestead is "exempt from seizure for the claims of creditors except for encumbrances properly fixed on homestead property," which include: (1) purchase money; (2) taxes on the property; (3) work and material used in constructing improvements on the property; (4) an owelty of partition; (5) the refinance of a lien against the homestead; (6) an extension of credit subject to certain conditions including security by a voluntary lien; and (7) a reverse mortgage which meets certain requirements); *Id.* § 52.001 (attaching judgment liens to real property except that property exempt from seizure or forced sale under Chapter 41, the Texas Constitution, or any other law). Mortgage lenders typically require an explicit waiver of this statutory protection of borrower equity.

How useful association foreclosure is as an enforcement tool depends greatly on the perfection and priority regime of the applicable state.[169] A first mortgage loan on a particular unit in a CIC enjoys senior priority to the association's assessment lien in all states, although the first mortgage priority is subject to a capped payment priority association lien in several states.[170] In those states lacking a six-month super-priority for assessment liens, the association will only be able to recover from the sale if foreclosure proceeds exceed the senior loan amount.[171]

Depending on the jurisdiction, lien foreclosures are effected either by a sale in a court action in equity or by private power of sale granted in the security instrument.[172] Judicial foreclosure is the exclusive method of foreclosure in over one-third of the states,[173] and it is available in

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Similarly, association declarations may purport to waive application of the homestead exemption for foreclosure of the association lien. Many states have passed statutes explicitly carving out CIC associations from the applicability of such limitations. The Colorado statute expressly authorizes an association to ignore the homestead exemption otherwise applicable in that state. BA Mortg., LLC v. Quail Creek Condo. Ass'n, 192 P.3d 447, 451 (Colo. App. 2008). Texas, a state with a very broad homestead exemption, allows association foreclosure to circumvent this limitation. Inwood N. Homeowners' Ass'n v. Harris, 736 S.W.2d 632, 637 (Tex. 1987). In other states, the applicability of the homestead exemption to association lien foreclosure proceedings is less clear. *See, e.g.*, Andres v. Indian Creek Phase III-B Homeowner's Ass'n, 901 So.2d 182, 182–83 (Fla. Dist. Ct. App. 2005) (expressing, in dicta, doubt that covenants purporting to waive the state's homestead exception would be effective); Knolls Condo. Ass'n v. Harms, 781 N.E.2d 261, 267–69 (Ill. 2002) (holding that the homestead exemption did not preclude the association suing for possession of a defaulting unit but not reaching the question of whether it would preclude foreclosure of the association's lien).

169. *See* HYATT, *supra* note 14, at 120–21 (discussing the practical value of an association's lien rights as dependent upon the state law authority for the lien, procedures for perfection and enforcement, and lien priority). In some states, perfection of the lien is automatic. In other states, a filing is required to perfect the lien. State law may require re-filing to maintain perfection. For example, in New Hampshire, a notice of an association's lien must be re-filed every six months to retain perfection. N.H. REV. STAT. ANN. § 356-B:46, III (LexisNexis 2010). States specifically prescribe the method of foreclosure and the process required in order to legally foreclose on real property. In addition, certain states have attempted to limit the power of associations to foreclose based on unpaid assessment liens. For example, in 2004, a bill in California that would have set a threshold of $2500 of unpaid assessments before an association could pursue foreclosure was vetoed by Governor Arnold Schwarzenegger. *See* Jim Wasserman, *Schwarzenegger Rejects Ban on Foreclosures*, ASSOCIATED PRESS, Oct. 1, 2004, *available at* http://www.calhomelaw.org/doc.asp?id=462 (discussing Governor Schwarzenegger's veto of a bill that would have required associations to use small claims courts, instead of nonjudicial foreclosure, to collect unpaid debts under $2500).

170. *See infra* Part I.C.2 (discussing assessment lien priority).

171. *See, e.g.*, Bd. of Dirs. of Olde Salem Homeowners Ass'n v. Sec'y of Veterans Affairs, 589 N.E.2d 761, 764 (Ill. App. Ct. 1992) (finding that a buyer at a mortgage foreclosure took the property free of assessments accruing prior to recording of the deed, which were extinguished by the foreclosure action); Long Island Sav. Bank, F.S.B. v. Gomez, 568 N.Y.S.2d 536, 537 (N.Y. Sup. Ct. 1991) (finding that an association's junior lien was extinguished by foreclosure of the senior priority mortgage).

172. NELSON & WHITMAN, *supra* note 58, at 600–01, 633.

173. *Id.* at 601 n.1. Judicial foreclosure is the exclusive or generally used method in

every jurisdiction.[174] Judicial foreclosures are complicated, costly, and time-consuming compared with non-judicial foreclosures pursuant to a power of sale.[175] Some states that permit a mortgage containing an explicit power of sale to be non-judicially foreclosed will likewise permit non-judicial foreclosure of association liens. Such states have a separate foreclosure statutory provision dealing solely with association liens.[176]

Most associations, as well as owners and legislatures, view the foreclosure of an assessment lien as "a last resort" for two reasons.[177] First, foreclosure proceedings—even in states permitting non-judicial foreclosure of association liens—involve significant upfront costs such as advertising, auction, and legal fees. These costs would have to be borne by the neighborhood as a whole, unless they can be recovered from the delinquent owner. Second, a buyer who purchases at an association foreclosure would take the property subject to a first priority mortgage lien unless that loan amount is paid off.[178] This vastly

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Arkansas, Delaware, Florida, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Montana, Nebraska, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, South Carolina, and Wisconsin. In two other states, Connecticut and Vermont, foreclosure is judicial but is not a public sale; rather, it is a transfer of ownership to the lienor (called strict foreclosure).

174. In some states, an explicit statutory right to foreclose through the court exists. In others, judicial foreclosure is available as an incident to the jurisdiction of courts of equity. *See* Lansing v. Goelet, 9 Cow. 346, 366, 403 (N.Y. 1827) (holding that the decree for the sale of mortgaged premises was within the inherent powers of a court of equity, in addition to a statutory right to foreclose through the court).

175. STEVEN W. BENDER ET AL., MODERN REAL ESTATE FINANCE AND LAND TRANSFER 419–21 (4th ed. 2008); NELSON & WHITMAN, *supra* note 58, at 601–02.

176. *E.g.*, Property Owners' Association Act, VA. CODE. ANN. tit. 55 § 516 (2007) (titled "Lien for Assessments"); Maryland Condominium Act, MD. CODE ANN., REAL PROP. § 11-110 (West 2003), *amended by* Act of May 10, 2011, ch. 387, H.B. 1246 (effective Oct. 1, 2011).

177. Benny L. Kass, *Condo Board Can Foreclose for Delinquent Fees*, WASH. POST, Feb. 14, 2009, at F4; *see also* Baker v. Monga, 590 N.E.2d 1162, 1164–65 (Mass. App. Ct. 1992) (holding that a unit valued at $350,000 could be foreclosed for the owner's nonpayment of assessments totaling less than $3000). A recent unsuccessful bill in California attempted to place a significant cost threshold on when an association could pursue foreclosure to enforce its lien for unpaid assessments. S.B. 1682, 2003–2004 Reg. Sess. (Cal. 2004).

178. Junior priority liens are wiped out by foreclosure and, after paying amounts owed to the association, are distributed to such lienors in order of priority, but buyers at the foreclosure of a junior lien take subject to senior liens. Most courts have held, and scholars have opined, that this "subject to" means that a junior lien foreclosure transfers the property with the senior liens intact but unpaid. NELSON & WHITMAN, *supra* note 58, at 611–14; *see also, e.g.*, Shaikh v. Burwell, 412 S.E.2d 924, 926 (N.C. Ct. App. 1992) ("If the trustee is only foreclosing on the junior deed of trust, the senior lien continues with the property and the trustee must sell subject to the senior lien."). In a puzzling recent Virginia decision, however, foreclosure of an association's junior lien was misinterpreted to mandate payment of the first mortgage, rather than as a sale of property subject to a first mortgage lien. Bd. of Dirs. of the Colchester Towne Condo. Council of Co-Owners v. Wachovia Bank, N.A., 581 S.E.2d 201, 206 (Va. 2003). The Supreme Court of Virginia, over a vigorous dissent, interpreted the statutory authority to foreclose the unit "subject to prior liens" to mean that proceeds of the association's foreclosure sale must be used first to

decreases the ability of the association to find a third-party buyer at such a sale. In fact, in today's environment of underwater properties, finding an interested third-party buyer at a junior lien foreclosure would be unlikely at best.

In the absence of a third-party buyer, the association in an assessment foreclosure would be forced to take title to the unit itself. While this strategy might allow an association to rent out a unit and pay rental proceeds toward association costs, this approach is risky.[179] Once an association takes title to a unit, it becomes responsible for the assessments on that unit, which means that the unit's assessment obligations will continue to be spread among the paying owners in the community—precisely the unsatisfactory result that collection efforts against the prior owner were trying to avoid in the first place. As the owner, the association also becomes liable for property taxes, meaning that yet another cost is passed on to the community. Although the association could theoretically mitigate these costs by renting out the unit, this would entail the association becoming a landlord, exposing the community to the various risks and liabilities of assuming that role.[180] Even if an association is willing to serve as a landlord, rental properties

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satisfy the lien of the first deed of trust before any delinquent assessments are reimbursed. *Id.* at 203–04. The doctrinal basis of this holding seems misconstrued. The majority cites principles of interpretation—that a statute should be read to be internally consistent—to support its conclusion. *Id.* at 203. But the asserted inconsistency seems to arise from the court's complete misunderstanding of secured transactions law. The court states that by granting first mortgage liens super priority in Virginia Code section 55-79.84(A), the Virginia Legislature implicitly required the judicial reformation of the statutory repayment waterfall in an association foreclosure, as contained in Virginia Code section 55-79.84(I)(5)(c). *Id.* at 203–04. As the dissent noted, this interpretation "is inconsistent with that phrase's well-understood and long accepted meaning." *Id.* at 205 (Lacy, J., dissenting). Justice Lacy also notes that there is nothing ambiguous or inconsistent in the statute that requires judicial re-writing of the language to reach the majority's result, chiding that "we generally do not engage in adding words to a statute." *Id.* While this decision runs contrary to nearly every other interpretation of the term "subject to," the Virginia General Assembly has thus far been unable to pass legislation correcting this judicial precedent. *See* S.B. 411, 2010 Sess. (Va. 2010) (stricken Jan. 27, 2010) (attempting to clarify the statute by adding language that states that the term "subject to" means that liens to which an association's lien is subordinate "shall survive the sale and be binding upon the purchaser at such sale").

179. *See, e.g.*, Daniel Vasquez, *Should Condo Associations Rent Units in Foreclosure?*, SUN SENTINEL (Mar. 18, 2009), http://articles.sun-sentinel.com/2009-03-18/news/0903170451_1_rent-units-condo-associations-foreclosure-action (explaining the various costs and liabilities that an association incurs when it becomes a landlord of units it acquires in assessment foreclosure proceedings).

180. *See, e.g.*, Matt Humphrey, *HOA Foreclosing to Rent Units? First Know the Risks*, HOALEADER.COM (Mar. 25, 2011), http://www.hoaleader.com/public/554.cfm (warning that an association becoming a landlord of a unit acquired in foreclosure is "very dangerous" because it "opens the association up to economic liability"). *But see* Gehrke-White, *supra* note 13 (explaining that in the context of long bank foreclosure delays, condominium association foreclosure and renting of units is the only way to obtain assessment funds from defaulting units).

that are subject to pending mortgage foreclosure—and therefore potentially terminable with little advance notice—would likely fetch rentals that are far below market. The depressed rental revenue may not be enough to pay property taxes and assessment charges on the unit.[181]

Generally, senior lienholders cannot be joined in a foreclosure action involuntarily.[182] Some dated case law supports the contention that a junior lienor may join a senior lienor in a combined foreclosure proceeding when the senior loan is also in default and is due and payable.[183] In the unlikely event that this doctrine would gain new traction, it could permit foreclosing associations to join a lender and potentially safeguard its lien in a sufficient sale or, at least, speed the process of senior lien foreclosure, giving associations the legal ability to self-protect in an environment of lender foreclosure delays. Most courts today, however, agree that a lienor has the right to choose the timing of foreclosure of its lien.[184]

2. Priority Baseline

As a general rule, liens on real property enjoy a priority based on the order in which they were perfected.[185] This first-in-time basic presumption is usually subject to a handful of exceptions under state law, including municipal real property taxes, which always enjoy the highest lien priority.[186] In addition, most states set the priority of a mechanic's lien supporting payment obligations for work done to the

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181. *See* Bruce Rogers, *Collecting Delinquent Assessments: Why the Old Ways Won't Work and How to Play the Association's Cards in the Great Recession*, LM FUNDING LLC, 1, http://www.lmfunding.com/assets/Collecting-Delinquent-Assessments-in-Todays-Market.pdf (last visited Oct. 30, 2011) (explaining that current economic reality is why only 4% of associations with delinquent assessments foreclose on their liens).

182. NELSON & WHITMAN, *supra* note 58, at 611; *see also, e.g.*, Osage Oil & Ref. Co. v. Mulber Oil Co., 43 F.2d 306, 308 (10th Cir. 1930) (holding that the junior lienor cannot enforce a sale for more than its own equity of redemption without consent of the senior lienor).

183. *See, e.g.*, Hefner v. Nw. Mut. Life Ins. Co., 123 U.S. 747, 754 (1887) (holding that when a first mortgagee's debt is due and payable, the first mortgagee may be made a party); Hagan v. Walker, 55 U.S. 29, 37 (1852) (holding that a senior lienor may be a "necessary party" to a foreclosure, when the senior lienor is also in default, so that "a sale may be made of the whole title"); Masters v. Templeton, 92 Ind. 447, 451–52 (1883) (allowing a junior mortgagee to join a senior mortgagee so that the "ultimate rights of the parties" may be determined in one action); Peabody v. Roberts, 47 Barb. 91, 102 (N.Y. 1866) (allowing a junior mortgagee to proceed with a foreclosure action despite a prior foreclosure and sale under the senior mortgage). Even as late as 1992, the court in *Shaikh v. Burwell* cited six possible "special circumstances" that would enable a junior lienor to join a senior lienor in a foreclosure action. *Shaikh*, 412 S.E.2d at 927–28.

184. NELSON & WHITMAN, *supra* note 58, at 612. This creative approach is similar to the "mortgage terminator" approach that has recently been used on occasion in Florida. *See Infra* Part II.A.2 (discussing creative strategies used by attorneys in seeking recovery for their clients).

185. BENDER ET AL., *supra* note 175, at 123.

186. *Id.* at 271–73.

real property itself as relating back to the date on which such work was commenced.[187] In the absence of a statutory directive to the contrary, assessment liens follow the general first-in-time priority rule, and because mortgage loans are typically funded prior to assessment delinquencies, such first mortgage liens are senior to assessment liens.[188] The California Condominium Act, for example, explicitly follows the first-in-time rule, setting lien priority according to the time a separate "notice of delinquent assessment" is filed in the land records.[189]

In some states, assessment liens are considered automatically perfected with the date of perfection relating back to the date on which the association was formed (when the declaration was filed in the land records).[190] However, statutes defining priority in such states specifically make an exception for first mortgage liens on individual units within the community, permitting the first mortgage to always enjoy a priority senior to the association lien, even though the first-in-time rule would otherwise deem the related-back perfected association lien to be first.[191] For example, the Virginia Condominium Act provides that the assessment lien is subordinate to "sums unpaid on any first mortgages or first deeds of trust recorded prior to the perfection of said lien for assessments and securing institutional lenders."[192]

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187. *See, e.g.*, CAL. CIV. CODE §§ 3134, 3137 (West 1993) (providing that liens for site improvements have priority based on the commencement of site improvements); 770 ILL. COMP. STAT. ANN. 60/16 (West 1989) (providing that no encumbrances placed upon land shall operate before a lien in favor of work done or materials furnished has been satisfied).

188. An increasing number of states have statutorily created a limited priority for such liens. *See infra* Part II.A (discussing some attempted and proposed solutions to the problem of assessment nonpayment and foreclosure delay). Some states define the time of perfection for association liens as relating back to the date on which the assessment was due. *See infra* note 190 and accompanying text.

189. CAL. CIV. CODE § 1367.1(b), (d) (West 2011).

190. The UCIOA takes this approach. *See* UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (1994), *available at* http://www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/ucioa94.htm (stating that recording of the declaration constitutes record notice and perfection of the lien); *see also* FLA. STAT. ANN. § 718.116(15)(a) (West 2011) (providing that the lien is effective dating back to the recording of the original declaration); TEX. PROP. CODE ANN. § 82.113 (West 1997) (providing that the association's lien for assessments is created by recordation of the declaration, which constitutes perfection); *see also, e.g.*, American Holidays, Inc. v. Foxtail Owners Ass'n, 821 P.2d 577, 580 (Wyo. 1991) (deeming the date the declaration was recorded as the date of perfection for assessment lien).

191. *See, e.g.*, COLO. REV. STAT. ANN. § 38-33.3-316 (LexisNexis 2010) (providing that any security interest created before the assessment becomes delinquent has priority over the assessment lien). This way of conceptualizing the priority of association liens likely originated with the FHA Model Condominium Act of 1961. In some cases, the priority granted to first mortgage liens is subject to a capped super-priority. *See infra* Part II.A (discussing capped "super priority" liens).

192. VA. CODE ANN. § 55-79.84A (LexisNexis 2007).

Arizona's Condominium Act protects first mortgage priority even further, providing that such liens are always superior to assessment liens regardless of when they arose.[193] Maryland and North Carolina also deem an association lien completely subordinate to first mortgage liens on units within the community.[194] In states where the statute is arguably vague as to the priority position of the first mortgage, courts have clarified that even an assertion of super-priority in the declaration establishing the community will not create a priority superior to a first mortgage lien.[195] Thus, regardless of jurisdiction, first mortgages on units within a community are senior in priority to association liens for unpaid assessments. Legislatures and courts cite a policy of promoting financing availability as the motivation for this priority scheme.[196]

Holders of junior claims on the property (both liens and holders of equity) must be joined in a foreclosure proceeding to terminate their rights.[197] Because the association is a junior lienor, a foreclosing first mortgage loan is required to name the association as a necessary party to the foreclosure proceeding, and any excess sale proceeds beyond the amount owed on the first mortgage will be applied to the association's claim. However, where mortgages are under-collateralized, foreclosure sales typically do not obtain sufficient proceeds to pay off the first mortgage, let alone junior liens. Whether paid off or not, junior liens are wiped out in foreclosure of the senior lien.

Courts and legislatures in some states have attempted to limit the extent of association losses and protect community members against non-payment of assessments, even those lacking any priority protection with respect to first mortgages.[198] In New York, for example, the

193. ARIZ. REV. STAT. ANN. § 33-1256B (West 2007) (effective through Jan. 1, 2012).

194. MD. CODE ANN., REAL PROP. § 11-110 (LexisNexis 2010); N.C. GEN STAT. ANN. § 47C-3-116 (LexisNexis 2009). Maryland recently enacted a three-month capped priority for unpaid assessments. *See infra* notes 290–92 and accompanying text.

195. *See* Holly Lake Ass'n v. Fed. Nat. Mortg. Ass'n, 660 So. 2d 266, 269 (Fla. 1995) (holding that an assessment lien relating back to the date of declaration would expose lenders to unknown risks and therefore cannot have priority); Tally Arms Condo. Ass'n, Inc. v. Breland, 854 So. 2d 28, 30 (Miss. Ct. App. 2003) (holding that a subsequent assessment lien cannot have priority over a mortgage lien); First Fed. Sav. & Loan Ass'n of Charleston v. Bailey, 450 S.E.2d 77, 81 (S.C. Ct. App. 1995) (holding that assessments fixed or determined subsequent to a mortgage lien are subordinate to the assessment lien).

196. *See, e.g*, Bd. of Dirs. of Colchester Towne Condo. Council of Co-Owners v. Wachovia Bank, N.A., et al., 581 S.E.2d 201, 202 (Va. 2003) (explaining that "the realities of the marketplace require that such lenders be encouraged to provide the desired financing for individual condominium units by granting priority to the lien of their first mortgages or first deeds of trust").

197. NELSON & WHITMAN, *supra* note 58, at 570–73, 602–08.

198. A limited priority lien for assessment liens has been proposed multiple times to the New York legislature, but lenders have lobbied against the adoption of the measure. The first year it

statutory lien securing all unpaid condominium assessments is junior in priority to first mortgage liens,[199] and New York case law has confirmed that all sums related to a first mortgage lien (including collection costs, fees, etc.) on a unit within a community take priority over an association lien.[200] If a unit is delinquent on assessments in New York, however, legislation provides that the association may obtain a court-appointed receiver to pay regular assessments to the association *prior to* making any mortgage payments, and collect rents directly from a tenant.[201] Case law clarified that this provision does not apply to special assessments that are payable by a receiver only after mortgage loan payments are made.[202]

Even without appointing a receiver or foreclosing its lien, associations in Florida, like New York, can collect rents directly from any tenants living in units owned by defaulting members.[203] The 2010 amendment to the Florida Common Interest Community Act provides that associations can collect rent payments directly from tenants when the owner of a unit is delinquent and further provides that if tenants do not pay rent to the association, the board can evict them.[204] The revised law also explicitly permits associations to suspend voting privileges for owners who are ninety days delinquent in their assessments and clarifies

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was proposed, the measure was allowed to die in committee. The next year, it was defeated on the floor. *See* Ronald A. Sher, Esq., *Habitat Board Leadership Conference Seminar: Condo Collections*, HIMMELFARB & SHER LLP, http://www.himmelfarb-sher.com/options/condo_collections.htm (last visited Aug. 16, 2011) (discussing a proposed law that would give assessment liens a limited priority for six months).

199. N.Y. REAL PROP. LAW § 339-z (McKinney 2006).

200. Bankers Trust Co. v. Bd. of Managers of Park 900 Condo., 616 N.E.2d 848, 849 (N.Y. 1993).

201. N.Y. REAL PROP. ACTS § 1325(2) (McKinney 2006).

202. *See* First N.Y. Bank for Bus. v. 155 E. 34 Realty Co., 158 Misc. 2d 658, 661 (N.Y. Sup. Ct. 1993) (holding that special assessments are generally for capital improvements well beyond the period of receivership, and thus, obligation for the special assessments cannot be placed on the receiver).

203. *See* S.B. 1196, 2010 Sess. (Fla. 2010) (effective July 1, 2010).

204. S.B. 1196, 2010 Sess. (Fla. 2010) (codified at Fla. Stat. § 718.116 (2011)). The newly amended Florida provision attempts to permit associations to walk the fine line between incurring landlord liability and having the authority to collect rents and evict tenants. Tenants in Florida and New York, however, raise a valid complaint that they have no contractual or property relationship with the association (except indirectly through their landlord) and that even though the statute in question purports to immunize tenants who pay rents to the association against eviction by the landlord, landlords can do much to lower a tenant's quality of life while still acting within the strict "letter of the law" of a lease. *See* Kenric Ward, *Condo Associations Put 'Hammer' Down on Renters*, SUNSHINE STATE NEWS (June 2, 2010), http://www.sunshinestatenews.com/story/condo-associations-put-hammer-down-renters (highlighting the potential pitfalls of the new law for tenants).

that associations can restrict delinquent owners' use of common areas.[205]

Bankruptcy of a delinquent owner may impact an association's ability to collect delinquent assessments, particularly under Chapter 12, which permits junior liens to be "stripped" of their collateral claims when the collateral's value is less than the amount owed on a senior debt.[206] In a November 2010 decision, the U.S. Bankruptcy Court for the Eastern District of Virginia ordered that a community association be stripped of its unpaid assessment lien in the amount of nearly $7000 because the property was subject to a first mortgage debt that exceeded its current county-assessed value, which, the court opined, left no excess security to which the association's lien could attach.[207] Although the association argued that the cited real estate value for the property was "artificially low" because of a depressed housing market,[208] the court refused to preserve the lien "based solely on anticipated future increase in the value of a secured creditor's collateral."[209] The court held that while under-secured creditors' liens are generally valid, in the case of a party whose secured claim has "inconsequential value," a bankruptcy filing should cause the lien to disappear.[210] The operation of the Bankruptcy Code in this case further bolsters the argument that a junior priority for association liens is inequitable, particularly in cases of homes securing under-collateralized mortgages.

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205. S.B. 1196, 2010 Sess. (Fla. 2010).

206. *See In re* Cook, No. 10-10113-SSM, 2010 WL 4687953 at *1–2 (Bankr. E.D. Va. Nov. 10, 2010) (holding that Section 506(d) of the Bankruptcy Code makes any junior lien void upon a prior lien exhausting a creditor's collateral); *see also* 11 U.S.C. § 523(a)(16) (2006). Although Congress has specified that post-petition assessments are non-dischargeable in Chapter 7 bankruptcies, this carve-out specifically does not apply to pre-petition debts including assessments. *Id.*

207. *In re Cook*, 2010 WL 4687953, at *2. Interestingly, county tax assessed value is not how a property's value is typically determined. Market players typically price according to comparable sales or stream-of-income value for a property, and even judicial review of foreclosure sale prices admits that there is no precise benchmark for real property valuation. *See* B.F.P. v. Resolution Trust Corp., 511 U.S. 531, 545 (1994) (mentioning that there are several ways to determine a property's fair market value).

208. The association cites the "economic crisis that was triggered by the sub-prime mortgage loan meltdown" as having caused the drop in property valuation. *In re Cook*, 2010 WL 4687953, at *2.

209. *Id.*

210. The court also noted that "[a]lthough there may well be policy arguments favoring preservation of liens for pre-petition assessments when debtors in reorganization cases propose to retain the property, such arguments are properly addressed to Congress." *Id.*

II. ALTERNATIVES TO FAILED PRIVATE GOVERNANCE

Under current laws, owners in a CIC face financial uncertainty stemming from the ownership structure and assessment model of their community. Linked fiscal fortunes means that owners face the threat of ever-increasing assessments due to their neighbors' delinquencies, and these unpaid assessments may never be recovered because of such neighbors' mortgage defaults. The status quo in most states is not only destabilizing, it is also inequitable. Association maintenance preserves the value of a lender's collateral, and passing the pro rata share of upkeep costs onto non-defaulting owners results in unjust enrichment of the lenders.[211] Courts and legislatures have struggled to resolve such unfairness, particularly now that the current crisis has highlighted this deficiency in the CIC assessment system.

A. Other Attempted and Proposed Solutions

1. Limited Priority Liens

a. UCIOA and Six-Month Limited Priority Lien

The drafters of the Uniform Common Interest Ownership Act ("UCIOA"),[212] recognizing that assessment liens would ordinarily be junior in priority to individual first mortgage liens, crafted an "innovative" solution to the problem of assessment nonpayment during mortgage default: the six-month "limited priority lien."[213] The UCIOA model, which has been adopted by eight states to date,[214] provides that

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211. *See generally* RAWLS, *supra* note 5, at 96 (advocating that beneficiaries of a cooperative venture should bear the costs of such a venture on a *pro rata* basis); Hart, *supra* note 5, at 185–86 (arguing that enjoyment of benefits by parties not bearing associated costs is inequitable).

212. *See generally* UNIF. COMMON INTEREST OWNERSHIP ACT (1994) [hereinafter UCIOA]. In 1977, the National Conference of Commissioners on Uniform State Laws began drafting the Uniform Condominium Act based on the 1974 Virginia model. Subsequently, the Conference prepared three uniform laws governing condominiums, cooperatives, and homeowners associations—the three forms of privately governed communities with different ownership structures. These were the Uniform Condominium Act, the Uniform Planned Community Act, and the Model Real Estate Cooperative Act. The Conference then combined the three acts, resulting in the UCIOA. This Act contains provisions governing condominiums, planned unit development/homeowner associations, as well as cooperatives.

213. Carl Lisman, Chair of UCIOA's Drafting Comm., Presentation to the Maryland Task Force on Common Ownership Communities—Maryland Dep't of Hous. and Cmty. Dev. at the American Homeowners Resource Center: The Uniform Common Interest Ownership Act (June 9, 2006) (transcript available at http://www.epohoa.org/index.php?option=com_content&view=article&id=104:formation-1975-a-birth-of-ucioa&catid=93:news&Itemid=111). Lisman seems to believe that the UCIOA limited priority lien solves the problem of non-payment of assessments, noting that "we are now convinced that we are more brilliant than we thought we were." *Id.*

214. *See infra* notes 221–28 (explaining that these eight states include Nevada, Alaska,

an assessment lien, which is normally subordinate in priority to first mortgages on units, is given limited priority upon foreclosure of the first priority mortgage lien "to the extent the common expense assessments based on the periodic budget adopted by the association . . . would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien."[215] Thus, an association under UCIOA would have a priority position arising at a mortgage foreclosure sale for unpaid assessments up to an amount equal to six months of regular-assessment assessments.[216]

The six-month capped "super priority" portion of the association lien does not have a true priority status under UCIOA since this six-month assessment lien cannot be foreclosed as senior to a mortgage lien. Rather, it either creates a *payment* priority for some portion of unpaid assessments,[217] which would take the first position in the foreclosure repayment "waterfall," or grants *durability* to some portion of unpaid assessments,[218] allowing the security for such debt to survive foreclosure.[219]

The UCIOA priority portion does not include costs incurred by the association to collect delinquent assessments, such as attorney fees. Some states, however, have enacted statutory variations that include such costs.[220] According to Washington, D.C. lawyer Catherine Park,

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Colorado, West Virginia, Connecticut, Vermont, Minnesota, and Delaware). Legislative proposals to adopt UCIOA are pending in six more states: Utah, Indiana, New Jersey, South Carolina, Kentucky, and Ohio.

215. UCIOA § 3-116.

216. *Id.* Under such a capped-priority arrangement, the priority position of the association lien is split: a super-priority position is given to up to six months of unpaid assessment amounts, and the remainder of unpaid amounts is accorded the typical priority position of the association lien, namely subordinate to the first mortgage lien. *Id.*

217. *See, e.g.*, MINN. STAT. ANN. § 515A.3-115 (West 2002 & Supp. 2010), *amended by* H.F. 1023, ch. 116, 2011 MINN. SESS. LAW SERV. (West) (providing that the lien does not have priority over a senior mortgage lien, but allows for recovery of assessments for a period of six months). Under this interpretation, six months of unpaid assessments are paid out of foreclosure proceeds prior to repayment of the first mortgage.

218. Under this interpretation, a lien securing six months of unpaid assessments would survive the first mortgage foreclosure. One problem with this second interpretation of the super-priority provision is that post-foreclosure, an association often still has to bring a lawsuit against the buyer or lender to recover the six months of allowable unpaid assessments. This can be onerous for the association. For example, in Georgia, an association cannot recover the costs of bringing an action to recover the six months' worth of assessments against the lender. First Fed. Sav. Bank of Ga. v. Eaglewood Court Condo. Ass'n, Inc., 367 S.E.2d 876, 878 (Ga. Ct. App. 1988) (finding that the statutory language limited recovery from the lender at six months of assessments, not including the costs of collecting such assessments).

219. The effect depends on a state's interpretation of the provision.

220. *See, e.g.*, MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 1996 & Supp. 2002); CONN. GEN. STAT. ANN. § 47-258 (West 2009 & Supp. 2011) (allowing for recovery of attorney's fees within the priority portion).

who specializes in condominium law and litigation, the failure of strict UCIOA states to include attorney costs can be exploited by mortgage lenders, which gamble that an association will not hire an attorney to recover "a mere six months" of unpaid assessments.[221]

The lien priority concept contained in UCIOA has gained traction even in states that have not otherwise enacted these uniform acts. Today, in the eight UCIOA states (Alaska,[222] Colorado,[223] Connecticut,[224] Delaware,[225] Minnesota,[226] Nevada,[227] Vermont,[228] and West Virginia[229]), in ten more states (Alabama,[230] Florida,[231] Illinois,[232] Maryland,[233] Massachusetts,[234] New Jersey,[235] Pennsylvania,[236] Rhode Island,[237] and Washington[238]), and in the

221. Catherine Park, *"Super Lien" Legislation: How Super Is It Really? And Why Isn't the Mortgage Industry Complying with the Legislation?*, LAW OFFICE OF CATHERINE PARK (July 10, 2010), http://cparklaw.com/condolaw/2010/07/10/super-lien-legislation-how-super-is-it-really-and-why-isnt-the-mortgage-industry-complying-with-the-legislation. According to Park, the only way for would-be homeowners to protect themselves in such jurisdictions is to "avoid buying in a small community" and thereby hope to minimize the budgetary impact of assessment defaults. *Id.*

222. ALASKA STAT. § 34.08.470 (2010).

223. Colorado Common Interest Ownership Act, COLO. REV. STAT. § 38-33.3-316 (LexisNexis 2010); *see infra* notes 241–46 and accompanying text.

224. CONN. GEN. STAT. ANN. § 47-258.

225. DEL. CODE ANN. tit. 25, § 81-316 (2009).

226. MINN STAT. ANN. § 515B.3-115(a), (e)(1)–(3), (f), (i) (West 2002 & Supp. 2010), *amended by* State Agencies—Courts And Common Interest Ownership Act, ch. 116, sec. 16, § 515B.3-115, 2011 MINN. SESS. LAW SERV. (West).

227. NEV. REV. STAT. ANN. § 116.3116(2)(c) (LexisNexis 2010), *amended by* Uniform Laws–Amendments–Common Interest Communities Act, ch. 389, sec. 49, § 116.3116, 2011 Nev. Legis. Serv. (West); *see infra* notes 273–74 and accompanying text.

228. VT. STAT. ANN. tit. 27, § 1323 (2006).

229. W. VA. CODE ANN. § 36B-3-116 (LexisNexis 2005).

230. ALA. CODE § 35-8A-316 (LexisNexis 1991).

231. FLA. STAT. ANN. (West 2011); *see infra* notes 280–86 and accompanying text.

232. 765 ILL. COMP. STAT. ANN. 605/9 (West 2009). Section 9(g) of the Illinois Condominium Property Act requires the association board to have "taken action" to trigger the requirement that subsequent purchasers of a foreclosed unit pay six months of unpaid assessments. *Id.*

233. MD. CODE ANN., REAL PROP. § 11-110 (LexisNexis 2010), *amended by* Condominiums and Homeowners Associations—Priority of Liens Act, ch. 387, sec. 2, § 11-110, 2011 Md. Legis. Serv. (West) (granting a mere four-month, $1200-capped priority to association assessment liens at mortgage lender foreclosure).

234. MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 1996 & Supp. 2002). The Massachusetts statute includes a provision for attorneys' fees together with a dollar-amount cap. *Id.*

235. N.J. STAT. ANN. § 46:8B-21 (West 2003 & Supp. 2010).

236. 68 PA. CONS. STAT. ANN. § 3314 (West 2004).

237. R.I. GEN. LAWS § 34-36.1-3.16 (1956 & Supp. 2010).

238. WASH. REV. CODE ANN. § 64.34.364 (West 2005).

District of Columbia,[239] community association liens enjoy a limited priority, typically capped at six months or less. Legislatures in five states (Indiana, Kentucky, Ohio, South Carolina, and Utah) have been considering adopting a UCIOA-based statute that would include a six-month lien priority for unpaid assessments.[240] Even with these progressive statutory developments in many states, more than thirty states lack any lien priority for association assessments.

To illustrate the typical UCIOA lien priority approach, consider the Colorado Common Interest Ownership Act ("CCIOA").[241] Under the Act, association liens, which include assessments and all collection costs, are considered automatically perfected as of the date the association was created.[242] This type of lien is subordinate to property tax liens and to a first deed of trust on the property, but it is superior to all other encumbrances of record, regardless of when such other lien is filed.[243] At foreclosure of a first deed of trust on a property,[244] the association lien will be paid according to a limited priority position to the extent of six months of budgeted assessment amounts.[245] Colorado courts have held that the lien may be more than assessments alone, as it also includes "attorney fees, interest & other allowable items."[246] In

239. D.C. CODE § 42-1903.13 (2001).

240. *See* MALLACH, *supra* note 29, at 12 (advising state policymakers to consider allowing borrowers of mortgages in foreclosure a six month forbearance period).

241. COLO. REV. STAT. § 38-33.3-316 (2011). The 1992 version of the Colorado Common Interest Ownership Act ("CCIOA") automatically applies to associations created after 1992, but any pre-1992 association can elect to avail itself of the protections and provisions of the Act. By electing to come under the 1992 CCIOA, an association can effectively change the provisions in its own governing documents, without filing an amendment, since application of the law is deemed to change inconsistent declaration language in order to conform to the Act.

242. *Id.* The automatically perfected lien applies to "any assessment levied against that unit or fines imposed against its unit owner," which includes fees, late charges, attorneys' fees, and interest. *Id.* § 38-33.3-316 (1). There are no limits on late fees and interest, but it is arguably unclear whether the statutory language includes attorney fees.

243. *Id.* § 38-33.3-316 (3). This is because the priority timing for the association lien relates back to the recordation of the declaration. This applies only to liens for deeds of trust recorded after 1992 when CCIOA was created. For all such provisions, the super-priority six-month lien applies, regardless of language in the community documents or the deed of trust to the contrary. *Id.*

244. A deed of trust is essentially a mortgage. The common foreclosure method for mortgage liens in Colorado is non-judicial foreclosure through power of sale in a deed of trust. The only way to foreclose an association lien, however, is through a judicial proceeding. *See, e.g.*, ORTEN CAVANAGH RICHMOND & HOLMES, LLC, COLO. FORECLOSURE LAWS 1–2, 8 (Mar. 2008), *available at* http://www.ocrhlaw.com/library/Colorado_Foreclosure_Laws.pdf (explaining the non-judicial foreclosure procedure in Colorado and contrasting the non-judicial procedure to the mandated judicial foreclosure procedure for association liens).

245. *Id.* at 8.

246. First Atl. Mortg., LLC v. Sunstone N. Homeowners Ass'n, 121 P.3d 254, 255 (Colo. App. 2005) (citing COLO. REV. STAT. § 38-33.3-316 (2)(b) (2010)).

Colorado, the lien is not payable out of foreclosure proceeds, but rather survives the foreclosure of the first deed of trust (a durability interpretation of the UCIOA lien priority provision).[247]

Within non-UCIOA states, some lien priority statutory provisions originated in response to past housing crises imperiling community associations in that jurisdiction. For example, Massachusetts' lien priority law grew out of the state's real estate boom and bust of the late 1980s and early 1990s.[248] Two decades ago, associations in Massachusetts struggled with massive budget shortfalls when homeowners abandoned units they could no longer afford, forcing the communities to increase assessments on the remaining owners to keep the association afloat. The remaining owners often could not afford to make up extra payments to bridge the budgetary gap, which led to a domino effect of assessment and mortgage delinquencies.[249] Today, CIC liens in Massachusetts have a capped super-priority because of judicial and legislative efforts to protect communities during the 1990s.[250]

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247. This follows logically from the limitation on non-judicial foreclosure of association liens. *See supra* notes 201–02 (explaining that New York case law provides that all sums related to a first mortgage lien on a unit within a community, including collection fees and costs, take priority over an association lien). However, New York legislation provides that if a unit is delinquent on assessments, the association is able to obtain a court-approved receiver to pay regular assessments to the association before making any mortgage payments. N.Y. REAL PROP. ACTS. § 1325(2) (McKinney 2006). The association may also collect rents directly from a tenant. *Id.*

248. MICHAEL GOODMAN & JAMES PALMA, OFFICE OF THE PRESIDENT, UMASS DONAHUE INST., WINNERS AND LOSERS IN THE MASSACHUSETTS HOUSING MARKET: A STUDY FOR CITIZENS' HOUSING AND PLANNING ASSOCIATION AND THE MASSACHUSETTS HOUSING PARTNERSHIP 2 (2004), *available at* http://www.massbenchmarks.org/publications/studies/pdf/housingmarket04.pdf.

249. *See* Grahame K. Wells, *The Use of Super-Liens to Promote Cooperation Between Condominium Associations and Lenders*, 13 ANN. REV. BANKING L. 477, 477–78 (1994) (citing Henry L. Judy & Robert A. Wittie, *Uniform Condominium Act: Selected Key Issues*, 13 REAL PROP., PROB., & TR. J. 437, 475 (1978)). The troublesome state of the economy during the late 1980s and early 1990s left many condominium owners with severe financial problems, which in turn, led those owners to stop paying condo fees. Subsequently, the condos could no longer afford to perform proper maintenance or pay utility bills, the utilities were shut off by their providers, and local governments condemned the buildings. *Id.*; *see also* James Winokur, *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 353, 355 (1992) (discussing the real estate economy of the 1990s as a catalyst for creating limited lien priorities in several states).

250. Baker v. Monga, 590 N.E.2d 1162, 1164 (Mass. App. Ct. 1992) (holding that owners had an absolute obligation to pay assessments and that owners lack the right to withhold payments); *see also* Trs. of Prince Condo. Trust v. Prosser, 592 N.E.2d 1301, 1302 (Mass. 1992) (reiterating the *Monga* court's holding, stating that "[f]or the same reason that tax payers 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"). The Massachusetts legislature attempted to further mitigate the harm felt by associations losing their

Rhode Island's lien priority law is one of the newest in the nation, and it passed unanimously in the state's House and Senate in June 2008.[251] This legislation increased the capped foreclosure and collections cost amount to $5000 and $7500, respectively (inclusive of legal fees), and provided for a six-month lien priority for assessment liens upon foreclosure of the first mortgage.[252] Before the measure came to a vote, and when seeking the governor's veto thereafter, the Rhode Island Mortgage Bankers Association strenuously objected to the new law's lien priority provisions, claiming that they would spell the end of residential mortgage finance for community association housing in Rhode Island.[253] Legislative counsel to the Bankers Association bemoaned the measure, claiming that "it's basically picking the lenders' pockets, at the end of the day."[254] Rhode Island disagreed and passed the measure.

By crafting legislation that creates a six-month limited lien priority for assessments, state legislatures hope to motivate first mortgage lenders to help pressure non-paying owners to pay their delinquent obligations. If their borrowers make all their association payments, lenders can avoid paying six months' worth of assessments out of their foreclosure proceeds. If, however, the property is under-collateralized and mortgage foreclosure takes vastly longer than six months, the six-month priority cap actually may (perversely) induce a lender to further delay foreclosure until there is a ready third-party purchaser on hand. This is because a lender purchasing at foreclosure will be liable for all subsequent assessments, and the foreclosure will also trigger the six-month payment obligation, increasing the prospective lender costs of foreclosing. Also, a lender is still likely to recover more in an upside-down loan if a borrower makes payments on the mortgage rather than association deficiencies because the lender will only have to reimburse a six-month capped amount of association deficiencies at some future time.

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entire assessment lien by passing legislation that provides for a six-month lien priority arising at closing. MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 2011).

251. R.I. GEN. LAWS § 34-36.1-3.16 (2010). The previous law not only failed to provide any lien priority for assessment liens, but capped an association's reimbursement for foreclosure costs at $2500, with any additional costs having to be paid by the community as a whole. Patricia Antonelli, *Changes to Rhode Island Law Affect Foreclosures, Priority of Condominium Liens for Assessments, Mortgage Escrow Accounts and Reverse Mortgages*, PARTRIDGE SNOW & HAHN LLP (July 2008), http://www.psh.com/content345.

252. R.I. GEN. LAWS § 34-36.1-3.16 (2010).

253. Dunn, *supra* note 6, at G1 (quoting Terrance Martiesian, a lawyer for the Rhode Island Mortgage Bankers Association, who remarked that "[a] bank is not going to take second place . . . in the chain of liens against the property. . . . They want to be first.").

254. *Id.* (quoting James Hahn).

b. Federal Housing Impacts on Association Fiscal Recovery

Federal agencies and GSEs, such as Fannie Mae and Freddie Mac, insure or guarantee more than nine out of every ten mortgages that have been originated since the meltdown in credit markets in 2008.[255] The FHA now insures nearly 50% of all residential mortgages, up from 1.7% of the market in 2006.[256] As the buyer or insurer of nearly every currently originated mortgage loan, these federal policies regarding lending risk have an enormous impact in terms of capital availability. The policies of the FHA and the GSEs impact the resolution of the community assessment issue in two ways: first, by requiring any super-priority of assessment liens to be limited at six months' worth of assessments and, second, by prohibiting loans secured by units located in condominiums with high rates of neighborhood mortgage defaults.[257]

The GSE secondary market purchasers and the FHA insurers specifically define qualifying mortgages as a mortgage subject to no greater than a six-month capped assessment lien priority.[258] This effectively prevents association recovery beyond that threshold.[259]

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255. DEP'T OF TREASURY & U.S. DEP'T OF HOUS. & URBAN DEV., REFORMING AMERICA'S HOUSING FINANCE MARKET: A REPORT TO CONGRESS 12 (2011), *available at* http://www.treasury.gov/initiatives/Documents/Reforming%20America%27s%20Housing%20Finance%20Market.pdf [hereinafter TREASURY/HUD REPORT]; *see also* CTR. FOR AM. PROGRESS, A RESPONSIBLE MARKET FOR HOUSING FINANCE: A PROGRESSIVE PLAN TO REFORM THE U.S. SECONDARY MARKET FOR RESIDENTIAL MORTGAGES 2 (2011), *available at* http://www.americanprogress.org/issues/2011/01/pdf/responsiblemarketforhousingfinance.pdf (explaining that "Fannie Mae and Freddie Mac also now purchase more than 80 percent of all multifamily mortgages, loans to owners, and developers of rental residential properties").

256. CTR. FOR AM. PROGRESS, *supra* note 255, at 44–45; *see also Government Affairs Update: FHA Condo Recertification Requirements*, NAT'L ASS'N OF REALTORS, http://www.realtor.org/wps/wcm/connect/15f94c8044f67a04b112f35d6aeab3b5/FHA%2BCondo%2BRecertification%2BRequirements%2B12.8.10.pdf?MOD=AJPERES&CACHEID=15f94c8044f67a04b112f35d6aeab3b5 (last visited Aug. 16, 2011); Rick Newman, *Kill Fannie and Freddie? Not Likely*, U.S. NEWS & WORLD REPORT (Feb. 21, 2011, 12:12 PM), http://money.msn.com/investing/kill-fannie-and-freddie-not-likely-usnews.aspx (explaining that most mortgages issued are currently supported by Fannie Mae, Freddie Mac or the FHA). In contrast, private lenders handled twenty percent of mortgages during "normal" times. *Id.*

257. *See Infra* notes 258–59 and accompanying text.

258. *See* FANNIE MAE, FORM 1054 (1208): WARRANTY OF CONDOMINIUM PROJECT LEGAL DOCUMENTS, *available at* https://www.efanniemae.com/sf/formsdocs/forms/pdf/projectrevs/1054.pdf (specifying that in order for a loan to be qualifying, "[a]ny first mortgagee who obtains title to a condominium unit pursuant to the remedies in the mortgage or through foreclosure will not be liable for more than six months of the unit's unpaid regularly budgeted dues or charges accrued before acquisition of the title to the unit by the mortgagee"); *see also Condominium Unit Mortgages—Project Analysis*, FREDDIE MAC (Apr. 2011), http://www.freddiemac.com/learn/pdfs/uw/condoprojectanalysis.pdf (requiring that the first mortgagee obtaining title to the unit be liable "for no more than six months of unpaid, regularly budgeted assessments or charges (for late fees and collection costs) accrued before acquisition").

259. Financing for non-qualifying loans is increasingly hard to obtain in the current economic climate. *See* Dunn, *supra* note 23, at G1 (discussing Rhode Island foreclosure).

These definitions of qualifying mortgages make it impossible for a state to increase the priority of a community assessment. Such funding or insuring requirements therefore indirectly, but effectively, limit a community's ability to fully recover delinquent assessments at foreclosure of an underwater unit. These federal guidelines drive the bulk of all mortgage lending and unless the six-month limitation is changed, will prevent state legislatures from acting to solve the community assessment delinquency problem.

In addition to their priority requirements for qualifying mortgages, policies of these entities significantly limit finance capital availability for condominium units. The Department of Housing and Urban Development ("HUD") maintains a list of "Approved Condominium Projects," and FHA, Fannie Mae, and Freddie Mac will not insure or purchase mortgages to units in condominiums that are not on the approved list.[260] The new approval process implemented in the wake of the Housing and Economic Recovery Act of 2008 now disallows "spot loan" approvals—approvals based on applications for individual unit mortgages rather than the condominium as a whole.[261] Condominium projects will not be approved unless, *inter alia*, no more than 15% of the total units are in arrears (more than thirty days past due) of their association assessments.[262] An association with more than 15% delinquent owners can go after those owners personally for the unpaid amounts and would be wise to do so.[263] But if the owners are unable to

260. *See* Mortgagee Letter 2009-19 from Brian D. Montgomery, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees & All FHA Roster Appraisers 1 (June 12, 2009), *available at* http://www.bestfhalender.com/wp-content/uploads/2010/01/09-19ml.pdf [hereinafter Montgomery, Mortgagee Letter 2009-19] (stating that the FHA "will now allow lenders to determine project eligibility, review project documentation, and certify to compliance . . . . HUD will continue to maintain a list of Approved Condominium Projects"); Mortgagee Letter 2009-46A from David H. Stevens, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees 1 (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46aml.pdf ("This Mortgagee Letter (ML) waives five provisions of that guidance and serves as a temporary directive to address current housing market conditions."); Mortgagee Letter 2009-46B from David H. Stevens, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees and All FHA Roster Appraisers 1 (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46bml.pdf [hereinafter Stevens, Mortgagee Letter 2009-46B] (stating that the FHA will allow lenders to determine project eligibility, review project documentation, and certify compliance, but FHA will continue to have a list of approved condominium projects).

261. *See supra* note 260. Previously, individual loans in a community could earn HUD approval even if the community as a whole did not get blanket approval from HUD. Such per-unit approval is no longer an option.

262. Stevens, Mortgagee Letter 2009-46B, *supra* note 260, at 4.

263. *See supra* notes 159–77 and accompanying text (discussing association collection efforts).

pay, the paying members make up the budgetary shortfall, while they are simultaneously denied access to financing because of their neighbors' default. Even if a community earns a coveted spot on HUD's "Approved" list, that approval expires in two years unless all requirements are re-certified to the satisfaction of HUD.[264]

Other requirements for condominium project approval also impact the resolution of the assessment delinquency issue and have contributed to a slowdown in condominium unit sales in an already sluggish market.[265] HUD requires that "[n]o more than 10 percent of the units" be owned by one entity, and states that "[a]t least 50 percent of the units of a project must be owner-occupied."[266] Such limitations may practically limit the ability of a condomininm association to foreclose on liens for unpaid assessments and rent out units in the community in order to attempt to recover some amounts toward the delinquency while also prohibiting troubled owners from generating income from property rental to meet obligations.[267] Furthermore, such restrictions make it more difficult for a unit to be sold, since once a community passes the 15% delinquency tipping point (or the 50% rental tipping point), financing for would-be purchasers is essentially no longer available. And most ironically, if a condominium's documents restrict a unit owner's freedom to rent a unit, which it must do to ensure compliance with HUD's 50% rental limitation, the FHA has deemed the documents

264. *See* Montgomery, Mortgagee Letter 2009-19, *supra* note 260 (explaining that the recertification deadline for previously approved condominiums, previously set for December 7, 2010, was extended to dates from December 31, 2010 to March 31, 2010, staggered according to the original project approval date); *see also Government Affairs Update: FHA Condominium Recertification Requirements*, NAT'L ASS'N OF REALTORS (Dec. 8, 2010), http://www.realtor.org/wps/wcm/connect/15f94c8044f67a04b112f35d6aeab3b5/FHA%2BCondo%2BRecertification%2BRequirements%2B12.8.10.pdf?MOD=AJPERES&CACHEID=15f94c8044f67a04b112f35d6aeab3b5 ("Mortgagee Letter 2009-46B states that FHA approved condominium projects must be recertified every two years").

265. *See, e.g.*, Mandyvilla, Comment to *New FHA Condo Guidelines*, BROKER OUTPOST MORTGAGE FORUMS (Dec. 20, 2009, 7:55 AM), http://forum.brokeroutpost.com/loans/forum/2/283263.htm ("[Realtors should] motivate sellers to slash the price [of condominium units offered for sale] NOW on their listings before the market does it for them. . . . This is going to be the nail in the condo market. Values are going to plummet around here due to the number of projects that are at 51% concentration [of investor owners] and above.").

266. Montgomery, Mortgagee Letter 2009-19, *supra* note 260, at 4.

267. *See* DAVID H. STEVENS, ASSISTANT SEC'Y FOR HOUS./FED. HOUS. COMM'R, U.S. DEP'T OF HOUS. & URBAN DEV'T.: CONDO APPROVAL PROCESS (May 2010), *available at* http://portal.hud.gov/hudportal/documents/huddoc?id=MAY2010.pdf (noting that although David Stevens, Assistant Secretary of HUD, explained in May 2010 that HUD modified this "50% owner occupancy requirement to allow the exclusion of vacant and tenant-occupied REOs from the calculation," such exclusions do not apply to real estate owned by *associations* rather than *lending banks*).

as violating the "free transferability" provisions.[268] The result is that it is impossible for a condominium to be adequately approved for FHA insurance, either because it allows rentals or because it does not. Fannie Mae and Freddie Mac require similar owner-occupancy percentages, and thus, a condominium today cannot simultaneously satisfy the criteria of the GSEs and the FHA.[269]

Because nearly half of all mortgage loans are now insured by the FHA, and almost the entire remainder is sold on the secondary market to either Fannie Mae or Freddie Mac, the policies of the FHA, Fannie Mae, and Freddie Mac hugely impact resolution of the issue of assessment recovery.[270] The current requirements for loans, however, work at cross-purposes: while the delinquency rate is used as a proxy for community fiscal health, the priority limits on association assessments remove from a community a potentially crucial tool for ensuring the association's financial well-being. In recognition of the harm to communities and lenders that can result from a community with excessive delinquencies, it seems that the FHA, Fannie Mae, and Freddie Mac should use their market power and definitions of qualifying mortgages to support community health rather than place roadblocks to recovery.

c. State Efforts to Add or Enhance Lien Priority

Because capped lien priority typically protects only six months' worth of assessments, the longer it takes to get a paying owner to take title to the unit, the less protection the law provides. In early 2010, Lender Processing Services, Inc. estimated that on average, it took fifteen months for a home loan to go from being thirty days late to the property being sold in foreclosure.[271] The lengthy foreclosure timeline is caused in part by the sheer magnitude of the increase in foreclosure

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268. 24 C.F.R. § 203.41 (2011).

269. Letter from Loura K. Sanchez, Managing Partner, Hindman Sanchez, to Comm. Ass'ns Inst. (Nov. 23, 2010) (on file with author).

270. *See* TREASURY/HUD REPORT, *supra* note 255, at 12 (explaining that the lack of private capital in the housing market since 2008 has led government agencies to insure or guarantee the vast majority of new mortgages); Jody Shenn & John Gittelsohn, *FHA Home-Loan Volume Is Sign of 'Very Sick System,' Agency's Stevens Says*, BLOOMBERG (May 24, 2010), http://www.bloomberg.com/news/2010-05-24/fha-home-loan-volume-is-sign-of-very-sick-system-agency-s-stevens-says.html (noting that the FHA, Fannie Mae and Freddie Mac have been financing more than 90% of U.S. home lending since the 2008 market collapse); Saskia Scholtes, *Fannie and Freddie Drive Home Loans*, FIN. TIMES (Apr. 2, 2008, 7:23 PM), http://www.ft.com/intl/cms/s/0/65e8ab08-00dd-11dda0e5000077b07658.html#axzz1TWkKeq6Y (discussing how government-sponsored mortgage companies have become the "backbone" of the U.S. mortgage market); *see also Infra* Part II.A.1.c.

271. Viega, *supra* note 8.

volume over the past few years—in 2010, there were more foreclosures commenced each month than were typically commenced in an entire year prior to 2005.[272] The recent foreclosure moratoriums and government investigations into bank procedures, introduced in all fifty states in October 2010, significantly lengthened the time needed to complete foreclosure,[273] as lenders have (appropriately) responded to increased procedural scrutiny by slowing the process to ensure validity of the foreclosure.[274]

Some states have responded to the longer foreclosure timeline and the financial dire straits of associations by increasing the capped amount of their lien priority statutes. Nevada increased the six-month period to nine months,[275] and Florida increased its cap to the lesser of twelve months' worth of assessments or 1% of the outstanding mortgage loan amount.[276] Although both of these enhanced lien priority measures increased ultimate recovery by an association, they failed to solve the underlying problem that still plagues the six-month capped priority laws: once the designated period has elapsed (be it six or nine or twelve months), lenders have no further incentive to contribute to property upkeep or to expeditiously foreclose so that someone new can take title.

The housing crash prompted the Nevada Legislature to swiftly pass legislation strengthening lien priority protection for assessment liens, increasing the six-month lien priority to a nine-month priority, effective October 1, 2009.[277] The state legislators were mindful of the FHA and GSE guidelines, however, so the Nevada statute has an automatic carve-out for mortgages purchased by the GSEs, limiting the lien priority to the maximum allowed by such entities' guidelines (namely, six

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272. *See supra* notes 18–19 and accompanying text (reporting 2010 foreclosure statistics).

273. Ariana Eunjung Cha & Dina Elboghdady, *50 State Attorneys General Announce Foreclosure Probe*, WASH. POST, Oct. 13, 2010, at A13.

274. Ensuring compliance with foreclosure procedure is crucial to protecting borrower rights and equity. Because the sale price at a foreclosure is not subject to substantive review, strict adherence to procedural safeguards is the only way that the system can ensure the price obtained is fair and that the borrower is given all notice and the right to redeem, which statutory law and equity require. *See, e.g.*, BFP v. Resolution Trust Corp., 511 U.S. 531, 545 (1994) (refusing to review the adequacy of a foreclosure sale price and instead focusing exclusively on the foreclosure process, stating, "[w]e deem, as the law has always deemed, that a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with").

275. NEV. REV. STAT. ANN. § 116.3116(2)(c) (2010).

276. FLA. STAT. ANN. § 718.116 (West 2010 & Supp. 2011), *preempted by In re* Spa at Sunset Isles Condo. Ass'n, Inc., No. 10-33758-PGH, 2011 WL 3290239 (Bankr. S.D. Fla. July 13, 2011).

277. NEV. REV. STAT. ANN. § 116.3116(2)(c) (2010).

months).[278] This carve-out undercuts the statute's effectiveness dramatically, as the vast majority of residential mortgage loans are originated for resale on the secondary market.[279] In addition, increasing the cap to nine months, even when applicable, rapidly became insufficient recovery as the post-default/pre-foreclosure duration of mortgages in the state increased.

Florida was the next state to increase the assessment lien priority cap amount. The Florida Distressed Condominium Relief Act of 2010, effective July 1, 2010, provides that a first mortgagee taking title to property through foreclosure is liable for the twelve months of unpaid common expenses and regular periodic assessments that came due during the immediately preceding year.[280] The total potential exposure of lenders under this statute, however, is capped at 1% of the outstanding mortgage debt.[281] While the previous change in the law implementing a six-month cap inspired widespread adherence among lenders who have not contested its retroactive application, Florida courts have not yet stated definitively that the Florida amendment creating a twelve-month cap can be applied retroactively.[282] In addition, although states like Colorado have specified that their statutory lien priority provisions trump association documents with provisions to the contrary, it is unclear whether this is true in Florida or whether Florida associations must amend their documents to take

278. *Id.*

279. *See* TREASURY/HUD REPORT, *supra* note 255, at 2. Secondary resales today are primarily through Fannie Mae and Freddie Mac. *Id.*

280. Distressed Condominium Relief Act, 2010 Fla. Sess. Law Serv. 36 (codified at Fla. Stat. Ch. 718.701–08). Previous modifications in the law increased the cap to twelve months for single family homes in CICs but left the cap at six months for condominium units. The 2010 amendment equalized recovery in both types of CICs. *Id.*

281. FLA. STAT. ANN. § 718.116(1)(b)2 (2011). According to some Florida lawyers, the new law permits unlimited recovery of unpaid assessments from third-party buyers at mortgage foreclosure (unlimited durability of the association lien) and caps recovery only from lenders. Telephone interview with Ben Solomon, Attorney, Association Law Group, P.L., North Bay Village, Fla. (Sept. 28, 2011) (notes on file with author) [hereinafter Solomon Interview]. Other Florida attorneys dispute this reading of the law, noting that the twelve-month cap applies to all foreclosure sales, regardless of the identity of the buyer, and expressing doubt that the new twelve-month limit will apply to foreclosures of mortgages originated before 2010. Telephone interview with Chuck Edgar, Attorney, Cherry, Edgar & Smith, P.A., Palm Beach Gardens, Fla. (Sept. 27, 2010) (notes on file with author) [hereinafter Edgar Interview]. Edgar agrees that the statutory language is ambiguous on this point but notes that there is nothing in the legislative history to suggest that Florida legislators intended to create a different rule for lender and third-party foreclosure buyers. *Id.*

282. Edgar notes that "Everyone is collecting the six months of assessments, and lenders aren't fighting it." Edgar Interview, *supra* note 281. But Edgar also opines that the twelve-month cap may not apply to mortgages originated prior to July 2010 and believes that the legislature in Florida cannot retroactively impose the cap, and only the federal government, not a state government, could pass a law that effects such an "impairment of contract." *Id.*

advantage of the enhanced lien priority if the documents reference the prior (six-month) capped level.[283] The flaws of Florida's newly amended statute are already apparent, and less than a year later, new legislation has been introduced to "refund and expand upon those amendments and to clarify other condo association issues."[284]

Florida has been coping with perhaps the worst volume and quality of foreclosures in the nation during the past few years, and the large quantity of foreclosures and many lender missteps have so far discouraged lenders at foreclosure from challenging the law or its application.[285] Even if unchallenged, the long delay between commencing and completing foreclosure proceedings in Florida makes the twelve-month capped priority still inadequate in many cases anyway.[286] In Florida, as in other states, the best way to ensure repayment of assessment amounts is to immediately start legal proceedings when a homeowner has not paid his dues to get a personal money judgment against the owner in order to compel collection. Pursuing a money judgment is often the cheaper and easier route for an association to take to recover unpaid assessments.

The Florida law is so new that the state's mortgage market has not yet reacted to the change. Interestingly, Florida's twelve-month limit does not have a GSE limit carve-out like the Nevada provision.[287] It is unclear how this limitation will play out in Florida with respect to availability of mortgage capital, since Fannie Mae and Freddie Mac specifically exclude debts for which a lender could be liable for more than six months of assessment charges from pools of qualifying mortgages.[288] Mortgage originators today almost never originate non-

283. *See id.* (noting that everyone is taking advantage of the six-month cap, despite the fact that it is unclear whether or not Florida associations need to amend their documents to take advantage of the enhanced lien priority); Solomon Interview, *supra* note 281 (stating that Florida law permits unlimited recovery of unpaid assessments from third-party buyers at mortgage foreclosure and caps recovery only from lenders).

284. Joshua Krut, *Board of Contributors: After Sweeping Changes In Florida's Condo Law, Expect New Revisions*, DAILY BUS. REV. (Feb. 23, 2011), http://www.law.com/jsp/article.jsp?id=1202482933797 (calling this pending legislation the "glitch bill" because it is designed to clarify unanswered questions relating to the amendments of the prior year).

285. *See* Edgar Interview, *supra* note 281 (agreeing that the statutory language is ambiguous but that the legislature did not intend to create a different rule).

286. *See, e.g.*, *supra* notes 110–12 and accompanying text (identifying incidents in which enhanced lien priority statutes failed to protect condominium associations).

287. It does, however, have a dollar-based cap of 1% of the mortgage loan amount. FLA. STAT. § 718.116(1)(b)2 (2010).

288. Section B4-2.1-06 of Fannie Mae's lending guidelines explicitly states that Fannie Mae will not purchase debt if the holder of the mortgage could be liable for more than six months of regular common expenses charged by a community association. *See* FANNIE MAE, SELLING GUIDE 575–76 (June 28, 2011).

FHA loans that they cannot sell on the secondary mortgage market, and the only truly active secondary residential mortgage market purchasers are the GSEs.[289] It remains to be seen if the Distressed Condominium Act adversely impacts the availability of mortgage financing in CIC homes in Florida, or if the GSEs will not enforce these guidelines there or will change their mandates.

After facing much resistance from lender lobbyists, the Maryland General Assembly approved a statute to grant CIC assessment liens a capped priority in mortgage lender foreclosure sales.[290] The new law requires that $1200 of assessments (or up to four months of assessments, if less) be paid to an association prior to payment on the mortgage debt at foreclosure.[291] Since foreclosure in Maryland takes a minimum of five months to complete,[292] this capped assessment liability is clearly inadequate to cover all of an association's costs during the pendency of foreclosure.

Bills specifically aimed at creating six-month limited priority for association assessment liens are currently pending in Ohio and Missouri. Each case is strongly supported by individuals who reside in CICs and community association lobbies, and each case is strongly opposed by bank lobbies. In Ohio, efforts to pass a UCIOA-based lien priority for assessments (House Bill 408) failed to achieve legislative action in the legislature's 2010 session.[293] The efforts are still alive, and proponents of the measure hope that 2011 will see passage of a law creating a provision for six months of assessments plus attorney fees, costs, and expenses to enjoy lien priority superior to all liens but those for property taxes. National and state lenders in Ohio have strongly opposed the bill, contending that it will increase lending costs and complexity and will chill mortgage lending in an already semi-frozen housing capital market.[294]

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289. *See* TREASURY/HUD REPORT, *supra* note 255, at 2 (discussing how the new plan developed by the administration will bring private capital into the market and decrease the role of Fannie Mae and Freddie Mac).

290. H.B. 1246, 428th Gen. Assemb. (Md. 2011). The original bill set the priority cap higher—six months plus late fees and collection costs—but this proposal met vigorous opposition by the Maryland Bankers Association. *Community Association Law Letter*, THOMAS SCHILD LAW GROUP LLC, 1 (Spring 2011), http://www.schildlaw.com/Spring%202011%20Newsletter.041811.pdf. The legislature cut down the cap in an effort to appease the mortgage lender lobby. *Id.*

291. Md. H.B. 1246.

292. *See* Mallory Malesky, *How Long Does Foreclosure Take in Maryland*, EHOW (Mar. 23, 2011), http://www.ehow.com/info_8098323_long-foreclosure-maryland.html (explaining Maryland foreclosure procedures).

293. *See* MALLACH, *supra* note 29 (discussing the foreclosure crisis in Ohio).

294. *See* Ann Fisher, *Condo Associations Want Plan to Make Owners Pay*, THE COLUMBUS

Banks are also concerned with potential retroactive application of the priority law with respect to loans that have already been funded.[295] While active debates on limited priority statutes remain in Ohio and Missouri, in many other states, efforts to create a limited lien priority for association assessments have never gained traction.[296]

d. Inadequacy of Limited Priority Liens

The priority law for community assessment liens varies among the states, but this problem has been insufficiently addressed in all of them. When unpaid upkeep costs are potentially unlimited, capped losses for the lender necessarily result in unlimited losses allocated to the members of the community. Thus, even a "super-priority" piece allocated to assessment liens becomes inadequate once that period has expired.

When foreclosure takes longer than six months and when foreclosure proceeds are inadequate to pay off a first mortgage—and both of these factors are more and more common today—only a fraction of unpaid assessments are paid, requiring paying members of the association to fund the remainder.[297] Furthermore, even in some jurisdictions with a limited association lien priority, proceeds at foreclosure do not automatically apply to unpaid assessments (the capped portion being deemed a durability rather than payment priority provision), and thus the association has to bring a lawsuit—and incur more community costs—just to recover the amounts that are legally theirs. Miami Beach Commissioner Jerry Libbin calls this problem an "outrageous loophole" in the law.[298]

DISPATCH, July 5, 2009, at 01B.

295. *See id.* ("Banks and other lenders typically have opposed such laws, contending that they increase the cost and complexity of lending.").

296. *See, e.g.*, S.B. 411, 2010 Gen. Assemb., Reg. Sess. (Va. 2010) (stricken Jan. 27, 2010) (establishing limited lien priority for condominium association assessments).

297. *See* Coleman, *supra* note 104, at 1A (noting that condominium owners in good standing are often charged "special assessments" to make up for unpaid fees from delinquents owners).

298. Admin, Comment to *Ruling May Help Homeowner Associations*, HISTORIC CITY NEWS (Feb. 6, 2010, 2:31 PM), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546. Libbin heralded the reverse foreclosure tactic, *see Infra* Part II.A.2, as an important step toward protecting owners in condominiums. *See id.* (noting that Libbin applauded a Miami-Dade Circuit court ruling ordering a "reverse foreclosure"). Florida's legislature considered a bill that would have required banks to complete foreclosure after a year of filing or pay all unpaid assessments, but this proposal never came to a vote. *See* Rob Samouce, *Laws Needed to Get Delinquent Properties Back on Market*, NAPLES DAILY NEWS (Jan. 2, 2010), http://www.naplesnews.com/news/2010/jan/02/laws-needed-get-deliquent-properties-back-market/ (noting that strong bank lobbying was the cause of legislative inaction on the bill); *see also HOA's Forcing "Reverse Foreclosures,"* TITLE SEARCH BLOG (Mar. 1, 2010, 10:26 AM), http://titlesearchblog.com/2010/03/01/hoas-forcing-reverse-fore closures/ (remarking that the bill

The general problem of unpaid assessments is dramatically exacerbated in the current market context where lenders (sometimes deliberately) delay foreclosure on defaulting properties.[299] Lenders can—and today often do—delay foreclosure. It is true that foreclosure can take a long time for other reasons: mortgage loan servicers are currently overwhelmed with the number of defaulting borrowers, and lenders look hopefully to future market price rebounds to recover under-collateralized loan amounts. In addition, mortgage servicers' faulty record-keeping and failure to follow legally-mandated procedures operate to stretch out the foreclosure timeline as well.[300]

But lenders also sometimes strategically delay based on their calculation that they will be unable to sell the property at foreclosure or resell the property afterwards because of the sluggish housing market.[301] Procrastination can help lenders avoid incurring the obligations of home ownership, including property taxes and community association assessments. This is particularly true in cases where there is a very real risk that the ultimate sale price for the property will not reimburse such costs. Once the lender owns the real estate (real estate owned, or "REO" properties), the lender itself is responsible for assessment charges and, unlike insolvent mortgage borrowers, can typically be sued successfully for assessment payments they neglect to make.[302] Because this obligation is assumed upon taking title, lenders in many cases prefer to postpone foreclosure,

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"never saw the light of day for a vote by the legislature").

299. *See, e.g.*, Marshall L. Jones, *Condo Associations Battle Deadbeat Owners, Balky Banks In Collecting Fees*, REAL EST. L. & INDUS. REP., Apr. 6, 2010, at 3 ("As lenders institute foreclosure proceedings against defaulting condominium owners, some condominium associations are seeing lenders delay in completing the foreclosure process.").

300. *See supra* note 3 and accompanying text. In addition to servicer and bank moratoriums on foreclosures, several states, including Connecticut and Texas, froze all foreclosures in October 2010 pending inquiry into faulty and fraudulent loan servicing procedures. Several other states stopped foreclosures by J.P. Morgan Chase, GMAC and Ally Financial, the institutions tainted with the "robo-signing" scandal. *See* Cha, *supra* note 3, at A9 (noting that the moratoriums have now been lifted, but the pace of foreclosure remains slow).

301. *See* Coleman, *supra* note 104, at 1A (noting that some banks deliberately delay taking back property worth less than the outstanding mortgage); Benny L. Kass, *Condo Associations Saddled with Unpaid Dues Demand that Banks Stop Delaying Foreclosures*, WASH. POST, Nov. 20, 2010, at E3 (noting that condo associations are often left with unpaid dues when banks, wanting to avoid assuming liability on unpaid condominium dues and taxes, delay foreclosure on a unit).

302. *See, e.g.*, Leigh Katzman, *Waiting for the Bank to Foreclose: A Modern Day Story*, KATZMAN GARFINKEL ROSENBAUM, 1–3, http://kgblawfirm.com/pdfs/Waiting for the bank to foreclose-LCK.pdf (last visited Oct. 30, 2011) (detailing all the costs that a lender will incur upon taking title to real estate at a mortgage foreclosure sale and concluding that "the bank can comfortably delay completing its foreclosure action knowing the full extent of its liability for past due assessments").

hoping that the market will improve and property resale will be more quickly forthcoming. As Florida attorney Ben Solomon explains, "[t]he bottom line is the banks don't want to assume the liability associated with the unit, including the obligation to pay maintenance assessments to the association."[303] In the meantime, collateral values are preserved through assessments that lenders neither pay nor reimburse.

Today, the delay between initial mortgage default and actual foreclosure sale is longer than ever before. Since bank liability for previously unpaid assessments is capped—or, in many places, non-existent—mortgage lenders receive an unjust enrichment of collateral upkeep at the cost of other members of the community. Currently, there is nothing in the law to prevent such an outcome.

Foreclosure delays increase the ultimate charges borne by the non-defaulting neighbors but also cause neighboring owners to suffer in other ways. As unpaid assessments increase, dues increase, units fall into disrepair, and abandonment increases the likelihood of vandalism and squatters. When foreclosure finally happens, both property values and quality of life for the community have declined.[304]

Focusing on the complete lack of even a capped assessment priority in a majority of states, Washington, D.C. association law expert and syndicated columnist Benny Kass has publicly called for nationwide campaigns to create UCIOA-like provisions in those states that have not yet passed such a law.[305] But even if the thirty-three states with no limited priority passed UCIOA-based six-month (or larger) caps, the underlying problem would persist: lenders can offload a theoretically unlimited amount of upkeep costs of their collateral onto innocent members of the community with no adequate recourse at law for the community and its paying members. And since the limited priority of assessment liens under UCIOA and similar statutes only takes effect upon a first mortgage foreclosure, the limited priority lien fails to force the bank's hand and achieve a more expeditious resolution through conveying the unit to an owner willing and able to contribute to community costs.[306]

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303. Sutta, *supra* note 6.

304. *See, e.g.*, Rogers, *supra* note 181, at 1–3 (describing the course of foreclosure proceedings); *supra* Part I.B.2 (discussing the financial tragedy of the commons associated with foreclosures in condominium associations).

305. *See* Kass, *infra* note 356 (stating that such monthly-based limited priority lien systems "must be enacted all over the country as soon as possible").

306. Note that some creative litigators have attempted to do just that, with some limited success in Florida. *See infra* Part II.A.2.

State legislatures could close this "loophole" by mandating true priority for community assessment liens (at least with respect to dues that are unpaid during a period of mortgage default) or by making CIC assessment liens non-extinguishable in foreclosure. Capping community losses rather than lender losses would eliminate the distortion that the current potential "free ride" creates for lenders weighing the costs of foreclosure. This would encourage lenders to pay community assessments during borrower defaults, whether or not it also encourages the pace of foreclosure to increase. Either way, the community's losses and contagion effects of the distressed properties is contained: at some defined point in time, a solvent interest-holder in a unit will be encouraged to pay the unit's equitable allocation of costs. This type of limited priority would be vastly more equitable than the UCIOA-type of total-amount capped lien, both in terms of allocating upkeep costs and in terms of efficiently motivating housing rollover and market stability.

2. Creative Litigation Strategies

Florida is perhaps the epicenter of the CIC assessment crisis.[307] Florida was the site of one of the largest housing booms over the past few decades.[308] In particular, condominium development and financing flourished in Florida through 2007.[309] Condominiums in Florida

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307. *See* ElBoghdady, *supra* note 10, at A14 (noting that nine of the twenty regions with the worst foreclosure rates were in Florida); Brad Heath, *Most Foreclosures Pack Into a Few Counties*, USA TODAY, Mar. 6, 2009, at 1A (noting that eight counties in Arizona, California, Florida, and Nevada were responsible for one quarter of all foreclosures in the U.S. in 2008). *See generally* Prashant Gopal, *Florida Condo Owners Footing Bill for Foreclosures*, BLOOMBERG BUS. WK. (Nov. 29, 2007), http://www.businessweek.com/the_thread/hotproperty/archives/2007/11/florida_condo_o.html (detailing results of the 2009 Florida Community Association Mortgage Foreclosure Survey). Florida is also one of the states most impacted by the housing crisis in general.

308. *See* MAUREEN F. MAITLAND & DAVID M. BLITZER, S&P/CASE-SHILLER HOME PRICE INDICES 2009, A YEAR IN REVIEW 5–6 (2010), *available at* http://www.standardandpoors.com/indices/index-research/en/us/?type=All&category=Economic (follow "S&P/Case-Shiller Home Price Indices: 2009 A Year In Review (PDF)" hyperlink) (showing double-digit rise in home prices in Florida, followed by a precipitous decline as the real estate market went into crisis); Haya El Nasser, *Florida Growth Outpaces National Trend*, USA TODAY (Mar. 22, 2011, 3:25:38 PM), http://www.usatoday.com/news/nation/census/2011-03-17-florida-census_N.htm (comparing growth rates in Florida to the rest of the country); *see also South Florida Absorbs Growth Across the Board*, SE. REAL EST. BUS. (Sept. 2005), http://www.southeastrebusiness.com/articles/SEP05/highlight2.html (enthusiastically discussing the robust growth of the real estate market in Florida—which in hindsight seems ironic and naïve).

309. *See, e.g.*, Richard Peep, *Condo Culture: How Florida Became Floridistan*, NEWGEOGRAPHY (May 22, 2011), http://www.newgeography.com/content/002245-condo-culture-how-florida-became-floridastan (telling of the appeal and growth of condominium developments and investment properties in Florida in the 1990s).

attracted many real estate investor-buyers,[310] and the demographics of the state—in particular, the high percentage of retired persons—made low-maintenance/high amenity housing particularly appealing. But this same demographic makes the population more vulnerable to escalating monthly housing costs. Because of these factors, Florida today presents the most extreme case of foreclosure delay spillovers and community governance insolvency. This foreclosure delay is rampant: there are ample news reports of lenders' strategic postponement of public auctions,[311] and the average foreclosure now takes longer than a year and a half.[312] Although the amended Florida law permits a capped recovery after mortgage foreclosure of an amount equal to the lesser of twelve months' worth of unpaid association assessments or 1% of the outstanding mortgage loan amount,[313] in most cases this limited amount will not cover all of an association's unpaid assessments.

Florida attorneys representing community associations have become very creative in seeking recovery for their clients. One particularly interesting tactic has been termed a "reverse foreclosure."[314] To achieve a reverse foreclosure, the association must first foreclose on its assessment lien and take title to a delinquent unit subject to the first mortgage lien.[315] The association, as now-owner of the property, files a motion for summary judgment in the mortgage lender's own foreclosure action, seeking judgment in favor of the lender.[316] The association

310. A majority of the condominium units in Florida in 2007 were non-owner occupied (investor properties). *See* Shimberg Ctr. for Affordable Hous., *State of Florida's Housing, 2007 Executive Summary*, AFFORDABLE HOUS. ISSUES, Apr. 2008, at 1, 3, *available at* http://www.shimberg.ufl.edu/pdf/Newslet-Apr08.pdf (listing statistics for owner-occupied condos in Florida).

311. *See, e.g.*, Coleman, *supra* note 104, at 1A ("[L]enders are in no hurry to take back delinquent units, only to have to turn around and sell them amid a market that has crashed.").

312. Interview with Kevin Miller, Attorney (Oct. 2010) [hereinafter Miller Interview] (notes on file with author).

313. S.B. 1196, 2010 Sess. (Fla. 2010) (codified at FLA. STAT. § 718.116 (2010)).

314. *See* Coleman, *supra* note 104, at 1A (describing reverse foreclosures as a "a tool that can force banks to pay association maintenance fees when unit owners don't); Susannah Nesmith, *Ruling Could Give Embattled Associations Relief*, DAILY BUS. REV. (Jan. 27, 2010), http://www.law.com/jsp/article.jsp?id=1202466596282 (describing a "reverse foreclosure" ruling in a Miami-Dade Circuit Court case forcing a bank to take title to a property from a homeowner association); Paul Brinkman, *Miami Judge Grants Reverse Foreclosure*, S. FLA. BUS. J. (Jan. 25, 2010, 4:04 PM), http://www.bizjournals.com/southflorida/stories/2010/01/25/daily10.html (quoting attorney Ben Solomon, who notes that reverse foreclosures reverse "will finally help associations force banks to take title to financially upside down units much faster than ever before"); *"Reverse Foreclosure" Makes Banks Accountable to HOA*, FLA. L. J. (Jan. 25, 2010), http://www.thefloridalawjournal.com/2010/01/reverse-foreclosure-makes-banks-accountable-to-hoa/ (noting reverse foreclosure is a legal strategy for condominium and homeowners associations to prevent banks from stalling foreclosures).

315. *See* Nesmith, *supra* note 314 (describing the procedures for enforcing a reverse foreclosure).

316. *Id.*

waives all claims for notice and sale of the property under Florida's foreclosure laws and moves that the court immediately order the title to be transferred to the lender.[317]

Keys Gate Community Association successfully employed the reverse foreclosure approach on a home to which it had taken title in 2007 after the owners stopped paying assessments.[318] The first mortgage lender on the unit, HSBC Bank USA, filed its own notice to foreclose two months after the association took title, but the foreclosure sale never happened.[319] Finding itself stuck with an empty house and two-and-one-half years worth of unpaid dues (over $5000), the association attempted the new strategy of moving for summary judgment in favor of the mortgage lender.[320] In January 2010, Miami-Dade Circuit Judge Jerald Bagley accepted the association's argument and ordered title immediately transferred to HSBC, making it liable for all future community assessments.[321] The court also ordered HSBC to pay the association's legal fees and court costs in connection with the reverse foreclosure action as well as the capped lien priority amount that trumped the first mortgage lien. Because this amount was capped, the association had to write off $3820 in unpaid fees, but at least the long delay in finding a financially responsible unit owner was finally over.[322] As Keys Gate attorney Ben Solomon put it, "[t]he quicker we can move these distressed properties through the process and into the hands of somebody who will pay a mortgage and pay taxes and pay their dues, the quicker we can get the economy back on track."[323]

In the wake of the Keys Gate success, the reverse foreclosure strategy gained popularity during early 2010.[324] Ben Solomon's firm, Association Law Group, filed eighty-three foreclosures around the state,

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317. *Id.*; Paul Owers & Lisa J. Huriash, *Fighting Over Foreclosures—Homeowner Associations Target Delinquent Tenants, Lax Lenders*, SUN SENTINEL, Aug. 10, 2010, at 1A.

318. HSBC Bank USA v. Keys Gate Cmty. Ass'n, Inc. No. 07-18411 CA 09 (Fla. Jan. 12, 2010).

319. *Id.*

320. Coleman, *supra* note 104, at 1A.

321. Peter L. Mosca, *Florida Court Decision Could Impact Builders and Bank Foreclosure Processes*, REALTY TIMES (Feb. 17, 2010), http://realtytimes.com/rtpages/20100217_florida court.htm.

322. *Id.*; *see also* Coleman, *supra* note 104, at 1A (describing Keys Gate Community Association's use of the reverse foreclosure tactic).

323. Nesmith, *supra* note 314.

324. *See Ruling May Help Homeowner Associations*, HIST. CITY NEWS (Feb. 5, 2010), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546 (noting that some firms have been in favor of reverse foreclosure to avoid paying past due fees).

with varying success.[325] The reverse foreclosure concept is novel, and both judges and lenders were confused by the summary judgment motion.[326] Some courts did not realize that the association in such cases was arguing for judgment for the lender; some lenders did not realize this either. While the Miami-Dade judges have been receptive to the idea of a reverse foreclosure, no district court has yet considered and approved the tactic.[327]

In some cases, the exotic nature of the reverse foreclosure claim caused lenders to just walk away. For example, Citibank responded to a reverse foreclosure motion by just writing off the entire mortgage debt, leaving the association owners owning the unit.[328] However, the association had hoped to win a financially competent owner by losing the foreclosure case, and by winning the case, the association lost access to the bank's deep pocket for future assessment costs.[329]

The reverse foreclosure strategy is interesting, but it is legally cumbersome and unpredictable. In addition, this judicial tactic is limited to situations where (a) the association has previously foreclosed on its lien, subject to a first mortgage lien, and (b) the first mortgagee has already filed a foreclosure action. If a lender has not yet commenced a court action for foreclosure, no summary judgment motion can be filed. In addition, the reverse foreclosure requires the unreimbursed costs of the association's own foreclosure action. Furthermore, the entire recovery by the association in Florida is capped at 1% of the outstanding mortgage loan or twelve months of assessment costs.[330] If the unit in default already has a tenant, there is an even better option available to the association. Under the 2010 amendment, the association can collect rents from a defaulting unit without having to foreclose or file a motion in a lender's proceeding, which may permit a more immediate and greater recovery for the community.[331]

Association lawyers in Florida have made other attempts to find an avenue for recourse within the existing legal framework. The Association Law Group pioneered a tactic they call "The Mortgage Terminator" to wipe out a mortgage lien in cases where an association has foreclosed on the unit and the mortgage lender has not commenced

325. Solomon Interview, *supra* note 281.
326. *Id.*
327. Miller Interview, *supra* note 312.
328. Sutta, *supra* note 6.
329. *See id.* (discussing Citibank's willingness to hand over title).
330. FLA. STAT. ANN. § 718.116.(1)(b)(1)(a)-(b) (West 2011).
331. *Id.*

foreclosure proceedings.[332] The association title-holder of the property brought its own case against Wells Fargo in a Broward County case in 2010, claiming that the bank lost its equitable claim to its real estate collateral by deliberately delaying commencement of foreclosure proceedings.[333] The court agreed and wiped out the mortgage lien.[334]

In another case where the lender strategically delayed foreclosure, the condominium association sued to force the lender to act. The trial court, in *United States Bank National Ass'n v. Tadmore*, found the association's arguments compelling and ordered the lender to "diligently proceed with the pending foreclosure action . . . or pay monthly maintenance fees on the condominium unit in foreclosure."[335] The court based its holding on its general equitable powers, concluding that the association was unreasonably prejudiced by the lender's deliberate delay in pursuing foreclosure.[336] Thus, the court reasoned that it was fair and equitable to order the lender to pay monthly assessments even prior to foreclosure.[337] The trial court decision in *Tadmore* at first sparked a flurry of interest in the concept of using equity to force an expeditious foreclosure, but the holding was short-lived. The appellate district court in *Tadmore* reversed, holding that the lender could not be obliged to pay condominium assessments on a unit it did not (yet) own.[338] There was no contractual obligation to pay those fees, and no obligation would arise until the lender acquired title.[339] Although the association's claim was made in equity, the court of appeals held that equity could only follow the law, not divert from it.[340]

Other associations pin their hopes on provisions in the Florida foreclosure statute that mandate a foreclosure sale to be scheduled no sooner than twenty and no later than thirty-five days after court

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332. Daniel Vasquez, Broward *Case May be First of Many*, MIAMI HERALD (Oct. 10, 2010), http://www.algpl.com/news/press/MH-Oct-10-2010.pdf.

333. *Id.*

334. *Id.*

335. U.S. Bank Nat'l Ass'n v. Tadmore, 23 So. 3d 822, 822 (Fla. Dist. Ct. App. 2009).

336. *Id.* at 823.

337. *Id.*

338. *Id.*

339. *Id.*

340. The court noted that "equity follows the law" and reasoned that therefore, equity "cannot be utilized to impose this obligation without limitation before title is passed." *Id.* While the *Tadmore* approach was creative, it is unsurprising that the trial decision was reversed. There is a long-standing view that each lienholder can determine its own foreclosure timing. *See* NELSON & WHITMAN, *supra* note 58, at 612 (stating that a foreclosure on a junior lien cannot affect a senior mortgagee's interest because the senior should be allowed to choose when to sell).

filing.[341] Although Florida attorney Kevin Miller opines that an association might be able to claim violation of this provision when foreclosure is unduly delayed, lenders uniformly have maintained that the provision creates remedies for the mortgagee alone.[342] In addition, an association, as a junior lienholder, could ask the court for a management conference for the foreclosure case according to a procedural rule designed to move cases along.[343]

The Florida statute leaves unanswered the question of how far association documents can go to enhance the scope and priority of the assessment lien.[344] Citing the statutory provision giving mortgage lenders priority over association liens,[345] the court in *Coral Lakes Community Ass'n, Inc. v. Busey Bank, N.A.*, for example, refused to hold a foreclosing lender jointly and severally liable with its borrower for unpaid assessments despite language in the declaration to that effect.[346] In an earlier case with similar declaration language, however, a Florida district court held that a wholly-owned subsidiary of the mortgage lender who acquired title at foreclosure would be deemed a third party not entitled to protection by the assessment priority cap[347] and thus, could be sued personally for the entire unpaid assessment amount.[348] The details of which entities could and could not be sued personally for unpaid assessments, based on language in the association's declaration, could end up being quite complicated as the disputes regarding transfer of mortgages muddy the question of which entity holds what interest in the property. The Florida statute is unclear, and Florida laws are inconsistent on this point.

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341. FLA. STAT. ANN. § 45.031 (1) (a) (West 2011).

342. Miller Interview, *supra* note 312. Even if courts agreed with the association's arguments with respect to this provision, there would be no way to use the statute to force lenders to commence a foreclosure proceeding.

343. *Id.*

344. A fifteen-year-old Florida case suggests that total super-priority of an association lien could be created by the association declaration. Holly Lake Ass'n v. Fed. Nat'l Mortg. Ass'n, 660 So. 2d 266, 269 (Fla. 1995). The hope that such precedent would endure has been chilled by a more recent Florida decision where the association documents provided that any subsequent parcel owner "regardless of how his or her title has been acquired, including by purchase at a foreclosure sale" is personally, jointly and severally liable for all unpaid assessments, along with the prior delinquent owner. Coral Lakes Cmty. Ass'n, Inc. v. Busey Bank, N.A., 30 So. 3d 579, 582 (Fla. Dist. Ct. App. 2010).

345. FLA. STAT. ANN. § 720.3085 (6) (West 2010).

346. *Coral Lakes Cmty. Ass'n, Inc.*, 30 So. 3d at 584.

347. FLA. STAT. ANN. § 718.116(1) (West 2010).

348. Strangely, the court held that the statutory limitation on post-foreclosure recovery of assessments applied only to limit a lender-purchaser at foreclosure, leaving a third-party foreclosure purchaser fully responsible for unpaid assessments. Bay Holdings, Inc. v. 2000 Island Blvd. Condo. Ass'n, 895 So. 2d 1197, 1197 (Fla. Dist. Ct. App. 2005).

3. True Lien Priority: An Analogy to Property Taxes

Community associations function like governments: they perform public functions and are funded by assessments paid by their citizenry. In fact, the trend over the past few decades has been for public governments to assign to private communities more and more responsibility for services that a municipality would otherwise provide.[349] Community governance and upkeep costs incurred by municipalities are funded through property taxes, and unpaid property taxes are secured by a lien on the subject property that enjoys true super-priority status. Unpaid taxes are therefore paid first (or remain burdening the property) at the foreclosure sale. The simplest solution to the CIC tragedy of the commons posed by unpaid and uncollectable assessments would be to grant true priority to liens securing such amounts, analogizing the assessments to property taxes. If association liens were granted complete and true priority over mortgage liens, then the association foreclosure would necessarily bring mortgage lenders "to the table" to pay for their collateral upkeep charges or to participate in a joint foreclosure proceeding.

On the one hand, an analogy between community assessments and property taxes is compelling; both governments offer public upkeep to a community such as paving, snow removal, and open space maintenance. In these ways, the community functions like a municipality proxy by providing services to the public.[350] In fact, taxpayers who live in New Jersey CICs have successfully claimed the right to offset a portion of their community assessments from property taxes based on a double taxation complaint.[351] However, this analogy can only be taken so far. Many community-provided amenities are actually a supplement to municipal services rather than their replacement, and in the vast majority of states, assessments are not legally considered local "taxes."[352] To the extent that community services provide private community benefits (such as amenity upkeep), they represent individual

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349. *See* TREESE ET AL., *supra* note 16, at 6 (stating that government privatizes its functions, requiring community associations to fulfill an otherwise municipal obligation).

350. The town of Reston, Virginia was the first CIC and provides many municipal government services. RESTON ASSOCIATION, http://www.reston.org/default.aspx?qenc=HzT9ACzZbNs%3d&fqenc=HzT9ACzZbNs%3d (last visited Aug. 1, 2011).

351. *See* HYATT, *supra* note 15, at 133 (citing Borough of Englewood Cliffs v. Estate of Allison, 174 A.2d 631, 640 (N.J. Super. Ct. 1961)) (reasoning that a property's true value does not include value of public rights transferred to a community).

352. Assessments are not deductible from federal and state tax impositions, for example, even when the community association services are a proxy for services normally provided by local municipalities. *See* HYATT, *supra* note 14, at 106 (arguing that community associations target assessments in a manner that local government cannot).

property-carrying costs rather than funding a benefit to the broader public, akin to property taxes.

Lenders would likely have strong objections to the idea that community assessments should be granted true priority by virtue of their tax-like function and likely will predict the disappearance of home mortgage credit should such a rule be adopted.[353] Nevertheless, having property taxes prime the mortgage lien has not dissuaded lenders from making mortgage loans. Lenders routinely protect themselves against any superior-priority payment obligation of their borrowers through establishing property tax escrow accounts. Lenders could demand similar escrow accounts for community assessments.[354] In fact, current Fannie Mae and Freddie Mac forms already specifically anticipate escrow account mandates for such amounts.[355]

4. Consent and Control by Community Members

Unlike a mortgage lender, who has the ability to perform a credit inquiry and refuse to lend money to a financially risky borrower, homeowners in condominiums and homeowner associations have no ability to force their neighbors to disclose the details of their finances. Even if this information were available, owners currently have little ability to control who buys properties in their community. One potential solution to the problem of financial interdependence in privately governed communities, however, would be to permit communities to perform credit diligence regarding prospective new members and control entry into the association. Washington, D.C. lawyer Benny Kass has suggested this type of solution: enable community boards of directors to approve or disapprove all potential purchasers of units.[356]

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353. The vigorous opposition mounted by the mortgage banking lobbyists to attempts to institute even a limited lien priority in states such as Ohio is a case in point. *See* Fisher, *supra* note 294, at 01B.

354. Such escrow accounts, however, might be more administratively expensive than those for insurance and taxes because many CICs assess monthly rather than yearly or bi-yearly.

355. *See* EFANNIEMAE.COM, https://www.efanniemae.com/sf/formsdocs/documents/sec instruments/ (last visited July 30, 2011) (providing mortgage documents by state). Associations, on the other hand, are vastly more limited in their ability to create property-specific escrow accounts upon, say, resale. Unless community documentation so provides, any efforts would be struck down as *ultra vires*.

356. Benny Kass, *Foreclosures are Impacting Condominium Projects*, REALTY TIMES (Apr. 30, 2007), http://realtytimes.com/rtnews/reu2pages/bennykass.htm?open&Vol=32&ID=715 realty (posing the question: "If the lenders will not screen their borrowers, why should a community association have to suffer by having a new owner who will not be able to meet his/her financial obligations to the association?").

Cooperatives have long had such ability to control the identity of their members.[357] New York cases have repeatedly upheld pre-approval provisions in cooperative documents and even individual denials of approval for cooperative membership based on criteria as indirectly relevant as an applicant's fame or legal training.[358] The justification for legally permitting such practices in cooperatives is typically its disparate ownership structure: owners are co-investors in an entity that holds title to the building in addition to being tenants of their particular unit. Financing of the building occurs at two levels: through the entity title holder and at the individual-unit-owner level. Because of this increased financial interconnectedness, courts have opined that cooperatives should be able to self-select their members.[359] In the context of condominiums and homeowner associations, however, power to disapprove would-be unit purchasers would be more problematic, opening a Pandora's Box of discrimination. The possible danger posed by such a solution underscores the importance of finding and enacting a viable solution through the priority law instead.

Property law is hostile to restraints on alienation, and courts suspiciously scrutinize restrictive covenants limiting the ability of an owner to sell his or her property. Economic theory in general argues for

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357. Cooperatives must still abide by the Fair Housing Act and may not discriminate based on membership in a protective class. Robinson v. 12 Lofts Realty, Inc., 610 F.2d 1032, 1036 (2d Cir. 1979).

358. *See, e.g.*, Weisner v. 791 Park Ave. Corp., 160 N.E.2d 720, 724 (N.Y. 1959) ("[T]here is no reason why the owners of the co-operative apartment house could not decide for themselves with whom they wish to share their [building]."); DeSoignies v. Cornasesk House Tenants' Corp., 800 N.Y.S.2d 679, 682 (N.Y. App. Div. 2005) (upholding the board's absolute right to control leasing "for any reason or no reason"); Simpson v. Berkley Owner's Corp., 623 N.Y.S.2d 583, 583 (N.Y. App. Div. 1995) (the cooperative board "had the right to withhold their approval of petitioners' purchaser for any reason or no reason"); Bachman v. State Div. of Human Rights, 481 N.Y.S.2d 858, 859–60 (N.Y. App. Div. 1984) (upholding the denial of a transfer of shares in an apartment because it was not discriminatory); Goldstone v. Constable, 443 N.Y.S.2d 380, 381–82 (N.Y. App. Div. 1981) (holding that "directors of this cooperative housing corporation have the contractual and inherent power to approve or disapprove the transfer of shares and the assignment of proprietary leases, absent discriminatory practices prohibited by law"). Cooperative boards have refused to permit owners to transfer units to many famous individuals, including Madonna, Gloria Vanderbilt, Mariah Carey, Calvin Klein, Antonio Banderas, Melanie Griffith, and former President Richard Nixon. MARRIANE M. JENNINGS, REAL ESTATE LAW 255 (8th ed. 2008) (citing Ellen Wulthorst, *New York Apartment Buyers Face Powerful Co-Op Boards*, EPOCH TIMES, Jan. 27–Feb. 2, 2005, at 13); *see also* Harvey S. Epstein, Note, Weisner *Revisited: A Reappraisal of a Co-op's Power to Arbitrarily Prohibit a Transfer of its Shares*, 14 FORDHAM URB. L.J. 477, 481–85 (1985–1986) (explaining that cooperative boards in New York arbitrarily prohibit transfer of residences, and applicants are subject to increasing scrutiny). For a current dispute involving the famous Dakota complex in Manhattan's Upper West Side, see Basil Katz, *Lawsuit Peeks into World of New York City Co-ops*, REUTERS, Feb. 3, 2011, *available at* http://www.reuters.com/article/2011/02/03/us-housing-newyork-idUSTRE7129IR20110203.

359. Subject to anti-discriminatory limitations imposed by the Fair Housing and the Civil Rights Acts.

free alienation of property so that society may achieve the property's highest and best use, as well as maximize its value.[360] Although free alienation increases individual member risks in the context of the entangled finances of a common interest community, courts typically strike down consent requirements as incompatible with fee simple absolute ownership rights.[361] Even explicit contract regimes restricting free transferability in the name of community, harmony, and joint objectives have been struck down as a restraint on alienation that is repugnant to the fee simple.[362] Retaining the right to approve purchasers through a covenant regime impermissibly recalls feudal controls; courts have consistently refused to enforce such restrictions.[363]

An association's right of first refusal to purchase a unit has been upheld, however, because an owner can be made economically whole by selling to the association in lieu of an objectionable buyer.[364] But such a provision will inadequately protect the financial interests of the community because it requires the community itself to fund the purchase and upkeep of a unit as the only way to block a prospective buyer. This is even more financially burdensome than permitting a prospective buyer to take title and then incur the costs of enforcing assessment obligations.

Although it is difficult to force bare approval requirements limiting an owner's ability to sell his unit in a condominium or homeowner association, it is very ordinary in a common interest community to control an owner's ability to rent a unit. Absolute prohibitions on renting are sometimes claimed to be an unreasonable restriction of fee title, but courts typically enforce initial limits on renting (an owner must occupy the unit for the first year, for example); limits on short-term

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360. JOSEPH WILLIAM SINGER, PROPERTY LAW: RULES, POLICIES, AND PRACTICES 450 (4th ed. 2006).

361. *See, e.g.*, Northwest Real Estate Co. v. Serio, 144 A. 245, 246 (Md. 1929) (holding that limitations on restraint of alienation are invalid).

362. *See, e.g.*, Riste v. E. Wash. Bible Camp, Inc., 605 P.2d 1294, 1295 (Wash. Ct. App. 1980) (holding that a clause preventing a grantee from transferring title for fee simple without approval from the grantor is a restraint on alienation and therefore void).

363. *See, e.g.*, Aquarian Found., Inc. v. Sholom House, Inc., 448 So. 2d 1166, 1169 (Fla. Dist. Ct. App. 1984) (holding that an association's right to withhold consent to a unit's transfer was "obviously an absolute restraint on alienation" because the association was not required to purchase the unit at fair market value itself upon refusing consent); *Northwest Real Estate Co.*, 144 A. at 246 (striking down as "clearly repugnant to fee-simple title" a deed covenant providing that land may not be subsequently sold without consent of the grantor); *Riste*, 605 P.2d at 1294 (refusing to enforce a restriction for a CIC limiting sale of land to persons approved by the seller church).

364. *See, e.g.*, Wolinsky v. Kadison, 449 N.E.2d 151, 155 (Ill. App. Ct. 1983) (holding that an association may exercise its right of first refusal after considering a prospective buyer's qualifications).

leasing (no leases with a term less than six months, for example); and even limits on the number of units in a community that can be rental-occupied at any time.[365] Such leasing limitations are typically upheld even when they are created in non-unanimous amendments to the governing documents.[366] Not only do courts enforce aggregate limitations on the percentage of units in a CIC that can be rented at any one time, but Fannie Mae, Freddie Mac, and the FHA have issued guidelines that limit the percentage of a community that can be rented out, likely as a proxy for financial health of the community.[367]

Although permitting association boards to exercise approval rights over sales might be judicially justified as an extension of the broad enforcement of leasing restrictions boards already can exercise in any case, it would be bad policy to rely on board diligence and approval as a way to protect the community's financial health, and this approach should be avoided. From a legal standpoint, requiring prior approval of purchasers would create a hardship for owners who are trying to sell, and indeed the approval right is repugnant to the fee. Such a requirement would mean that a would-be seller would not only have to find a willing buyer, but would also have to prove that the candidate was a credible financial risk. In a tight market, the hardship and delay caused by this requirement would further freeze out sales of units and would increase the possibility that an owner would default instead of re-selling.

In addition, the power to approve buyers is fraught with the potential for abuse by other members of the association, and to solve one problem (uncollectable assessments) by creating others (too much board power limiting freedom to transfer property and the potential for insidious discrimination) is nonsensical. These problems are already rampant and difficult to resolve in co-ops.[368] Further, using the CIC structure to

365. Woodside Vill. Condo. Ass'n, Inc. v. Jahen, 806 So. 2d 452, 462 (Fla. 2002) (holding that a leasing restriction was reasonable).

366. *See* Apple II Condo. Ass'n v. Worth Bank & Trust, 659 N.E.2d 93, 97 (Ill. App. Ct. 1995) (holding that the leasing restrictions were a valid exercise of association authority). Even disparate impact based on race does not invalidate a leasing restriction. *See* Villas West II of Willowridge v. McGlothin, 841 N.E.2d 584, 601 (Ind. Ct. App. 2006) (refusing to hold that every discriminatory action is illegal), *vacated*, 885 N.E.2d 1274 (Ind. 2008).

367. Fannie Mae and Freddie Mac will not buy loans secured by properties in common interest communities where more than 49% of the units are occupied by tenants rather than owners. *See* FANNIE MAE, CONDOMINIUM PROJECT REVIEW: OPTIONS FOR PROJECT APPROVAL 1–2 (2010), *available at* https://www.efanniemae.com/sf/refmaterials/approvedprojects/pdf/condoprojectreview.pdf (outlining the requirements for project approval); FREDDIE MAC, FREDDIE MAC CONDOMINUM UNIT MORTGAGES 3 (2011), *available at* http://www.freddiemae.com/learn/pdfs/uw/condo.pdf (outlining more requirements for project approval).

368. *See* Matt Chaban, *Board to Death: As Co-ops Swagger Back from the Brink, Brooklyn Pols Plot Their Demise*, N.Y. OBSERVER (Apr. 26, 2011), http://www.observer.com/2011/real-

create legal limits on a seller's right to transfer to certain types of borrowers harkens back to the days of racial discrimination because the perpetuation of racial segregation was the initial motivation for forming many early suburban CICs.[369]

The unsavory history of homeowner associations—still obvious from many first-generation restrictive covenants in the land records—reveals a dark side of private governments: racially segregated neighborhoods where restrictive covenants contractually barred would-be sellers from selling to certain would-be buyers based on pernicious discriminatory criteria. The U.S. Supreme Court in *Shelley v. Kraemer* held with tortured legal reasoning that racially-based restrictive covenants were unenforceable under the Fourteenth Amendment because the enforcement of a contract to discriminate would amount to government action.[370] Then, Congress passed the Fair Housing Act, which made discriminatory sale restrictions illegal and invalid.[371] Today, because of that Act, decisions to rent or sell housing may not lawfully be based on "race, color, religion, sex, familial status, or national origin."[372]

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estate/board-death-co-ops-swagger-back-brink-brooklyn-pols-plot-their-demise (reporting that cooperative boards in New York need not disclose the reason for disapproving a prospective member and that it remains difficult and unpredictable to obtain board approval and sell or buy in a cooperative in New York); *see also* Bay Holdings, Inc. v. 2000 Island Blvd. Condo. Ass'n, 895 So. 2d 1197, 1197 (Fla. Dist. Ct. Ap. 2005) (upholding a statutory cap that limits a first mortgagee's liability for unpaid assessments). A current bill proposes requiring cooperatives to provide a statement of the reasons for refusing consent to a transfer. A. 8347 § 1, 2011–2012 Reg. Sess. (N.Y. 2011), *available at* http://open.nysenate.gov/legislation/api/1.0/lrs-print/bill/A8347-2011. Several such bills have been introduced in the past. John Barone, *Limiting the Autonomy of Cooperative Apartment Corporation Governing Boards*, 2 CARDOZO PUB. L. POL'Y & ETHICS J. 179, 179 (2004).

369. In fact, many community association documents on the land records still contain racial occupancy clauses. Even though such clauses have no legal force today, their continuing existence in the chain of title serve as an unfortunate reminder of one of the initial motives of community ownership structures. It is well near impossible to strike such language from the record. *See* Stephen Magagnini, *Reminders of Racism, Old Covenants Linger on Records*, SACRAMENTO BEE, Jan. 17, 2005, at A1 (reporting on the difficulty of removing a restrictive racial occupancy clause from a Sacramento community association's property records).

370. 334 U.S. 1, 19 (1948) (holding that state action existed when a court enforced racial restrictions). The holding of *Shelley* has continually perplexed legal theorists because it was decided in the 1940s. *See, e.g.*, Francis A. Allen, *Remembering* Shelley v. Kraemer*: Of Public and Private Worlds*, 67 WASH. U. L. Q. 709, 710–12 (1989) (arguing that the significance of *Shelley* changes over time); Lino Graglia, *State Action: Constitutional Phoenix*, 67 WASH. U. L. Q. 777, 787 (1989) (stating that of the Supreme Court cases regarding state action, the *Shelley* holding is the most criticized); Mark Tushnet, Shelley v. Kraemer *and Theories of Equality*, 33 N.Y. L. SCH. L. REV. 383, 384–85 (1988) (arguing that the substantive holding in *Shelley* was identical to the state action holding).

371. Fair Housing Act of 1968, 42 U.S.C. §§ 3601–3619 (2006).

372. 42 U.S.C. § 3604 (2006).

On the one hand, it is perhaps too soon in our history to give blanket membership approval power to community associations because the original *raison d'etre* of homeowner associations was to keep certain people out of them.[373] If such power existed, courts would necessarily need to exercise some sort of oversight scrutiny to assess the reasonableness of any approval or denial to make sure it did not violate the provisions of the Fair Housing Act or otherwise impermissibly bar alienability of property. The benefits of any self-protecting membership approval empowerment, therefore, must be balanced against the costs of potential discrimination and the cost of judicial efforts needed to police appropriate disapprovals of neighbor sales.

Mortgage lenders (theoretically) already do credit diligence on would-be buyers in communities as part of their underwriting.[374] It would be costly and difficult to force an association to inquire as to credit scores, employment, and salary. Such inquires would also be unnecessary in cases where another entity is already assessing these exact same criteria for a would-be buyer—namely, his or her mortgage lender. It would be wasteful and inefficient to require the non-expert volunteer directors to try to replicate this effort.

Because neighbors do not (and probably should not) have the ability to do financial investigations of would-be buyers in their community, association members cannot manage their own risks in this regard. Mortgage lenders, on the other hand, are best able to do such investigations at the lowest cost because they specifically assess the financial health of potential borrowers and can set the terms or limit the availability of mortgage loans accordingly.[375]

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373. *See supra* note 370 and accompanying text.

374. From 2000 to 2007, many mortgage originators neglected to do any credit diligence or at least did a terrible job. *See* Yuliya Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, 24 REV. FIN. STUD. 1848, 1873–75 (2011) (showing a decrease in the spread between prime and subprime mortgages, which is typically used to compensate lenders for the increased risk of subprime mortgages, concluding that the decrease in this spread was not sustainable, and indicating that loosening underwriting standards was one of the factors). In 2006, Steven Krystofiak, president of the Mortgage Brokers Association for Responsible Lending, submitted a written statement into the record of a Federal Reserve public hearing on mortgage regulation, reporting that his organization had compared a sample of 100 stated income mortgage applications to IRS records and found almost 60% of the sampled loans had overstated their income by more than 50%. *Inside the Liar Loan: How the Mortgage Industry Nurtured Deceit*, SLATE MAG. (Apr. 24, 2008, 11:25 AM), http://www.slate.com/id/2189576 (citing Written Statement of Krystofiak, President, Mortgage Bankers Association for Responsible Lending, Building Sustainable Homeownership: Public Hearing on the Home Equity Lending Market Before the Federal Reserve Bank of San Francisco (June 16, 2006), http://www.federalreserve.gov/seers/2006/august/20060801/op-1253/op-1253_3_1.pdf).

375. Mortgage lenders also perform collateral due diligence (property appraisals) and are therefore well-situated to prevent a property from being so over-burdened with debt that a

B. Eroding Mortgage Priority

1. Equitable Reallocation of Payment Default Costs

Capped recoveries and limited priority liens are ineffective in a climate of underwater loans and long foreclosure timelines. Reverse foreclosures and other creative litigation strategies may obtain relief in certain situations but are inadequate to generally protect communities from the fallout of foreclosure freezes. Although there is some appeal to analogizing assessments to property taxes and granting a true priority status to assessment liens, it would be almost impossible for such a proposal to garner sufficient political support to pass. Allowing community members more extensive approval rights over property transfers within their community raises property and liberty rights concerns that vastly outweigh the benefits of permitting self-policing due diligence in sales. The best party to perform credit diligence of new (or refinancing) members in a CIC is the party already performing this role: the mortgage lender.[376] The best party to control for unrealistic loans, sloppy foreclosure proceedings, and unwarranted delays is also the mortgage lender. Thus, the mortgage lender should bear costs occasioned by its failure to diligently protect against the foreseeable externalities of its lending activities. In a situation where the property is underwater, the only party with a valuable interest in the property is the mortgage lender. The lender, as the sole property interest holder in this case, should bear the upkeep costs that protect and enhance the value of its security pending foreclosure.

Statutes should be passed in each state to create proper incentives for lenders to monitor or pay assessment delinquencies. Rather than relying on limited-priority liens, this proposal—an eroding first priority for first mortgage liens—would treat the priority position of a lender's first lien as conditioned upon foreclosure within a certain amount of time after mortgage default (e.g., six months). Thereafter, every month of unpaid assessments would become secured by a lien superior in payment priority to the first mortgage. Importantly, such a lien would have no upside cap, meaning recovery by the association would theoretically be unlimited, while the maximum paid by the neighbors would be limited. Such an eroding mortgage approach would cap the loss to the association rather than the loss to the lender, which is appropriate because it is the lender who controls the timing of the foreclosure sale.

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foreclosure sale will not net sufficient proceeds to cover obligations secured by the property.

376. *See supra* note 375 and accompanying text (noting that mortgage lenders perform collateral due diligence).

Under this proposal, the priority of the assessment lien would effectively erode the first priority of the mortgagee. This would likely incentivize lenders to pay assessments on behalf of their borrowers who are delinquent and add such costs to the debt. Most mortgage instruments already permit lenders to do this. Increased lender responsibility for its share of community upkeep might also motivate more expeditious foreclosure proceedings. Either way, the costs borne by an association would be minimized.[377] This better cost allocation regime would make sure that lenders are no longer distorted in their foreclosure timing analyses, which would ensure that delays in foreclosure result from relevant loan and market factors, not from a lender's mere desire to free-ride by avoiding collateral upkeep costs.

Lenders would reasonably respond to such a law by making a better credit evaluation prior to advancing funds regarding a borrower's ability to pay not only the mortgage loan but also the applicable assessments. Lenders would also have even more reason to ensure an accurate appraisal of collateral value. Any change in the legal framework of home lending that achieves this outcome is likely beneficial to individuals and the economy as a whole.[378] Also, such an evaluation currently cannot be done by the association itself, but it can be easily and cheaply achieved by lenders.[379] Lenders might respond to such a law by establishing an escrow account for association assessments, similar to accounts lenders already require for property tax and insurance amounts (and as already anticipated by Fannie Mae and Freddie Mac form instruments).[380] Finally, this law would motivate lenders during foreclosure to pay outstanding assessments to avoid incurring additional costs and fees. Having an assessment back-up source would benefit all property values in the community and keep other owners from being penalized for having delinquent neighbors. Lender-funded upkeep also avoids the situation of unjust enrichment that currently exists when neighbors end up paying for the upkeep on mortgaged properties for which they hold no interest.

Allowing a first mortgage lender's priority to erode over time as foreclosure is delayed is therefore both equitable and efficient.

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377. Reasonable collection costs should be included in the priority lien amount; however, this proposal does raise the important question of collection cost and late fee abuses, discussed *infra* Part II.B.4.

378. *See generally supra* Part I.A.2 (discussing the negative externalities of constructive abandonment).

379. Lenders today are evaluating not only their borrowers' ability to pay assessment obligations, but also the ability of all other owners in the community to pay their assessments.

380. *See supra* note 354 and accompanying text (noting that lenders routinely establish property tax escrow accounts to protect themselves against superior priority payment obligations).

Uncapping lender liability for assessments will lead to assessment obligations being met more frequently by someone. This approach will also create a disincentive for irresponsible delays in foreclosure and, unlike the six-month limited-priority regime, will continue to be effective even if foreclosure does take a long time to complete. A system of eroding mortgage priority could allocate some limited portion of unpaid assessments to a community or could allocate all unpaid amounts to the lender, depending on when the lien erosion "clock" would start.[381]

Unlike the limited lien priority system, an eroding first priority system will not merely reduce association losses—it will tangibly improve community stability. Because responsible neighbors will be insulated from default spillover, recovery can occur; investors can purchase units secure in the knowledge that their investment is not subject to the unforeseeable and uncontrollable default rates of neighboring property loans. Lenders can lend on units in CICs knowing that the community will continue to be maintained and property values will be preserved, all at a cost allocation that is fair and equitable.

Ultimately, this system even benefits the first mortgage lenders who bear priority erosion losses as well because the value of their collateral will be preserved. Eroding lien priority should lead to a better recovery in foreclosure sales, which should offset the priority losses the system entails. For this reason, the GSEs should revise their policies and permit uncapped lender responsibility for collateral upkeep. Although a six-month limit is easier for a lender to prospectively quantify (because the maximum amount of foreclosure proceeds paid to an association is pre-determined), this approach depresses the property's value and limits capital availability to the entire community. Allowing a fairer allocation of community costs justifiably supports values and stability in the community—an outcome beneficial for the community's lenders as well as its owners.

2. Promoting Foreclosure as Policy

One effect of the eroding mortgage priority solution is that lenders will be discouraged from delaying foreclosure just to avoid payment of community assessments. A possible result is that foreclosures of community association properties may proceed more expeditiously,

381. In lieu of having a front-end delay before erosion of a lien begins, a state could choose a shared-liability approach to assessments, mandating that a certain percentage of all unpaid assessments at foreclosure enjoy a payment priority. Under this system, the cost to a neighborhood would continue to grow as foreclosure is delayed, but so would the cost to a lender. This approach, however, would at least somewhat curtail the lender's collateral upkeep free-ride.

which is arguably harder on defaulting homeowners who face losing their homes more quickly. Although it is politically difficult for governments to push for quicker foreclosures (which is seen as making the poor owners lose vis-à-vis the banks), providing an incentive for banks to foreclose promptly is actually good in terms of the neighbors and the community as a whole.[382]

In some ways, both defaulting borrowers and mortgage lenders benefit from foreclosure delays, all at the expense of the community.[383] Delinquent owners can stay in their homes, cost-free,[384] and lenders can wait out a bad market while avoiding the carrying costs on a property.[385] The people who really lose from this delay are those least able to control for it: the innocent neighbors who fund the unpaid assessment bills.

Undue foreclosure delays adversely affect the wider market as well. Without lower-priced sales to pull down comparable sale values of homes, housing prices remain propped up at unsustainable levels. Delaying foreclosure sales, therefore, also delays the housing market

382. Politicians frequently balk at this approach of "getting it over with," and economists disagree about whether it is better to allow borrowers rent-free possession during a general market downturn or not. *See, e.g.*, Brady Dennis & Ariana Eunjung Cha, *Pelosi Calls for Federal Inquiry on Mortgage Lenders*, WASH. POST, Oct. 6, 2010, at A15 (discussing political reasons to push for foreclosure moratoriums while quoting Guy Cecala, the publisher of *Inside Mortgage Finance*, as warning that further slowdown in foreclosure sales would "delay significantly any recovery of the housing market"); Dina ElBoghdady, *Anxiously Waiting for the Sale to Go Through*, WASH. POST, Oct. 9, 2010, at A11 (discussing why foreclosure delays increase market uncertainty and the problems that result); Pearlstein, *supra* note 121, at A09 (explaining that "the longer the foreclosure process goes on, the longer it will take for the excess supply of houses to be absorbed, for prices to stabilize and for the real estate market to return to something closer to a normal equilibrium").

383. At the least, the parties benefit from delays where there is not a third party to buy the property from the lender at foreclosure or soon thereafter.

384. News stories tell of increasing numbers of homeowners who stop paying their mortgages, betting that it will take the lender a very long time to foreclose and explain that the threat of foreclosure is so temporally remote that it becomes merely "theoretical." *E.g.*, David Streitfeld, *Owners Stop Paying Mortgages . . . and Stop Fretting About It*, N.Y. TIMES, June 1, 2010, at A1 ("A growing number . . . are fashioning a sort of homemade mortgage modification, one that brings their payments all the way down to zero.").

385. *See* Ruger, *supra* note 2, at A1 ("[B]anks put off the foreclosure sales in many cases because once they take the property, they become liable for taxes, fees and maintenance."). Some banks even delay after acquiring the property at a foreclosure sale, waiting as long as possible to record the deed in order to procrastinate the day they are legally required to contribute to property upkeep. In the past year, some states legislatures have proposed laws to address this trend, requiring that deeds be filed within thirty or ninety days of a foreclosure sale. *See, e.g.*, S.B. 141, 150th Gen. Assemb., Reg. Sess. (Ga. 2009) (requiring foreclosure deeds to be recorded within ninety days); S.B. 128, 75th Sess. (Nev. 2009) (requiring foreclosure deeds to be recorded within thirty days).

from reaching equilibrium.[386] Only when prices reflect fundamental values will the market start recovering in earnest.

Undue foreclosure delays also discourage home buyers and investors who face uncertain timing and title.[387] Lenders avoid financing because of the uncertainty posed by community properties left in limbo.[388] In addition, delaying foreclosures also keeps the capital markets from establishing accurate pricing for mortgage-backed securities products, slowing the recovery in that market as well.[389]

During the limbo of threatened foreclosure, properties are generally not maintained at the optimal level.[390] This threat to quality of our housing stock is nowhere greater than in CICs, where a few delinquent properties can actually cause a decrease in the upkeep of the entire community. Our housing stock is at risk of deterioration if responsible "gatekeepers" are not funding its upkeep. The longer the limbo is drawn out, the more extreme upkeep problems will be.

It sounds draconian, but the best thing for the community in the case of a nonpaying unit owner facing foreclosure is to have the foreclosure sale take place as swiftly as possible. Unnecessary delay costs the entire community money and increases uncertainty. Any benefits accruing to the lender (or borrower) from such delay are purchased with other people's money. Plus, perceived lender benefits may be illusory because decline in collateral upkeep and increase in community assessment deficiencies will significantly drive down the value of the property and the lender's ultimate recovery at foreclosure.

3. Lender Disorganization and Misbehavior

Blame for the financial troubles of associations—like blame for the housing crisis—targets the mortgage lenders,[391] but the eroding lien

386. In 2006, the Office of Federal Housing Enterprise Oversight ("OFHEO") calculated the ratio of equivalent rents to home prices (comparing the amount for which a given home would rent to the home's purchase price) and found that nationwide, the average rental value of homes was only 70% of the purchase price. Stewart & Brannon, *supra* note 40, at 16 fig.1.

387. *See supra* note 122 and accompanying text (discussing how the uncertainty of assessments affects would-be buyers and new investors).

388. *See supra* notes 260–64 and accompanying text (describing the obstacles to financing faced by condominiums that are in limbo).

389. *See supra* notes 4 and 10 and accompanying text (discussing how many foreclosure sales do not even cover the amount owed on the mortgages and how the amount of mortgages in default force a fewer number of individuals to cover the burden of upkeep costs).

390. *See supra* Part I.A.2 (noting that a defaulting homeowner facing foreclosure has little incentive to make improvements on the home).

391. Miami Beach City Commissioner Jerry Libbin, for example, blames "greedy banks" that "refuse to take financial responsibility for their reckless lending" for causing the mass of association delinquencies that end up saddling the remaining owners of condominium units with

proposal is not punitive. Rather, proper upkeep allocation is a prerequisite to market recovery. Thus far, mortgage lenders have strongly objected to being forced to pay assessments on behalf of properties they are unable to sell quickly,[392] although their own self-interest leads banks to take on maintenance obligations for collateral not located in privately-governed communities. Governments and consumer protection groups have begged lenders to cut homeowners a break, yet homeowners face being sued by Florida associations for not foreclosing quickly enough.[393] The volume of defaulted properties is itself a barrier to expeditious foreclosure.[394] Servicers are overwhelmed with as many new mortgage defaults each month as previously occurred in an entire year.[395]

In the case of homes not located in CICs, lenders cannot avoid maintenance of constructively (or literally) abandoned properties prior to foreclosure. To prevent the ravages of permissive waste, lenders hire a manager to maintain such properties, buy insurance on the properties, and even pay to have necessary repairs done. Such collateral preservation steps are merely prudent business decisions and do not necessarily force lenders to foreclose at a time other than their choosing. Alternately, lenders can decide to modify loan obligations to free up borrower capital to meet needed upkeep costs. Lenders outside of CICs regularly act upon the clear understanding that maintenance of collateral value is in their own best interest. The only reason lenders do not incur such costs in CIC properties is that someone else is already doing the maintenance and picking up the tab.

"huge special assessments." *Miami Beach Commissioner Jerry Libbin Applauds 'Reverse Foreclosure' Ruling, Renews Call for State Lawmakers to Enact Comprehensive Foreclosure Reforms*, PR NEWSWIRE (Jan. 27, 2010), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546. Libbin has been "spearheading a state-wide campaign to protect condominium unit owners from unfair assessments levied on them" because of the housing meltdown, claiming that "loopholes in laws have allowed banks to escape from paying their fair share—forcing tens of thousands of Florida condo unit owners in good standing to pick up the tab." *Id.*

392. Alex Sanchez, president and CEO of the Florida Bankers Association, explains the lender perspective: "We get hit from every side. Some people say we're foreclosing too fast; others say we're foreclosing too slow [sic]. Bankers want to keep Florida families in their homes. Foreclosure is a last remedy." Coleman, *supra* note 104, at 1A.

393. *See supra* Part II.A.1.c (discussing government efforts to extend foreclosure timelines).

394. *See* Eunjung Cha & Dennis, *supra* note 3, at A9 (warning that uncertainty in foreclosure procedures scares away buyers and creates an even more "traumatic market" situation, where foreclosure buyers are even more scarce); Gretchen Morgenson & Geraldine Fabrikant, *Florida's High Speed Answer to a Foreclosure Mess*, N.Y. TIMES, Sept. 5, 2010, at BU1 (explaining that the huge backlog of foreclosure cases in Florida has led to some corner-cutting by the judicial department as well as lenders and that the backlog continues to increase anyway).

395. Viega, *supra* note 9.

Foreclosures cannot proceed when it is unclear who owns what loans.[396] Because a mortgage follows the note, only ownership (and, typically, possession) of the note evidencing the debt can permit an entity to foreclose on the mortgage. Before the advent of the secondary mortgage market and securitization, note ownership was easy to track because in most cases loan originators remained holders of the instrument. But with the growth of the secondary market and the innovation of mortgage-backed securitization and its related products, ownership of mortgage debt was passed on post-closing and became segmented through pools of loans.[397] By the mid-1990s, most mortgage

396. On October 13, 2010, all fifty states began a joint investigation into mortgage foreclosures. This investigation was sparked by the "robo-signing" scandal. Robo-signing refers to the practice of having employees sign off on thousands of foreclosure affidavits, stating that they had reviewed the underlying paperwork when, in fact, they had not. *See* Eunjung Cha & Dennis, *supra* note 382, at A15 (discussing House Speaker Nancy Pelosi's call for the Justice Department to investigate mortgage lenders and how Maryland joined other states that sought to halt foreclosure sales while lender forgery and fraud claims were fully explored). The robo-signing scandal and associated moratoriums slowed down the foreclosure process significantly and left millions of homes "in limbo." *Id.*; *see also Congressional Oversight Panel: Hearing on TARP Foreclosure Mitigation Programs*, 111th Cong. 3 (2010) (testimony of Julia Gordon, Center for Responsible Lending) (stating that servicers engaged in "shoddy, abusive, and even illegal practices related to the foreclosure process" cause a lack of confidence in the process among buyers, which slows the absorption of real estate-owned inventory and an overall recovery of the housing market); Eunjung Cha, Mufson & Yang, *supra* note 3, at A11 (discussing the political pressure for the federal government to impose a full moratorium on foreclosures due to concerns over banks' foreclosure procedures); *supra* note 3 and accompanying text (discussing the moratoriums on mortgage foreclosures announced by large lenders due to sloppy or fraudulent servicer foreclosure procedures, describing the political reaction to the moratoriums, and stating that the procedural concerns prompting the moratoriums still linger despite the fact that the moratoriums have since been lifted). Although the moratoriums have now been lifted, the pace of foreclosure has significantly slowed in the wake of such scandals, resulting in a renewed focus on foreclosure procedure and mortgage ownership. For a more detailed discussion of some of the problems of note ownership and chain of title for mortgage notes in the secondary market and a proposal regarding possible future systemic solutions, see Dale A. Whitman, *How Negotiability has Fouled up the Secondary Mortgage Market, and What to Do About It*, 37 PEPP. L. REV. 737, 757–69 (2010).

397. The securitization concept basically holds that by splitting a group (pool) of mortgage loans into multiple classes (tranches) with a hierarchy of repayment rights (the top tranche has the least risky position in terms of credit and repayment risk), the mere grouping and tranching of the pool will dramatically reduce risks for investors holding the top tier position because the lower-positioned investors provide a buffer by bearing the first loss. Theoretically, this is true even if the entire pool is made up of risky mortgage loans: the lower tranches act as a risk shock absorber. Wall Street opined that pooling and tranching can be done several times, supposedly reducing risk of top-tiered securities with each re-tranching. This theory, widely accepted in the dawn of the twenty-first century, seems to work less well under real market stress—as seen in the meltdown of the subprime market. The structure of securitization in the abstract was not the problem, it was rather the valuation model for securitized products that was inadequate. For an overview comparison of securitization and traditional bank lending, see Gerald Hanweck, Anthony Sanders & Robert Van Order, *Securitization Versus Traditional Banks: An Agnostic View of the Future of Fannie Mae, Freddie Mac and Banks*, FINREG21 (Sept. 28, 2009), http://www.finreg21.com/lombard-street/securitization-versus-traditional-banks-an-agnostic-

banks no longer intended to originate mortgages for their own portfolios but rather acted as intermediaries—originating mortgages in order to sell them on the secondary market in turn.[398]

Loan ownership changes, through secondary market sales of mortgage loans, pooling, tranching, and securitization sales of pieces of those loans, were supposedly all tracked through the Mortgage Electronic Registration System ("MERS").[399] Although MERS records of loans often do permit ownership to be tracked, the individual notes have in many cases become lost along the way.[400] Because the lien (the mortgage) follows the payment obligation (the note), production of the note or a court-allowed substitute is a prerequisite to commencing a foreclosure proceeding.[401]

The delay is unfortunate but unavoidable: foreclosure as a process requires strict adherence in order to assure the fairness of the result.[402] If foreclosures must slow down to ensure procedural due process, then a slower timeline is essential.[403] The costs of these foreclosure delays, however, should be borne by the entities who could have avoided the problems causing the delays—namely, the lenders or servicers. Hopefully, foreclosures will not be delayed more than necessary as a result of political posturing because foreclosure delay causes far more problems than it solves.[404]

Many of the problems plaguing the housing market today—from the robo-signing scandal to the poorly-underwritten loans in the first place—are products of lender sloppiness, disorganization, and (sometimes) misbehavior. The structure of the market itself encouraged

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view-future-fannie-mae-freddie-ma (providing a concise description of the development of mortgage-backed securitization); *see also* Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 535–51 (2002) (providing a summary of the basics of loan securitization).

398. ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 381–82 (3d ed. 2007). *See generally* ANDREW DAVIDSON, ANTHONY B. SANDERS & LAN-LING WOLFF, SECURITIZATION: STRUCTURING AND INVESTMENT ANALYSIS (2003).

399. *See* Whitman, *supra* note 396, at 765 n.157 (describing MERS, which was "created by the major participants in the secondary mortgage market to maintain an electronic, on-line registry of mortgage assignments").

400. *Id.* at 757.

401. *Id.* at 757–59.

402. This is very similar to how election law procedures assure fair election results and how trial procedures assure viable findings of fact.

403. It is paramount to ensure that foreclosure sales are valid because flawed foreclosures raise three problems that threaten housing markets and the broader economy: the foreclosure itself may not be warranted or conducted correctly (with proper parties); buyers at foreclosure are not assured of good title; and lack of confidence in titles to land slows housing market recovery.

404. *See supra* Part I.A.2 (discussing the negative impact of constructive abandonment).

risk-taking at the originating lender level. Because borrower credit risk was assumed by the secondary market purchaser and securitizer of the loans, often with insurance companies providing credit enhancement to the mortgage pool, and was then passed on (in whole or in part) to investors in the pool that provided the actual funds through purchasing mortgage-backed securities,[405] there was very little incentive for mortgage lenders to perform sufficient due diligence before advancing funds. The *New York Times* decries sloppy lending, property appraisals, and securities ratings, pointing out that "[s]ince we trust, why verify?" seems to have been the industry motto.[406]

Again, there were many guilty parties in sloppy lending and loan transfers. But as between the mortgage lenders and the borrower's neighbors, the lenders clearly emerge as more culpable. Thus, between these two categories of parties, the choice for cost allocation is likewise clear: the mortgage lender is the only party who can avoid similar problems in the future. As the least-cost avoider, economic theory supports the equitable judgment here: lenders should bear costs caused by their failure to carefully underwrite their lending, properly document their mortgage sales and securitizations, and promptly and correctly foreclose.[407]

Lenders uniformly lobby to keep the system as-is, particularly in states with no limited lien priority for assessments. But in reality, bankers' associations that decry a viable solution to private governance failure are acting against their own long-term interest. Although lenders may see themselves as paying the price of revisions in the lien priority scheme, they very well could also be lenders on non-defaulting units currently being burdened with increasing assessments or, at the very least, facing the uncertainty of assessment increases in the future. A lender may desire to make a loan on a unit in a community where a large percentage of owners could stop paying assessments at any time. This uncertainty hurts owners and their lenders.[408]

Alternatively, if the community could ensure the expected revenue stream, the risk to all lenders decreases even though their exposure in

405. *See supra* note 397 (describing the securitization concept involving pools and tranches).

406. Floyd Norris, *Banks Stuck with Bill for Bad Loans*, N.Y. TIMES, Aug. 20, 2010, at B1.

407. This is not to say that uncertain foreclosures should be permitted. Strict procedural protections and requirements must be maintained. But any additional community costs incurred by lender missteps must be borne by lenders alone--not by the neighborhoods in which their collateral is located.

408. This is why Fannie Mae, Freddie Mac, FHA, and other lenders impose a limit on the percentage of delinquencies before they will purchase or insure (or originate) loans in a community association. It is also why the GSEs want to approve community reserves levels. *See supra* Part II.A.1.b (discussing how lender policies affect assessment recovery).

terms of their non-paying borrowers goes up. The downside, however, should not pose a problem; lenders can manage this risk much more easily than the uncertainty risk related to potentially unrecoverable assessments. Lenders already take measures to protect themselves against property tax amounts that can accrue and are payable prior to their mortgage loan out of foreclosure proceeds. Lenders need only to set up reserve accounts and affirmatively require payment of association assessments to control for borrower misbehavior and their own loss exposure from the loss of lien priority.

Lenders also benefit from legislation empowering associations to ultimately recover their upkeep costs because, by keeping the community association solvent and active, lenders reap the benefits of supported property values and well-maintained communities. Even when lenders "save" money by delaying foreclosure to avoid paying assessments, they drive down the property value of their own collateral by causing community assessments to increase while services decline. In essence, lenders commit their own waste when they fail to ensure payment of association assessments.

4. Association Assessment Abuses

Some commentators target association expenditures in general as wasteful spending, but statutory oversight of association budgeting and amenities is not a good idea. Rather than pass laws requiring communities to tighten their belts, this is best left to the governance system in place. There is nothing preventing members from voting to cut back services and save community funds. Furthermore, if a lender begins paying assessments after foreclosure, the lender will be able to assert the unit's voting rights and have some input into community costs and fees.

Associations are typically empowered to charge late fees and collection costs in addition to delinquent assessments.[409] Clearly, associations must be able to recoup the costs of collecting delinquent assessments. Some assert, however, that late fees and collection costs are out of control.[410] Allegations abound that community associations hire lawyers who abuse the system by charging outrageous fees.[411]

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409. HYATT, *supra* note 15, at 121–22 (describing two methods of imposing late fees in CIC associations: flat rate and monthly interest fees).

410. *See, e.g.*, Ngoc Nguyen, *Hard-Pressed Homeowners Facing Another Financial Threat*, N.Y. TIMES, Apr. 15, 2011, at A19A (depicting cases where association debts were "turned over" to collection agencies and the tenfold increase in the amount owing due to fees and interest).

411. *Id.*; *see also* Shirley Wise, *Reverse Foreclosures—Are the Associations the Victims Here?*, EZINEARTICLES (Aug. 30, 2010), http://ezinearticles.com/?Reverse-Foreclosures---Are-the-Associations-the-Victims-Here?&id=4879390 (reporting that "the association attorneys add

Some California lawmakers, for example, have highlighted the danger of so-called "foreclosure factories"—law firms and collection agencies that charge an association $1500 to $2000 for taking over a foreclosure proceeding against a delinquent owner.[412] The associations tack the amount paid to assessment collectors onto the delinquent charges, and the collection cost amounts can be "shockingly high."[413]

Current government oversight of collection cost charges is minimal: only the California State Legislature has considered specifically limiting debt collection practices of CIC associations.[414] Recent attention to the plight of both association residents and nonpaying owners facing foreclosure suggests that additional state regulation of assessment collection may be on the horizon.[415]

Concern over unconscionably high late fees and collection costs may be warranted, as there are few legal limits on what a CIC association can impose on its members as long as it follows the procedures set forth in its governing documents.[416] If mortgage lenders are on the hook for

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outrageous fees for their services," are "unwilling to discount the amount not even by a dollar" and that these unfair practices "need to be questioned"). *See generally* EVAN MCKENZIE, PRIVATOPIA: HOMEOWNER ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENT (1996) (criticizing the entire governance system of CICs as prone to abuse).

412. *Id.*; *see also* Wasserman, *supra* note 12 (describing the problems related to associations that can easily foreclose on homes and describing recent legislative efforts to make foreclosure more difficult).

413. Ngai Pindell, *Tensions Between HOA Super Liens and Purchasers at Foreclosure*, LAND USE PROF BLOG (Jan. 29, 2010), http://lawprofessors.typepad.com/land_use/2010/01/tensions-between-hoa-super-liens-and-purchasers-at-foreclosure.html. Collection costs charged by associations are much maligned. Professor Pindell opines that "the only entities capable of engendering more ill will than over-zealous lenders are HOAs" and notes that "many see these perceived, excessive HOA charges as yet another manifestation of unchecked and intrusive power over homes and communities." *Id.*

414. *See* S.B. 561, 2011–2012 Reg. Sess. (Cal. 2011) (providing that "an association shall not voluntarily assign or pledge the association's right to collect payment or assessments to a third party . . . [unless] the third party agrees in writing to collect payments or assessments on behalf of the association in the manner set forth in this chapter" and prohibiting "a third party that has contracted with an association to collect assessments, fees, or payments . . . [from] act[ing] as trustee in foreclosure proceedings"); *see also* Nguyen, *supra* note 411, at A19A (reporting that "the California Senate Judiciary Committee passed a bill to curtail predatory practices by collection agencies" for homeowner association debt). The federal Fair Debt Collection Practices Act may also apply to limit the tactics an association may employ to collect unpaid assessments. *See* Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692–1692p (2006); *supra* note 162 and accompanying text (discussing the Fair Debt Collection Practices Act).

415. Pending bills in Utah and Arizona bar the use of debt collectors to obtain unpaid assessments. Conlin & Lush, *supra* note 5.

416. *See, e.g.*, O'Buck v. Cottonwood Vill. Condo. Ass'n, 750 P.2d 813, 818 (Alaska 1988) (upholding association rule banning television antennae in spite of no showing of adverse effect on the value of units and holding that owners of units in CICs "consciously sacrifice some freedom of choice in their decision to live in this type of housing"); Villa de las Palmas Homeowners Ass'n v. Terifaj, 90 P.3d 1223, 1234–35 (Cal. 2004) (upholding amendment to

unpaid assessments plus fees, such lenders might validly complain that an association might manipulate costs in order to obtain coverage of community expense from lenders' deep pockets. There may therefore be compelling reasons to have statutory limits on late fees and charges that an association can impose in order to prohibit a paying majority from unfairly allocating association costs. Some statutory oversight would be particularly warranted in cases where such charges are ultimately recoverable in full from a first mortgage lender in its foreclosure sale. Just as the current inequitable allocation of costs among members is unfair, it would be equally unfair to pass on a lion's share of community costs to lenders.

CONCLUSION

Today's unprecedented delay in foreclosures of vast numbers of financially underwater property harms non-defaulting owners in privately governed communities. The financial "commons" of entangled fiscal fortunes in such neighborhoods illustrates a fundamental flaw in the common interest community system of ownership that must be remedied to prevent the potential failure of such governance forms during periods of great economic stress. The adverse external impact of community assessment delinquencies is an important but often overlooked problem, which under the current housing crisis is reaching critical levels in some localities. Certain government and market actions, including current foreclosure moratoriums and delays, exacerbate the problem, spreading financial distress to innocent homeowners and bringing property values down in a tangible and significant way. Leaving community associations effectively bankrupt is a lose-lose scenario and we need prompt legislative action to prevent this result.

Current lien priority laws fail to protect the interests of such communities and their paying members. Even in the handful of states that have enacted protective limited lien priority provisions with respect to community association assessments, assessment lien priority is almost always capped at six months' worth of delinquent assessments. Because foreclosures take months or years longer than the time period representing the recoverable assessment amounts, such laws provide no real incentive for lender responsibility or expeditious foreclosure sales. As foreclosure is delayed, costs continue to mount while neighbors pay the costs left unpaid by delinquent owners.

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condominium declaration banning pets despite statute providing that no declaration can prohibit all pets).

To effectively preserve property values and protect blameless homeowners in planned communities, states across the nation must adopt measures to enable private governments to perform their roles. Allowing delayed foreclosures to erode the lien priority of a first mortgage achieves the needed result with the most contained and best-allocated costs. Although creating incentives for prompt foreclosures may at first glance seem perverse in a difficult economy, it is the only answer to the insolvency contagion threatened by assessment delinquencies and foreclosure delays. Finding solvent owners to replace those who hold title to houses they can ill afford—both in terms of financing and upkeep costs—is paramount. Continuing to mandate that paying members of a community association provide private financial support to the defaulting homeowners is unfair, inefficient, and poor policy indeed.

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DISTRICT COURT

CLARK COUNTY, NEVADA

WINGBROOK CAPITAL, LLC., Plaintiff, vs. PEPPERTREE HOMEOWNERS ASSOCIATION; and DOES 1-10 and ROE ENTITIES 1-10, INCLUSIVE Defendants.	Case No. A-11-636948-B Dept. No. XI **ORDER**

This matter came before the Court on May 24, 2011 at 9:00 a.m., upon the Plaintiff's Motion for Summary Judgment on Claim of Declaratory Relief. James R. Adams, Esq., of Adams Law Group, Ltd., and Puoy K. Premsrirut, Esq., of Puoy K. Premsrirut, Esq., Inc., appeared on behalf of the Plaintiff. Kurt Bonds, Esq., of Alverson, Taylor, Mortensen & Sanders appeared on behalf of the Defendant. The Honorable Court, having read the briefs on file and having heard oral argument, and for good cause appearing hereby rules:

WHEREAS the Parties have engaged in and have concluded a Nevada Real Estate Division mediation (ADR #11-25) wherein the Parties mediated a dispute over the sum of $13,190.33; and

WHEREAS the subject of the mediation was whether NRS 116.3116 permitted Defendant to charge to Plaintiff $14,037.83, or whether some lesser amount was due pursuant to NRS 116.3116; and

WHEREAS, the Court has determined that a justiciable controversy exists in this matter as Defendant claims it has a right pursuant to NRS 116.3116 to charge and retain proceeds in the amount $14,037.83 from Plaintiff and Plaintiff, a purchaser of a home at foreclosure which is located within the Defendant homeowners' association, contests this charge and claims that Defendant exceeded the limits of NRS 116.3116 and overcharged it for the super priority lien; and

WHEREAS there exists in this case a controversy in which a claim of right is asserted by Plaintiff against Defendant who has an interest in contesting it; and

WHEREAS Plaintiff and Defendant, the contesting parties hereto, are clearly adverse and hold different views regarding the meaning and applicability of NRS §116.3116 (including whether Defendant charged too much for the super priority lien); and

WHEREAS Plaintiff has a legal interest in the controversy as it was Plaintiff's money which had been demanded and transferred to Defendant and it was Plaintiff's property that had been the subject of a homeowners' association lien by Defendant; and

WHEREAS the issue of the meaning, application and interpretation of NRS 116.3116 is ripe for determination in this case as the present controversy is real, it exists now, and it affects the Parties hereto; and

WHEREAS, therefore, the Court finds that issuing a declaratory judgment relating to the meaning and interpretation of NRS 116.3116 would terminate some of the uncertainty and controversy giving rise to the present proceeding; and

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WHEREAS, pursuant to NRS 30.040 Plaintiff and Defendant are parties whose rights, status or other legal relations are affected by NRS 116.3116 and they may, therefore, have determined by this Court any question of construction or validity arising under NRS 116.3116 and obtain a declaration of rights, status or other legal relations thereunder;

THE COURT, THEREFORE, DECLARES, ORDERS, ADJUDGES AND DECREES as follows:

1. NRS 116.3116 is a statute which creates for the benefit of Nevada homeowners' associations a lien against a homeowner's unit for any construction penalty that is imposed against the unit's owner pursuant to NRS 116.310305, any assessment levied against that unit or any fines imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due (the "Statutory Lien"). The homeowners' associations' Statutory Lien is noticed and perfected by the recording of the associations' declaration and, pursuant to NRS 116.3116(4), no further recordation of any claim of lien for assessment is required.

2. Pursuant to NRS 116.3116(2), the homeowners' association's Statutory Lien is junior to a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent ("First Security Interest") except for a portion of the homeowners' association's Statutory Lien which remains prior to the First Security Interest (the "Super Priority Lien").

3. Homeowners' associations, therefore, have a Super Priority Lien which has priority over the First Security Interest on a homeowners' unit. However, the Super Priority Lien amount is not without limits and NRS 116.3116 provides that the amount of the Super Priority Lien (i.e., that amount of a homeowners' associations' Statutory Lien which retains priority status over the First Security Interest) is limited "to the extent" of those assessments for common expenses based upon the associations' periodic budget that would have become due in the 9 month period immediately preceding an

associations' institution of an action to enforce its Statutory Lien and "to the extent of" external repair costs pursuant to NRS 116.310312:

4. The words "to the extent of" contained in NRS 116.3116(2) mean "no more than," which clearly indicates a maximum figure or a cap on the Super Priority Lien which cannot be exceeded.

5. Therefore, after the foreclosure by a First Security Interest holder of a unit located within a homeowners' association, pursuant to NRS 116.3116 the monetary limit of a homeowners' association's Super Priority Lien is limited to a maximum amount equaling 9 times the homeowners' association's monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the institution of an action to enforce the lien (the "Assessment Cap Figure") plus external repair costs pursuant to NRS 116.310312.

6. While assessments, penalties, fees, charges, late charges, fines and interest may be included within the Assessment Cap Figure, in no event can the total amount of the Assessment Cap Figure exceed an amount equaling 9 times the homeowners' association's monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the association's institution of an action to enforce the lien.

7. The Super Priority Lien equals the Assessment Cap Figure plus external repair costs pursuant to NRS 116.310312.

8. After providing a homeowner with notice and hearing, NRS 116.310312 permits a homeowners' association to enter the grounds of a homeowners' unit and maintain the exterior of the unit in accordance with the standards set forth in the association's governing documents. Pursuant to NRS 116.310312(2)(b), a homeowners' association may also remove or abate a public nuisance on the exterior of a unit. The association may order that the costs of such maintenance or abatement, including interest, inspection fees, notification fees and collection costs for such maintenance

or abatement to be charged against the unit ("Exterior Repair Costs"). NRS 116.310312(9)(a) provides that "Exterior" of the unit includes, without limitation, all landscaping outside of a unit and the exterior of all property exclusively owned by the unit owner.

9. Therefore, the Super Priority Lien consists solely and exclusively of the Assessment Cap Figure and the Exterior Repair Costs. No other costs, fees, fines, penalties, assessments, charges, late charges, or interest or any other costs may be included within the Super Priority Lien.

10. Pursuant to NRS 116.3116, the maximum amount of the Assessment Cap Figure portion of Defendant's Super Priority Lien cannot exceed $1,552.50 which equals 9 times the Defendant's monthly assessments. As Defendant has assessed against Plaintiff $1,552.50 for past due assessments incurred prior to Plaintiff's ownership of the property, the additional late fees of $135.00 and accrued interest on the Assessment Cap Figure are impermissible and cannot be included in the Assessment Cap Figure as the addition of those costs exceed the Assessment Cap Figure of $1,552.50 and violates NRS 116.3116.

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11. The External Repair Costs portion of the Super Priority Lien shall be determined by this Court at a later date when the Court is provided with all necessary evidence to make that determination.

IT IS SO ORDERED.

DISTRICT COURT JUDGE

June 2, 2011
Date

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DISTRICT COURT

CLARK COUNTY, NEVADA

PECCOLE RANCH COMMUNITY ASSOCIATION, a domestic non-profit homeowners association corporation, Plaintiff, vs. ELSINORE, LLC, a Nevada Limited Liability Company, Defendant. ELSINORE, LLC., on behalf of itself and as representatives of the class herein defined Counter Claimant, vs. PECCOLE RANCH COMMUNITY ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Counter Defendant.	CASE NO. A-12-658044-C DEPT. NO. XV Date of Hearing: August 29, 2012 Time of Hearing: 9:00 a.m. **ORDER DENYING IN PART AND GRANTING IN PART PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT**

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DISTRICT COURT

CLARK COUNTY, NEVADA

PECCOLE RANCH COMMUNITY ASSOCIATION, a domestic non-profit homeowners association corporation, Plaintiff, vs. ELSINORE, LLC, a Nevada Limited Liability Company, Defendant. ELSINORE, LLC., on behalf of itself and as representatives of the class herein defined Counter Claimant, vs. PECCOLE RANCH COMMUNITY ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Counter Defendant.	CASE NO. A-12-658044-C DEPT. NO. XV Date of Hearing: August 29, 2012 Time of Hearing: 9:00 a.m. **ORDER DENYING IN PART AND GRANTING IN PART PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT**

42798

This matter came before the Court on August 29, 2012, at 9:00 a.m., upon the Plaintiff's MOTION FOR PARTIAL SUMMARY JUDGMENT. James R. Adams, Esq., of ADAMS LAW GROUP, LTD., and Puoy K. Premsrirut, Esq., of PUOY K. PREMSRIRUT, ESQ., INC., appeared on behalf of the Defendant/Counter Claimant. Don Springmeyer, Esq., of WOLF, RIFKIN, SHAPIRO, SCHULMAN & RABKIN, LLP., appeared on behalf of the Plaintiff/Counter Defendant. The Honorable Court, having read the briefs on file and having heard oral argument, and for good cause appearing hereby, DECLARES, ORDERS, ADJUDGES AND DECREES that Plaintiff's Motion for Partial Summary Judgment is denied in part and granted in part.

WHEREAS, the undisputed facts are as follows: Plaintiff is a Nevada homeowners association. Defendant was an owner of residential real property located within the Peccole Ranch Community Association. In particular, Defendant purchased the property located at 2209 Storkspur, Las Vegas, NV, at a foreclosure sale on or about September 8, 2008. Defendant had obtained title to the property through a trustee's sale whereby a secured first trust deed holder foreclosed on the property thereby extinguishing Plaintiff's statutory general homeowners' association lien against the property, but for the super priority portion of that general lien. According to Defendant, the Association by itself or through its authorized agents, demanded and collected amounts from the Defendant. The amount demanded was $2,580.70. The amount allegedly paid by Defendant was $2,649.90.

IT IS FURTHER ORDERED that NRCP 56(b) provides as follows: A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in the party's favor as to all or any part thereof.

The Court may enter summary judgment on questions of law where the facts are not in dispute. *Exchange Bank v. Strout Realty*, 94 Nev. 86, 525 P.2d 589 (1978). Thus, this Court may issue partial summary judgment on the declaratory issues pertaining to NRS 116.3116 and CC&Rs Section 8.3. Summary judgment is appropriate only when the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no

genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. NRCP 56(c); *Pegasus v. Reno Newspapers, Inc.*, 118 Nev. 706, 713 (2002). "A factual dispute is genuine when the evidence is such that a rational trier of fact could return a verdict for the nonmoving party." *Wood v. Safeway, Inc.*, 121 Nev. 724, 731 (2005). The substantive law controls which factual disputes are material and will preclude summary judgment; factual disputes not germane and central to the claims for relief are irrelevant. *Id.* The burden to establish the absence of a triable issue of fact is on the moving party, and the court is obligated to construe the evidence in the light most favorable to the party against whom the motion is directed. *Butler v. Bogdonovich*, 101 Nev. 449, 451 (1985); *Hidden Wells Ranch, Inc. v. Strip Realty, Inc.*, 83 Nev. 143, 145 (1967). Where the party moving for summary judgment will bear the burden of persuasion at trial, it must present evidence that would entitle it to judgment as a matter of law in the absence of contrary evidence. *Francis v. Wynn Las Vegas, LLC*, 127 Nev. Adv. Rep. 60 (2011) (quoting *Cuzze v. Univ. & Comm. Coll. Sys. of Nev.*, 123 Nev. 598, 602-03 (2007)). If the nonmoving party will bear the burden of persuasion at trial, the moving party may satisfy the burden of production by either (1) submitting evidence that negates an essential element of the nonmoving party s claim or (2) pointing out ... that there is an absence of evidence to support the nonmoving party's case. *Id.* In such instances, the nonmoving party must do more than simply show that there is some metaphysical doubt as to the operative facts to defeat a motion for summary judgment. *Wood, supra* (quoting *Matsushita Electric Industrial Co. v. Zenith Radio*, 475 U.S. 574 (1986)). When the motion is made and supported as required by Rule 56, the nonmoving party must transcend the pleadings and, by affidavit or other admissible evidence, introduce specific facts that show a genuine issue of material fact. *Francis*, 262 P.3d at 714-15. The non-moving party's documentation must be admissible evidence, and he or she is not entitled to build a case on the gossamer threads of whimsy, speculation and conjecture. *Posadas v. City of Reno*, 109 Nev. 448, 452 (1993) (quoting *Collins v. Union Fed. Savings & Loan*, 99 Nev. 284 (1983)). In considering a motion for summary judgment, the court should not regard Rule 56 as a disfavored procedural shortcut, but should instead view it as an integral part of the ... Rules [of Civil Procedure] as a whole, which are designed to secure the just,

speedy and inexpensive determination of every action. *Wood*, 121 Nev. at 730-31 (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986)). Accordingly, when the movant has met the standard and the non-moving party has failed to establish a genuine issue of material fact, it is incumbent upon the court to grant the judgment sought forthwith. NRCP 56(c); *Dzack v. Marshall*, 80 Nev. 345 (1964).

The Plaintiff Association requested the following relief:

1. That pursuant to NRS 116.3116, the Association has a Super Priority Lien over a first security interest recorded against the property for nine (9) months of assessments immediately preceding institution of an action to enforce the lien.
2. That the Association's Super Priority Lien Amount pursuant to NRS 116.3116 includes interest, late fees and costs of collection, which are in addition to, not capped by, the applicable period of common expense assessments.
3. That the Association's Super Priority Lien Amount pursuant to NRS 116.3116(2) includes costs of collection, which pursuant to NRS 116.310313 may include any fee, including legal fees and costs, and
4. That NRS 116.3116 supersedes the provisions of Section 8.3 of the Association s CC&Rs.

The Court finds that, in accordance with recent rulings by the Eighth Judicial District Court Honorable Judges Gonzalez, Denton, and Scann, Summary Judgment on requests numbers 1, 2 and 3 are DENIED.

Summary judgment on Plaintiff's request number 4 is GRANTED.

Pursuant to NRS 116.3116(2), the Association's Statutory Lien has priority over a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent the (First Security Interest) only to the extent of those assessments for common expenses based upon the Association's periodic budget that would have become due in the 9 month period immediately preceding an the Association's institution of an action to enforce its statutory general lien and to the extent of external repair pursuant to NRS 116.310312. This portion will be

referred to as the "Super Priority Lien". The Super Priority Lien amount is not without limits. The Association's Super Priority Lien Amount pursuant to NRS 116.3116 may include interest, late fees and costs of collection, but is capped by the applicable period of common expense assessments, i.e., a figure equaling 9 months of common expense assessments based upon the Association's periodic budget. The words to the extent of contained in NRS 116.3116(2) mean no more than, which clearly indicates a maximum figure or a cap on the Super Priority Lien which cannot be exceeded.

Therefore, after the foreclosure by a First Security Interest holder of a unit located within a homeowners' association, pursuant to NRS 116.3116(2), the monetary limit of a homeowners' association's Super Priority Lien is limited to a maximum amount equaling 9 times the homeowners' association's monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the institution of an action to enforce the lien, plus external repair costs pursuant to NRS 116.310312.

For the foregoing reasons, the Court denies Plaintiff's Motion for Partial Summary Judgment on requests 1, 2 and 3 and grants request 4.

IT IS SO ORDERED.

DISTRICT COURT JUDGE — Date: 9.13.12

Abbi Silver

Submitted by:

9/6/12
Date

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DISTRICT COURT

CLARK COUNTY, NEVADA

PREM DEFERRED TRUST, on behalf of itself and as representatives of the class herein defined Plaintiff, vs. ALIANTE MASTER ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Defendant.	CASE NO. A-11-651107-B DEPT. NO 29 **ORDER**

This matter came before the Court on 07/24/2012, at 10:00 a.m., on Plaintiff and the Class' MOTION FOR SUMMARY JUDGMENT ON DECLARATORY RELIEF and Defendant Aliante Master Association's OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT ON CLAIM FOR DECLARATORY RELIEF AND COUNTER-MOTION FOR SUMMARY JUDGMENT. James R. Adams, Esq., of Adams Law Group, Ltd., appeared on behalf of the Plaintiff and the Class. Kurt Bonds, Esq., of Alverson, Taylor, Mortensen & Sanders appeared on behalf of the Defendant. Patrick Reilly, Esq., of Holland and Hart appeared on behalf of Nevada Association Services, Inc., and RMI Management, Inc., as Amici Curiae of the Court.

After review and consideration of all the pleadings and briefs of Plaintiff, Defendant and the Amici Curiae, including all exhibits attached thereto, and including the oral arguments of Counsel for Plaintiff and the Class, Counsel for Defendant and Counsel for the Amici Curiae, the Honorable Court hereby rules:

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DISTRICT COURT

CLARK COUNTY, NEVADA

PREM DEFERRED TRUST, on behalf of itself and as representatives of the class herein defined Plaintiff, vs. ALIANTE MASTER ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Defendant.	CASE NO. A-11-651107-B DEPT. NO 29 **ORDER**

This matter came before the Court on 07/24/2012, at 10:00 a.m., on Plaintiff and the Class' MOTION FOR SUMMARY JUDGMENT ON DECLARATORY RELIEF and Defendant Aliante Master Association's OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT ON CLAIM FOR DECLARATORY RELIEF AND COUNTER-MOTION FOR SUMMARY JUDGMENT. James R. Adams, Esq., of Adams Law Group, Ltd., appeared on behalf of the Plaintiff and the Class. Kurt Bonds, Esq., of Alverson, Taylor, Mortensen & Sanders appeared on behalf of the Defendant. Patrick Reilly, Esq., of Holland and Hart appeared on behalf of Nevada Association Services, Inc., and RMI Management, Inc., as Amici Curiae of the Court.

After review and consideration of all the pleadings and briefs of Plaintiff, Defendant and the Amici Curiae, including all exhibits attached thereto, and including the oral arguments of Counsel for Plaintiff and the Class, Counsel for Defendant and Counsel for the Amici Curiae, the Honorable Court hereby rules:

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WHEREAS, the Court has determined that a justiciable controversy exists in this matter as Plaintiff and the Class have asserted a claim of right under NRS §116.3116(2) (the "Super Priority Lien" statute) against Defendant and Defendant has an interest in contesting said claim. The issue contained in the briefing is, therefore, ripe for determination. Further, the present controversy is between persons or entities whose interests are adverse and who have a legal interest in the controversy (*Kress v. Corey* 65 Nev. 1, 189 P.2d 352 (1948)); and

WHEREAS Plaintiff, the Class and the Defendant, the contesting parties hereto, are clearly adverse and hold different views regarding the meaning and applicability of NRS §116.3116; and

WHEREAS Plaintiff and the Class, and the Defendant have a legal interest in the controversy as it is Plaintiff's and the Class' property that is the subject of Defendant's Super Priority Lien and all parties, therefore, have a legal interest in a determination of to what extent the Super Priority Lien can exist; and

WHEREAS the issue of the meaning, application and interpretation of NRS §116.3116 is ripe for determination in this case as the present controversy is real, it exists now, and it affects the parties hereto; and

WHEREAS, therefore, the Court finds that issuing a declaratory judgment relating to the meaning and interpretation of NRS §116.3116 would terminate some of the uncertainty and controversy giving rise to the present proceeding; and

WHEREAS, pursuant to NRS §30.040 Plaintiff, the Class and the Defendant are parties whose rights, status or other legal relations are affected by NRS §116.3116 and they may, therefore, have determined by this Court any question of construction or validity arising under NRS §116.3116 and obtain a declaration of rights, status or other legal relations thereunder.

THE COURT, THEREFORE, DECLARES, ORDERS, ADJUDGES AND DECREES as follows:

1. Plaintiff's and the Class' MOTION FOR SUMMARY JUDGMENT ON CLAIM OF DECLARATORY RELIEF is granted.
2. Defendant's COUNTER-MOTION FOR SUMMARY JUDGMENT is denied.

3. NRS §116.3116(1) is a statute which creates for the benefit of Nevada homeowners' associations a statutory lien against a homeowner's unit for (a) any construction penalty that is imposed against the unit's owner pursuant to NRS §116.310305, (b) any assessment levied against that unit, and (c) any fines imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due (the "General Statutory Lien").

4. Pursuant to NRS §116.3116(2), the homeowners' association's General Statutory Lien is junior to a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent ("First Security Interest") except for a portion of the homeowners' association's General Statutory Lien which remains superior to the First Security Interest (the "Super Priority Lien").

5. Defendant, as a Nevada homeowners' association, therefore, has a Super Priority Lien which has payment priority over the First Security Interest on a homeowners' unit. However, the Super Priority Lien amount is not without limits and NRS §116.3116(2) is clear that the amount of the Super Priority Lien (that portion of the General Statutory Lien which retains a priority payment status over the First Security Interest) is limited "to the extent" of a homeowners' association's assessments for common expenses based upon the association's periodic budget that would have become due, in the absence of acceleration, in the 9 month period immediately preceding Defendant's institution of an action to enforce its General Statutory Lien (which is 9 months of regular, common assessments) and "to the extent of" external repair costs pursuant to NRS §116.310312 unless regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien.

6. The base assessment figure used in the calculation of the Super Priority Lien is the unit's un-accelerated, monthly assessment figure for association common expenses which is wholly determined by the homeowners association's "periodic budget," as adopted by the association, and not determined by any other document or statute. Thus, the phrase contained in NRS §116.3116(2) which states, "... to the extent of the assessments for common expenses

based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien..." means a maximum figure equaling 9 months of an association's regular, monthly (not annual) assessments. If assessments are paid quarterly, then 3 quarters of assessments (i.e., 9 months) would equal the Super Priority Lien, plus external repair costs pursuant to NRS §116.310312.

7. The words "to the extent of" contained in NRS §116.3116(2) mean "no more than," which clearly indicates a maximum figure or a cap on the Super Priority Lien which cannot be exceeded.

8. Thus, while assessments, penalties, fees, charges, late charges, fines and interest may be included within the Super Priority Lien, in no event can the total amount of the Super Priority Lien exceed an amount equaling 9 months of the Defendant's regular monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the association's institution of an action to enforce the lien, plus external repair costs pursuant to NRS 116.310312.

9. In addition to the arguments of counsel contained in the briefs on file, in rendering this decision, the Court considered all exhibits appended to such all briefs, including but not limited to law review articles, the legislative history of NRS 116.3116, the history of the Uniform Common Interest Ownership Act, intermediate appellate and supreme court case law of other states, and the Commission on Common-Interest Communities & Condominium Hotels' Advisory Opinion which opined that a homeowners' association may collect as a part of the Super Priority Lien interest, late fees or charges, and the costs of collecting, but did not directly opine upon the issue of whether there was a maximum limit to the Super Priority Lien regardless of the constituent elements thereof, which was the question before this Court.

10. While the Court considered all such supporting materials, the Court is bound by the precedent of the Nevada Supreme Court which directs trial courts that, "[W]here a statute is clear on its face, a court may not go beyond the language of the statute in determining the

legislature's intent." *Diaz v. Eighth Judicial Dist. Court ex rel. County of Clark*, 116 Nev. 88, 94, 993 P.2d 50 (2000).

11. The Court finds that NRS 116.3116 is clear on its face. After the foreclosure by a first security interest on a unit recorded before the date on which the assessment sought to be enforced became delinquent, a portion of a homeowners' association's statutory lien under NRS 116.3116(1) is prior to the first security interest only to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 (exterior repair costs) and only to the extent of the assessments for common expenses which are based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien. The 9 month figure is derived by taking the monthly assessment figure for common expenses as contained in the association's periodic budget which existed immediately prior to the association's institution of an action to enforce its lien, and multiplying by 9.

12. Prior to the October 1, 2009, amendment increasing the Super Priority Lien, the maximum amount of the Super Priority Lien was limited to the extent of the assessments for common expenses which are based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien.

IT IS SO ORDERED.

DISTRICT COURT JUDGE Dept. 24 2012 Date

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December 12, 2012

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Las Vegas, Nevada 89101

Dear Prem Investments:

In November, the prior Director of the Nevada Department of Business & Industry, Terry Johnson, informed you that your request for an advisory opinion from the Director's office was sent by Director Johnson to the Real Estate Division. Enclosed please find the Division's Advisory Opinion #13-01, issued in response to your request for an advisory opinion on the questions posed concerning the super priority lien in NRS 116.3116.

This advisory opinion will be posted on the Division's web site. It provides the Division's interpretation of NRS 116 statutes applicable to the questions posed.

Sincerely,

Gail J. Anderson
Administrator

Encl. Advisory Opinion 13-01

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STATE OF NEVADA
DEPARTMENT OF BUSINESS AND INDUSTRY
REAL ESTATE DIVISION
ADVISORY OPINION

Subject:	Advisory No. 13-01	20 pages
The Super Priority Lien	Issued By: Real Estate Division	
	Amends/ Supersedes N/A	
Reference(s): NRS 116.3102; ; NRS 116.310312; NRS 116.310313; NRS 116.3115; NRS 116.3116; NRS 116.31162; Commission for Common Interest Communities and Condominium Hotels Advisory Opinion No. 2010-01		Issue Date: December 12, 2012

QUESTION #1:

Pursuant to NRS 116.3116, may the portion of the association's lien which is superior to a unit's first security interest (referred to as the "super priority lien") contain "costs of collecting" defined by NRS 116.310313?

QUESTION #2:

Pursuant to NRS 116.3116, may the sum total of the super priority lien ever exceed 9 times the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115, plus charges incurred by the association on a unit pursuant to NRS 116.310312?

QUESTION #3:

Pursuant to NRS 116.3116, must the association institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3 in order for the super priority lien to exist?

SHORT ANSWER TO #1:

No. The association's lien does not include "costs of collecting" defined by NRS 116.310313, so the super priority portion of the lien may not include such costs. NRS 116.310313 does not say such charges are a lien on the unit, and NRS 116.3116 does not make such charges part of the association's lien.

SHORT ANSWER TO #2:

No. The language in NRS 116.3116(2) defines the super priority lien. The super priority lien consists of unpaid assessments based on the association's budget and NRS 116.310312 charges, nothing more. The super priority lien is limited to: (1) 9 months of assessments; and (2) charges allowed by NRS 116.310312. The super priority lien based on assessments may not exceed 9 months of assessments as reflected in the association's budget, and it may not include penalties, fees, late charges, fines, or interest. References in NRS 116.3116(2) to assessments and charges pursuant to NRS 116.310312 define the super priority lien, and are not merely to determine a dollar amount for the super priority lien.

SHORT ANSWER TO #3:

No. The association must *take action* to enforce its super priority lien, but it need not institute a civil action by the filing of a complaint. The association may begin the process for foreclosure in NRS 116.31162 or exercise any other remedy it has to enforce the lien.

ANALYSIS OF THE ISSUES:

This advisory opinion – provided in accordance with NRS 116.623 – details the Real Estate Division's opinion as to the interpretation of NRS 116.3116(1) and (2). The Division hopes to help association boards understand the meaning of the statute so they are better equipped to represent the interests of their members. Associations are encouraged to look at the entirety of a situation surrounding a particular deficiency and evaluate the association's best option for collection. The first step in that analysis is to understand what constitutes the association's lien, what is not part of the lien, and the status of the lien compared to other liens recorded against the unit.

Subsection (1) of NRS 116.3116 describes what constitutes the association's lien; and subsection (2) states the lien's priority compared to other liens recorded against a unit. NRS 116.3116 comes from the Uniform Common Interest Ownership Act (1982) (the "Uniform Act"), which Nevada adopted in 1991. So, in addition to looking at the language of the relevant Nevada statute, this analysis includes references to the Uniform Act's equivalent provision (§ 3-116) and its comments.

I. NRS 116.3116(1) DEFINES WHAT THE ASSOCIATION'S LIEN CONSISTS OF.

NRS 116.3116(1) provides generally for the lien associations have against units within common-interest communities. NRS 116.3116(1) states as follows:

> The association has a lien on a unit for **any construction penalty that is imposed against the unit's owner pursuant to NRS 116.310305, any assessment levied against that unit or any fines** imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due. **Unless the declaration otherwise provides, any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS 116.3102 are enforceable as assessments** under this section. If an assessment is payable in installments, the full amount of the assessment is a lien from the time the first installment thereof becomes due.

(emphasis added).

Based on this provision, the association's lien includes assessments, construction penalties, and fines imposed against a unit when they become due. In addition – unless the declaration otherwise provides – penalties, fees, charges, late charges, fines, and interest charged pursuant to NRS 116.3102(1)(j) through (n) are also part of the association's lien in that such items are enforceable as if they were assessments. Assessments can be foreclosed pursuant to NRS 116.31162, but liens for fines and penalties may not be foreclosed unless they satisfy the requirements of NRS 116.31162(4). Therefore, it is important to accurately categorize what comprises each portion of the association's lien to evaluate enforcement options.

A. "COSTS OF COLLECTING" (DEFINED BY NRS 116.310313) ARE NOT PART OF THE ASSOCIATION'S LIEN

NRS 116.3116(1) does not specifically make costs of collecting part of the association's lien, so the determination must be whether such costs can be included under the incorporated provisions of NRS 116.3102. NRS 116.3102(1)(j) through (n) identifies five very specific categories of penalties, fees, charges, late charges, fines, and interest associations may impose. This language encompasses all penalties, fees,

charges, late charges, fines, and interest that are part of the lien described in NRS 116.3116(1).

NRS 116.3102(1)(j) through (n) states:

> 1. Except as otherwise provided in this section, and subject to the provisions of the declaration, the association may do any or all of the following: ...
> (j) Impose and receive any payments, fees or charges for the use, rental or operation of the common elements, other than limited common elements described in subsections 2 and 4 of NRS 116.2102, and for services provided to the units' owners, including, without limitation, any services provided pursuant to NRS 116.310312.
> **(k) Impose charges for late payment of assessments pursuant to NRS 116.3115.**
> (l) Impose construction penalties when authorized pursuant to NRS 116.310305.
> (m) Impose reasonable fines for violations of the governing documents of the association only if the association complies with the requirements set forth in NRS 116.31031.
> (n) Impose reasonable charges for the preparation and recordation of any amendments to the declaration or any statements of unpaid assessments, and impose reasonable fees, not to exceed the amounts authorized by NRS 116.4109, for preparing and furnishing the documents and certificate required by that section.

(emphasis added).

Whatever charges the association is permitted to impose by virtue of these provisions are part of the association's lien. Subsection (k) – emphasized above – has been used – the Division believes improperly – to support the conclusion that associations may include costs of collecting past due obligations as part of the association's lien. The Commission for Common Interest Communities and Condominium Hotels issued Advisory Opinion No. 2010-01 in December of 2010. The Commission's advisory concludes as follows:

> An association may collect as a part of the super priority lien (a) interest permitted by NRS 116.3115, (b) late fees or charges authorized by the declaration, (c) charges for preparing any statements of unpaid assessments and (d) the "costs of collecting" authorized by NRS 116.310313.

Analysis of what constitutes the *super priority lien* portion of the association's lien is discussed in Section III, but the Division agrees that the association's lien does include items noted as (a), (b) and (c) of the Commission's advisory opinion above. To support item (d), the Commission relies on NRS 116.3102(1)(k) which gives associations the power to: "Impose charges for late payment of assessments pursuant to NRS 116.3115." This language would include interest authorized by statute and late fees if authorized by the association's declaration.

"Costs of collecting" defined by NRS 116.310313 is too broad to fall within the parameters of charges for late payment of assessments.[1] By definition, "costs of collecting" relate to the collection of past due "obligations." "Obligations" are defined as "any assessment, fine, construction penalty, fee, charge or interest levied or imposed against a unit's owner."[2] In other words, costs of collecting includes more than "charges for late payment of assessments."[3] Therefore, the plain language of NRS 116.3116(1) does not incorporate costs of collecting into the association's lien. Further review of the relevant statutes and legislative action supports this conclusion.

B. PRIOR LEGISLATIVE ACTION SUPPORTS THE POSITION THAT COSTS OF COLLECTING ARE NOT PART OF THE ASSOCIATION'S LIEN DESCRIBED BY NRS 116.3116(1).

The language of NRS 116.3116(1) allows for "charges for late payment of assessments" to be part of the association's lien.[4] "Charges for late payments" is not the same as "costs of collecting." "Costs of collecting" was first defined in NRS 116 by the adoption of NRS 116.310313 in 2009. NRS 116.310313(1) provides for the association's

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[1] Charges for late payment of assessments comes from NRS 116.3102(1)(k) and is incorporated into NRS 116.3116(1).

[2] NRS 116.310313.

[3] "Costs of collecting" includes any fee, charge or cost, by whatever name, including, without limitation, any collection fee, filing fee, recording fee, fee related to the preparation, recording or delivery of a lien or lien rescission, title search lien fee, bankruptcy search fee, referral fee, fee for postage or delivery and any other fee or cost that an association charges a unit's owner for the investigation, enforcement or collection of a past due obligation. The term does not include any costs incurred by an association if a lawsuit is filed to enforce any past due obligation or any costs awarded by a court. NRS 116.310313(3)(a).

[4] NRS 116.3102(1)(k) (incorporated into NRS 116.3116(1)).

right to charge a unit owner "reasonable fees to cover the costs of collecting any past due obligation." NRS 116.310313 is not referenced in NRS 116.3116 or NRS 116.3102, nor does NRS 116.310313 specifically provide for the association's right to lien the unit for such costs.

In contrast, NRS 116.310312, also adopted in 2009, allows an association to enter the grounds of a unit to maintain the property or abate a nuisance existing on the exterior of the unit. NRS 116.310312 specifically provides for the association's expenses to be a lien on the unit and provides that the lien is prior to the first security interest.[5] NRS 116.3102(1)(j) was amended to allow these expenses to be part of the lien described in NRS 116.3116(1). And NRS 116.3116(2) was amended to allow these expenses to be included in the association's super priority lien.

The Commission's advisory opinion from December 2010 also relies on changes to the Uniform Act from 2008 to support the notion that collection costs should be part of the association's super priority lien. Nevada has not adopted those changes to the Uniform Act. Since the Commission's advisory opinion, the Nevada Legislature had an opportunity to clarify the law in this regard.

In 2011, the Nevada Legislature considered Senate Bill 174, which proposed changes to NRS 116.3116. S.B. 174 originally included changes to NRS 116.3116(1) such that the association's lien would specifically include "costs of collecting" as defined in NRS 116.310313. S.B. 174 proposed changes to NRS 116.3116 (1) and (2) to bring the statute in line with the changes to the same provision in the Uniform Act amended in 2008.

The Uniform Act's amendments were removed from S.B. 174 by the first reprint. As amended, S.B. 174 proposed changes to NRS 116.3116(2) expanding the super priority lien amount to include costs of collecting not to exceed $1,950, in addition to 9 months

[5] See NRS 116.310312(4) and (6).

of assessments. S.B. 174 was discussed in great detail and ultimately died in committee.[6]

Also in 2011, Senate Bill 204 – as originally introduced – included changes to NRS 116.3116(1) to expand the association's lien to include attorney's fees and costs and "any other sums due to the association."[7] The bill's language was taken from the Uniform Act amendments in 2008. All changes to NRS 116.3116(1) were removed from the hill prior to approval.

The Nevada Legislature's actions in the 2009 and 2011 sessions are indicative of its intent not to make costs of collecting part of the lien. The Nevada Legislature could have made the costs of collecting part of the association's lien, like it did for costs under NRS 116.310312. It did not do so. In order for the association to have a right to lien a unit under NRS 116.3116(1), the charge or expense must fall within a category listed in the plain language of the statute. Costs of collecting do not fall within that language. Based on the foregoing, the Division concludes that the association's lien does not include "costs of collecting" as defined by NRS 116.310313.

A possible concern regarding this outcome could be that an association may not be able to recover their collection costs relating to a foreclosure of an assessment lien. While that may seem like an unreasonable outcome, a look at the bigger picture must be considered to put it in perspective. NRS 116.31162 through NRS 116.31168, inclusive, outlines the association's ability to enforce its lien through foreclosure. Associations have a lien for assessments that is enforced through foreclosure. The association's expenses are reimbursed to the association from the proceeds of the sale. NRS 116.31164(3)(c) allows the proceeds of the foreclosure sale to be distributed in the following order:

(1) The reasonable expenses of sale;

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[6] See http://leg.state.nv.us/Session/76th2011/Reports/history.cfm?ID=423.
[7] Senate Bill No. 204 – Senator Copening, Sec. 49, ln. 1-16, February 28, 2011.

(2) The reasonable expenses of securing possession before sale, holding, maintaining, and preparing the unit for sale, including payment of taxes and other governmental charges, premiums on hazard and liability insurance, and, to the extent provided for by the declaration, reasonable attorney's fees and other legal expenses incurred by the association;
(3) Satisfaction of the association's lien;
(4) Satisfaction in the order of priority of any subordinate claim of record; and
(5) Remittance of any excess to the unit's owner.

Subsections (1) and (2) allow the association to receive its expenses to enforce its lien through foreclosure *before* the association's lien is satisfied. Obviously, if there are no proceeds from a sale or a sale never takes place, the association has no way to collect its expenses other than through a civil action against the unit owner. Associations must consider this consequence when making decisions regarding collection policies understanding that every delinquent assessment may not be treated the same.

II. NRS 116.3116(2) ESTABLISHES THE PRIORITY OF THE ASSOCIATION'S LIEN.

Having established that the association has a lien on the unit as described in subsection (1) of NRS 116.3116, we now turn to subsection (2) to determine the lien's priority in relation to other liens recorded against the unit. The lien described by NRS 116.3116(1) is what is referred to in subsection (2). Understanding the priority of the lien is an important consideration for any board of directors looking to enforce the lien through foreclosure or to preserve the lien in the event of foreclosure by a first security interest.

NRS 116.3116(2) provides that the association's lien is prior to all other liens recorded against the unit *except:* liens recorded against the unit before the declaration; first security interests (first deeds of trust); and real estate taxes or other governmental assessments. There is one exception to the exceptions, so to speak, when it comes to priority of the association's lien. This exception makes a portion of an association's lien prior to the first security interest. The portion of the association's lien given priority status to a first security interest is what is referred to as the "super priority lien" to

distinguish it from the other portion of the association's lien that is subordinate to a first security interest.

The ramifications of the super priority lien are significant in light of the fact that superior liens, when foreclosed, remove all junior liens. An association can foreclose its super priority lien and the first security interest holder will either pay the super priority lien amount or lose its security. NRS 116.3116 is found in the Uniform Act at § 3-116. Nevada adopted the original language from § 3-116 of the Uniform Act in 1991. From its inception, the concept of a super priority lien was a novel approach. The Uniform Act comments to § 3-116 state:

> [A]s to prior first security interests the association's lien does have priority for 6 months' assessments based on the periodic budget. A significant departure from existing practice, the 6 months' priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders. As a practical matter, secured lenders will most likely pay the 6 months' assessments demanded by the association rather than having the association foreclose on the unit. If the lender wishes, an escrow for assessments can be required.

This comment on § 3-116 illustrates the intent to allow for 6 months of assessments to be prior to a first security interest. The reason this was done was to accommodate the association's need to enforce collection of unpaid assessments. The controversy surrounding the super priority lien is in defining its limit. This is an important consideration for an association looking to enforce its lien. There is little benefit to an association if it incurs expenses pursuing unpaid assessments that will be eliminated by an imminent foreclosure of the first security interest. As stated in the comment, it is also likely that the holder of the first security interest will pay the super priority lien amount to avoid foreclosure by the association.

III. THE AMOUNT OF THE SUPER PRIORITY LIEN IS LIMITED BY THE PLAIN LANGUAGE OF NRS 116.3116(2).

NRS 116.3116(2) states:

> A lien under this section is prior to all other liens and encumbrances on a unit except:
> (a) Liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances which the association creates, assumes or takes subject to;
> (b) A first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent or, in a cooperative, the first security interest encumbering only the unit's owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent; and
> (c) Liens for real estate taxes and other governmental assessments or charges against the unit or cooperative.
> ***The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien,*** unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien. If federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien, the period during which the lien is prior to all security interests described in paragraph (b) must be determined in accordance with those federal regulations, except that notwithstanding the provisions of the federal regulations, the period of priority for the lien must not be less than the 6 months immediately preceding institution of an action to enforce the lien. This subsection does not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association.

(emphasis added)

Having found previously that costs of collecting are not part of the lien means they are not part of the super priority lien. The question then becomes what can be included as part of the super priority lien. Prior to 2009, the super priority lien was limited to 6 months of assessments. In 2009, the Nevada legislature changed the 6 months of

assessments to 9 months and added expenses for abatement under NRS 116.310312 to the super priority lien amount. But to the extent federal law applicable to the first security interest limits the super priority lien, the super priority lien is limited to 6 months of assessments.

The emphasized language in the portion of the statute above identifies the portion of the association's lien that is prior to the first security interest, i.e. what comprises the super priority lien. This language states that there are two components to the super priority lien. The first is "to the extent of any charges" incurred by the association pursuant to NRS 116.310312. NRS 116.310312(4) makes clear that the charges assessed against the unit pursuant to this section are a lien on the unit and subsection (6) makes it clear that such lien is prior to first security interests. These costs are also specifically part of the lien described in NRS 116.3116(1) incorporated through NRS 116.3102(1)(j). This portion of the super priority lien is specific to charges incurred pursuant to NRS 116.310312. Payment of those charges relieves their super priority lien status. There does not seem to be any confusion as to what this part of the super priority lien is. Analysis of the super priority lien will focus on the second portion.

A. THE SUPER PRIORITY LIEN ATTRIBUTABLE TO ASSESSMENTS IS LIMITED TO 9 MONTHS OF ASSESSMENTS AND CONSISTS ONLY OF ASSESSMENTS.

The second portion of the super priority lien is "to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien."

The statute uses the language "to the extent of the assessments" to illustrate that there is a limit on the amount of the super priority lien, just like the language concerning expenses pursuant to NRS 116.310312, but this portion concerns assessments. The limit on the super priority lien is based on the assessments for

common expenses reflected in a budget adopted pursuant to NRS 116.3115 which would have become due in 9 months. The assessment portion of the super priority lien is no different than the portion derived from NRS 116.310312. Each portion of the super priority lien is limited to the specific charge stated and nothing else.

Therefore, while the association's *lien* may include any penalties, fees, charges, late charges, fines and interest charged pursuant to NRS 116.3102 (1) (j) to (n), inclusive, the total amount of the *super priority lien* attributed to assessments is no more than 9 months of the monthly assessment reflected in the association's budget. Association budgets do not reflect late charges or interest attributed to an anticipated delinquent owner, so there is no basis to conclude that such charges could be included in the super priority lien or in addition to the assessments. Such extraneous charges are not included in the association's super priority lien.

NRS 116.3116 originally provided for 6 months of assessments as the super priority lien. Comments to the Uniform Act quoted previously support the conclusion that the original intent was for 6 months of the assessments alone to comprise the super priority lien amount and not the penalties, charges, or interest. It is possible that an argument could be made that the language is so clear in this regard one should not look to legislative intent. But considering the controversy surrounding the meaning of this statute, the better argument is that legislative intent should be used to determine the meaning.

The Commission's advisory opinion of December 2010 concluded that assessments *and* additional costs are part of the super priority lien. The Commission's advisory opinion relies in part on a Wake Forest Law Review[8] article from 1992 discussing the Uniform Act. This article actually concludes that the Uniform Act language limits the

[8] See James Winokur, *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 353, 366-69 (1992).

amount of the super priority lien to 6 months of assessments, but that the super priority lien does not necessarily consist of only delinquent assessments.[9] It can include fines, interest, and late charges.[10] The concept here is that all parts of the lien are prior to a first security interest and that reference to assessments for the super priority lien is only to define a specific dollar amount.

The Division disagrees with this interpretation because of the unreasonable consequences it leaves open. For example, a unit owner may pay the delinquent assessment amount leaving late charges and interest as part of the super priority lien. If the super priority lien can encompass more than just delinquent assessments in this situation, it would give the association the right to foreclose its lien consisting only of late charges and interest prior to the first security interest. It is also unreasonable to expect that fines (which cannot be foreclosed generally) survive a foreclosure of the first security interest. Either the lender or the new buyer would be forced to pay the prior owner's fines. The Division does not find that these consequences are reasonable or intended by the drafters of the Uniform Act or by the Nevada Legislature. Even the 2008 revisions to the Uniform Act do not allow for anything other than assessments and costs incurred to foreclose the lien to be included in the super priority lien. Fines, interest, and late charges are not *costs* the association incurs.

In 2009, the Nevada Legislature revised NRS 116.3116 to expand the association's super priority lien. Assembly Bill 204 sought to extend the super priority lien of 6 months of assessments to 2 years of assessments.[11] The Commission's chairman, Michael Buckley, testified on March 6, 2009 before the Assembly Committee on Judiciary on A.B. 204 that the law was unclear as to whether the 6 month priority can

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[9] See id. at 367 (referring to the super priority lien as the "six months assessment ceiling" being computed from the periodic budget).
[10] See id.
[11] See http://leg.state.nv.us/Session/75th2009/Reports/history.cfm?ID=416.

include the association's costs and attorneys' fees.[12] Mr. Buckley explained that the Uniform Act amendments in 2008 allowed for the collection of attorneys' fees and costs incurred by the association in foreclosing the assessment lien as part of the super priority lien. Mr. Buckley requested that the 2008 change to the Uniform Act be included in A.B. 204. Mr. Buckley's requested change to A.B. 204 to expand the super priority lien never made it into A.B. 204. Ultimately, A.B. 204 was adopted to change 6 months to 9 months, but commenting on the intent of the bill, Assemblywoman Ellen Spiegel stated:

> Assessments covered under A.B. 204 are the regular monthly or quarterly dues for their home. *I carefully put this bill together to make sure it did not include any assessments for penalties, fines or late fees.* The bill covers the basic monies the association uses to build its regular budgets.

(emphasis added).[13]

It is significant that the legislative intent in changing 6 months to 9 months was with the understanding that no portion of that amount would be for penalties, fines, or late fees and that it only covers the basic monies associations use to build their regular budgets. It does make sense that a lien superior to a first security interest would not include penalties, fines, and interest. To say that the super priority lien includes more than just 9 months of assessments allows several undesirable and unreasonable consequences.

B. NEVADA HAS NOT ADOPTED AMENDMENTS TO THE UNIFORM ACT TO ALTER THE ORIGINAL INTENT OF THE SUPER PRIORITY LIEN.

The changes to the Uniform Act support the contention that only what is referenced as the super priority lien in NRS 116.3116(2) is what comprises the super priority lien. In 2008, § 3-116 of the Uniform Act was revised as follows:

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[12] See Minutes of the Meeting of the Assembly Committee on Judiciary, Seventy-fifth Session, March 6, 2009 at 44-45.
[13] See Minutes of the Senate Committee on Judiciary, Seventy-fifth Session, May 8, 2009 at 27.

SECTION 3-116. LIEN FOR ~~ASSESSMENTS~~; SUMS DUE ASSOCIATION; ENFORCEMENT.

(a) The association has a statutory lien on a unit for any assessment ~~levied against~~ attributable to that unit or fines imposed against its unit owner. Unless the declaration otherwise provides, reasonable attorney's fees and costs, other fees, charges, late charges, fines, and interest charged pursuant to Section 3-102(a)(10), (11), and (12), and any other sums due to the association under the declaration, this [act], or as a result of an administrative, arbitration, mediation, or judicial decision are enforceable in the same manner as unpaid assessments under this section. If an assessment is payable in installments, the lien is for the full amount of the assessment from the time the first installment thereof becomes due.

(b) A lien under this section is prior to all other liens and encumbrances on a unit except:

~~(i)~~(1) liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances ~~which~~ that the association creates, assumes, or takes subject to~~,~~ ;

~~(ii)~~(2) except as otherwise provided in subsection (c), a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent, or, in a cooperative, the first security interest encumbering only the unit owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent~~;~~; and

~~(iii)~~(3) liens for real estate taxes and other governmental assessments or charges against the unit or cooperative.

(c) A ~~The~~ lien under this section is also prior to all security interests described in subsection (b)(2) ~~clause (ii) above~~ to the extent of both the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien and reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien. ~~This subsection~~ Subsection (b) and this subsection ~~does~~ do not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association. [~~The~~ A lien under this section is not subject to ~~the provisions of~~ [insert appropriate reference to state homestead, dower and curtesy, or other exemptions].]

Explaining the reason for the changes to these sections, the Uniform Act includes the following comments:

> Associations must be legitimately concerned, as fiduciaries of the unit owners, that the association be able to collect periodic common charges from recalcitrant unit owners in a timely way. To address those concerns, the section contains these 2008 amendments:
>
> First, subsection (a) is amended to add the cost of the association's reasonable attorneys fees and court costs to the total value of the association's existing 'super lien' – currently, 6 months of regular common assessments. This amendment is identical to the amendment adopted by Connecticut in 1991; see C.G.S. Section 47-258(b). The increased amount of the association's lien has been approved by Fannie Mae and local lenders and has become a significant tool in the successful collection efforts enjoyed by associations in that state.

The Uniform Act's amendment in 2008 is very telling about § 3-116's original intent. The comments state reasonable attorneys' fees and court costs are *added* to the super priority lien stating that it is currently 6 months of regular common assessments. The Uniform Act adds attorneys' fees and costs to subsection (a) which defines the association's lien. Those attorneys' fees and costs attributable to foreclosure efforts are also added to subsection (c) which defines the super priority lien amount.

If the association's lien ever included attorneys' fees and court costs as "charges for late payment of assessments" or if such sum was part of the super priority lien, there would be no reason to add this language to subsection (a) and (c). Or at a minimum, the comments would assert the amendment was simply to make the language more clear. It is also clear by the language that only what is specified as part of the super priority lien can comprise the super priority lien. The additional language defining the super priority lien provides for costs that are *incurred* by the association foreclosing the lien. This is further evidence that the super priority lien does not and never did consist of interest, fines, penalties or late charges. These charges are not incurred by the association and they should not be part of any super priority lien.

The Nevada Legislature had the opportunity to change NRS 116.3116 in 2009 and 2011 to conform to the Uniform Act. It chose not to. While the revisions under the

Uniform Act may make sense to some and they may be adopted in other jurisdictions, the fact of the matter is, Nevada has not adopted those changes. The changes to the Uniform Act cannot be insinuated into the language of NRS 116.3116. Based on the plain language of NRS 116.3116, legislative intent, and the comments to the Uniform Act, the Division concludes that the super priority lien is limited to expenses stemming from NRS 116.310312 and assessments as reflected in the association's budget for the immediately preceding 9 months from institution of an action to enforce the association's lien.

IV. "ACTION" AS USED IN NRS 116.3116 DOES NOT REQUIRE A CIVIL ACTION ON THE PART OF THE ASSOCIATION.

NRS 116.3116(2) provides that the super priority lien pertaining to assessments consists of those assessments "which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien." NRS 116.3116 requires that the association take action to enforce its lien in order to determine the immediately preceding 9 months of assessments. The question presented is whether this action must be a civil action.

During the Senate Committee on Judiciary hearing on May 8, 2009, the Chair of the Committee, Terry Care, stated with reference to AB 204:

> One thing that bothers me about section 2 is the duty of the association to enforce the liens, but I understand the argument with the economy and the high rate of delinquencies not only to mortgage payments but monthly assessments. Bill Uffelman, speaking for the Nevada Bankers Association, broke it down to a 210-day scheme that went into the current law of six months. Even though you asked for two years, I looked at nine months, thinking the association has a duty to move on these delinquencies.

NRS 116 does not require an association to take any particular action to enforce its lien, but that it institutes "an action." NRS 116.31162 provides the first steps to foreclose the association's lien. This process is started by the mailing of a notice of delinquent

assessment as provided in NRS 116.31162(1)(a). At that point, the immediately preceding 9 months of assessments based on the association's budget determine the amount of the super priority lien. The Division concludes that this action by the association to begin the foreclosure of its lien is "action to enforce the lien" as provided in NRS 116.3116(2). The association is not required to institute a civil action in court to trigger the 9 month look back provided in NRS 116.3116(2). Associations should make the delinquent assessment known to the first security holder in an effort to receive the super priority lien amount from them as timely as possible.

ADVISORY CONCLUSION:

An association's lien consists of assessments, construction penalties, and fines. Unless the association's declaration provides otherwise, the association's lien also includes all penalties, fees, charges, late charges, fines and interest pursuant to NRS 116.3102(1)(j) through (n). While charges for late payment of assessments are part of the association's lien, "costs of collecting" as defined by NRS 116.310313, are not. "Costs of collecting" defined by NRS 116.310313 includes costs of collecting any *obligation*, not just assessments. Costs of collecting are not merely a charge for a late payment of assessments. Since costs of collecting are not part of the association's lien in NRS 116.3116(1), they cannot be part of the super priority lien detailed in subsection (2).

The super priority lien consists of two components. By virtue of the detail provided by the statute, the super priority lien applies to the charges incurred under NRS 116.310312 and up to 9 months of assessments as reflected in the association's regular budget. The Nevada Legislature has not adopted changes to NRS 116.3116 that were made to the Uniform Act in 2008 despite multiple opportunities to do so. In fact, the Legislative intent seems rather clear with Assemblywoman Spiegel's comments to A.B. 204 that changed 6 months of assessments to 9 months. Assemblywoman Spiegel stated that she "carefully put this bill together to make sure it did not include any

assessments for penalties, fines or late fees." This is consistent with the comments to the Uniform Act stating the priority is for assessments based on the periodic budget. In other words, when the super priority lien language refers to 9 months of assessments, assessments are the only component. Just as when the language refers to charges pursuant to NRS 116.310312, those charges are the only component. Not in either case can you substitute other portions of the entire lien and make it superior to a first security interest.

Associations need to evaluate their collection policies in a manner that makes sense for the recovery of unpaid assessments. Associations need to consider the foreclosure of the first security interest and the chances that they may not be paid back for the costs of collection. Associations may recover costs of collecting unpaid assessments if there are proceeds from the association's foreclosure.[14] But costs of collecting are not a lien under NRS 116.310313 or NRS 116.3116(1); they are the personal liability of the unit owner.

Perhaps an effective approach for an association is to start with foreclosure of the assessment lien after a nine month assessment delinquency or sooner if the association receives a foreclosure notice from the first security interest holder. The association will always want to enforce its lien for assessments to trigger the super priority lien. This can be accomplished by starting the foreclosure process. The association can use the super priority lien to force the first security interest holder to pay that amount. The association should incur only the expense it believes is necessary to receive payment of assessments. If the first security interest holder does not foreclose, the association will maintain its assessment lien consisting of assessments, late charges, and interest. If a loan modification or short sale is worked out with the owner's lender, the association is better off limiting its expenses and more likely to recover the assessments. Adding unnecessary costs of collection – especially after a short period of delinquency – can

[14] NRS 116.31164.

make it all the more impossible for the owner to come current or for a short sale to close. This situation does not benefit the association or its members.

IN THE SUPREME COURT OF THE STATE OF NEVADA

HORIZONS AT SEVEN HILLS HOMEOWNERS ASSOCIATION, Appellant, v. IKON HOLDINGS, LLC, a Nevada limited liability company; Respondent,	CASE NO. 63178 Dist. Ct. Case No. A-11-647850-B

RESPONDENT'S APPENDIX

VOL. 1

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DATED this 24th day of February, 2014.

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Nevada Administrative Code Currentness
Chapter 232. State Departments
Department of Bnsiness and Industry
Practice Before Department

NAC 232.040

NAC 232.040 Petition for declaratory order or advisory opinion: Authorization; filing; contents. (NRS 233B.120)

1. Except as otherwise provided in subsection 4, an interested person may petition the Director to issue a declaratory order or advisory opinion concerning the applicability of a statute, regulation or decision of the Department or any of its divisions.

2. The original and one copy of the petition must be filed with:

(a) The chief who is authorized to administer or enforce the statute or regulation or to issue the decision; or

(b) The Director, if the statute, regulation or decision is administered or enforced by the Director.

3. The petition must include:

(a) The name and address of the petitioner;

(b) The reason for requesting the order or opinion;

(c) A statement of facts that support the petition; and

(d) A clear and concise statement of the question to be decided by the Director or chief and the relief sought by the petitioner.

4. An interested person may not file a petition for a declaratory order or an advisory opinion concerning a question or matter that is an issue in an administrative, civil or criminal proceeding in which the interested person is a party.

Credits
(Added to NAC by Dep't of Commerce, eff. 12-17-87; A 5-14-92)

Current through July 31, 2013, Supplement 2013-1

NAC 232.040, NV ADC 232.040

RA0001

End of Document

MINUTES OF THE MEETING
OF THE
ASSEMBLY COMMITTEE ON JUDICIARY

Seventy-Fourth Session
April 3, 2007

The Committee on Judiciary was called to order by Chairman Bernie Anderson at 7:43 a.m., on Tuesday, April 3, 2007, in Room 3138 of the Legislative Building, 401 South Carson Street, Carson City, Nevada. The meeting was videoconferenced to Room 4401 of the Grant Sawyer State Office Building, 555 East Washington Avenue, Las Vegas, Nevada. Copies of the minutes, including the Agenda (Exhibit A), the Attendance Roster (Exhibit B), and other substantive exhibits are available and on file in the Research Library of the Legislative Counsel Bureau and on the Nevada Legislature's website at www.leg.state.nv.us/74th/committees/. In addition, copies of the audio record may be purchased through the Legislative Counsel Bureau's Publications Office (email: publications@lcb.state.nv.us; telephone: 775-684-6835).

COMMITTEE MEMBERS PRESENT:

Assemblyman Bernie Anderson, Chairman
Assemblyman William Horne, Vice Chairman
Assemblywoman Francis Allen
Assemblyman Ty Cobb
Assemblyman Marcus Conklin
Assemblywoman Susan Gerhardt
Assemblyman Ed Goedhart
Assemblyman Garn Mabey
Assemblyman Mark Manendo
Assemblyman John Oceguera
Assemblyman James Ohrenschall
Assemblyman Tick Segerblom

COMMITTEE MEMBERS ABSENT:

Assemblyman John C. Carpenter (Excused)
Assemblyman Harry Mortenson (Excused)

STAFF MEMBERS PRESENT:

Jennifer M. Chisel, Committee Policy Analyst
Risa Lang, Committee Counsel
Kaci Kerfeld, Committee Secretary
Matt Mowbray, Committee Assistant

OTHERS PRESENT:

Donna Toussaint, Private Citizen, West Sahara Community, Las Vegas, Nevada
Dan Newburn, Private Citizen, Las Vegas, Nevada
Kevin Janison, Private Citizen, Las Vegas, Nevada
Wallace Riddle, Private Citizen, Las Vegas, Nevada
Sandy Ambrose, Private Citizen, Las Vegas, Nevada
Gary Randall, Private Citizen, Las Vegas, Nevada
Bob Sidell, Representing Value Alliance, Las Vegas, Nevada
Karen Dennison, Representing the American Resort Development Association and Lake at Las Vegas Joint Venture Community, Nevada
Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities
Marilyn Brainard, Commissioner, Nevada Commission for Common-Interest Communities
Gail Anderson, Administrator, Department of Business and Industry, Real Estate Division, Nevada
Shari O'Donnell, Vice President of Government Affairs and Community Relations, Signature Homes, Nevada, Representing Nevada Commission for Common-Interest Communities
Kevin Ruth, Representing Community Association Management Companies through Executive Officers, Nevada
Randy Eckland, Representing the Howard Hughes Corporation and the Summerlin Community Association Management Team, Nevada
David Stone, Owner, Nevada Association Service
David Thomas, Resident, Summerlin Community, Nevada
Judy Farrah, Chairman of the Community Associations Institute of Nevada, and Representing Legislative Action Committee
Michael Trudell, Manager, Caughlin Ranch Homeowners Association, Nevada
Sam McMullen, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada

Mandy Shavinsky, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada
Bruce Arkell, Representing the Nevada Association of Land Surveyors

Chairman Anderson:
[Meeting called to order and roll called.]

I have an email addressed to Assemblyman Goedhart regarding Assembly Bill 371 which needs to be entered into the record (Exhibit C).

Let us open the hearing on Assembly Bill 396.

Assembly Bill 396: Makes various changes to the provisions governing common-interest communities. (BDR 10-1284)

Assemblywoman Francis O. Allen, Assembly District No. 4:
[Read from prepared testimony (Exhibit D). Also submitted proposed amendments (Exhibit E).]

Chairman Anderson:
If a homeowner in a common-interest community wishes to give away their voting rights to a certain person, may they do so?

Assemblywoman Allen:
Yes. This does not prevent proxy voting. They can fill out a form in which a person is named to vote on their behalf. This only prevents the systematic process of delegate voting, where one person represents an entire neighborhood.

Chairman Anderson:
If everyone on the block wants the same person to be their representative, would that be allowed?

Assemblywoman Allen:
The neighbors are allowed to cast ballots. They can acquire a proxy and give it to the person they choose to vote for them. The only thing that this does not allow is the systematic casting of votes, which many people do not even know takes place. For example, in our own races, only 40 or 50 percent of the electorate comes out to vote. What if the incumbent could cast the rest of the balance in their own favor?

Assemblyman Horne:
Is there anything to prevent an association from obtaining proxies that say "you agree that I will be able to cast your vote if at any time should you choose not to cast a ballot?"

Assemblywoman Allen:
No, it would not prohibit that. If a homeowners association (HOA) is determined, they could manipulate their rules to get the incumbents reelected. We can only do a finite amount of things. This would be a strong message from the legislature saying that we believe one man equals one vote.

Assemblyman Horne:
Could there be a provision that uses conspicuous language that states failure to vote in any particular election will allow your vote to be exercised by your delegate and may be cast for themselves? That would give the homeowners a fair warning that should they not vote, their delegate would get it.

Assemblywoman Allen:
That is not afforded to people right now. I am open to any suggestions from the Committee as to how to clarify this portion.

Donna Toussaint, Private Citizen, West Sahara Community, Las Vegas, Nevada:
I believe in the democratic process. Delegate voting disenfranchises everybody in the community. It costs thousands of dollars to hold a delegate election and we have to elect delegates every year. In my community, the homeowners pay $20 per month for assessments. We have seven sub associations, six of whom do not care what the master does. We have 2,208 single units, 60 businesses, and 1,800 apartments. The West Sahara Community Association sends a letter to every unit owner, including businesses, requesting that they submit their name to be a delegate. For each mailing, we have to pay for postage, copies, envelopes, and staff, which is around $800. We need 84 delegates; last year we received twelve, and this year we received eight. We compile the responses we receive with their resumes and send everything back out to the unit owners; another $800. We get the third mailing back and call a special meeting at which we open the ballots in public. After that is done, we have to send all of the information back out to the unit owners; another $800. In our community, for every 50 homes there is one delegate. If everyone in area number one votes in favor of one person, but that area did not have a delegate, those votes cannot be counted. In area number two, if we have one person say they will be a delegate and one person who actually votes, that delegate can cast all 50 votes for all of the homeowners in favor of whoever that delegate wants. I do not know where the equity is in this. It is very expensive for our HOA and the system does not work. Delegates may work when the developer is still

involved, but my community is 22 years old. With seven sub associations, the delegate system has created more apathy than you can imagine. Why would anybody vote for a board of directors when they do not know whether or not their vote will count? The homeowners get very confused as to why there is or is not a delegate. It creates the problem where the homeowners get angry and they feel like they do not have a voice. They do not want someone telling them what they have to say. We do not use proxies in our community because the proxy process was abused so much in the late 80's and early 90's. We need 84 delegates in order to have a complete election. Since 1985, the West Sahara Community Association has not had a legal election because we cannot get 84 delegates. We cannot change our documents because we cannot get enough delegates. We need help from the legislature. Our documents are 22 years old and they are written very poorly. This system is broken, costly, and expensive.

Chairman Anderson:
As I understand it, your community has been divided into districts and the election within each district is determined by the number of people who show up to vote. If you have one person who is nominated in that district and that person is the only one that votes, then they get the seat. Is that correct?

Donna Toussaint:
As far as delegates, that is correct. When you are electing the board of directors, you cannot count someone's vote unless they have a delegate. Once a delegate is elected, they can vote any way they want.

Chairman Anderson:
So a representative is elected because he received the only vote from the district and was the only person willing to take on the responsibility. He then has the responsibility of electing a board of directors, but he is not obligated to vote a particular way.

Donna Toussaint:
We would hope that the delegates would cast the votes the way the members would like them to be cast, but that is not always the situation. We have people who want to vote but we cannot count their votes if they do not have a delegate.

Chairman Anderson:
It is not any different than the election that brought in the 42 of us. We all represent the same number of people, but that does not mean that they are all registered voters. The numbers of registered voters in our districts are

dramatically different. If a representative is elected to make decisions, are they entitled to make decisions whether everybody in the district likes it or not?

Donna Toussaint:
Suppose you were running for election and the state law said that in order for you to be elected, there would have to be a delegate in place to cast the votes. If you received 98 percent of the votes but the delegate just did not like you, he could vote for someone else. If a homeowner decides to cast his vote, the vote should count for the person they want. People do not vote because they know that their vote does not count.

Chairman Anderson:
Representative democracies are difficult to understand because they do not have a direct election.

Donna Toussaint:
I would like the way the state government works to funnel down to HOA and not have a system like the electoral college. I think it would be beneficial to the community and to the homeowners.

Dan Newburn, Private Citizen, Las Vegas, Nevada:
In 1994, the Summerlin Community Baptist Church started with seven people. A few years later, we purchased property in the Summerlin North Association. Shortly after we moved into the building, we were notified that we would need to begin paying a monthly assessment which would be based on the number of houses that could have been built on the four acres we owned. When I purchased my private home in Summerlin, it was made absolutely clear that we were moving into a HOA and there would be a monthly fee. That subject was never brought up when purchasing the church. During the years we owned the property and did not have a building on it, we did not pay any assessments. I inquired among the other churches in the area and found that five of the churches as well as the Hebrew Academy and other nonprofits did not pay a fee, and that only the new churches being built were being assessed. We met with the Board of Directors and felt that they too thought one house of worship should not be treated differently than another house of worship. I felt we were on our way to equality when I discovered that one of the larger churches that had been recently built had approached the association and asked if they could pay $100,000 up front so they would not have to make a monthly payment. The Board of Directors agreed to that, and it was suggested to us that if they exempted the other churches in the community from paying assessments, they would have to rebate that money. It is unfair, and the Board, at different times, also thought it was unfair. If we wanted to minister there, we would have to pay the fee. The only way this could be changed is if the Legislature would

make the change. It would benefit all of the churches. The $6,000 per year that the Summerlin Community Baptist Church pays to the association could be used to do other things to serve the community.

Chairman Anderson:
When purchasing the property, did you tell the HOA of the intended usage?

Dan Newburn:
Yes, they actively solicited that we build a Baptist Church in the Association.

Chairman Anderson:
Did they sell the property to you at a reduced rate as compared to other property in the area?

Dan Newburn:
I suspect they did, but we did not ask them to do that. We paid the price they gave us.

Chairman Anderson:
Discussing this issue on another piece of legislation, the general indication is that the HOA's often want to bring churches in to provide the feeling of community which is not offered in dollars and cents. To attract the churches, they often give an upfront deal on the property as compared to other types of usages.

Dan Newburn:
I know they did that with some of the other places of worship early on because they were very desirous. I do not know what they did with other churches but they gave us a price and we paid that price.

Assemblywoman Allen:
Assemblywoman Marilyn Kirkpatrick and Assemblywoman Sheila Leslie have asked to amend this bill with regard to HOA mailings. I consider it a friendly amendment and agree with what they have to say.

Kevin Janison, Private Citizen, Las Vegas, Nevada:
When you are elected, you represent all of the people in your district, whether they voted for you or not. Representing a constituent on issues is much different then representing a district based upon people who chose not to vote. The Electoral College is determined by the number of votes cast, not the number of votes not cast. If you have a dispute with your HOA, they give you a couple of options. They say that you can move out of your home or you can choose to run for the board. In my HOA where there are 16,000 homes, I can

knock on 7,000 doors and completely convince those people that I am the right man for the job. Even if all of them vote, someone else can be sitting in his living room watching Monday night football and be able to cast 9,000 votes because the turnout is less than 10 percent. It gives the delegates over 90 percent of the votes cast. I do not know of any other place where people get to vote for individual candidates by casting ballots for other people. These people are rewarded if the turnout is low so that they do not have to knock on doors. They can sit back and maintain their seat year after year. It is impossible to get new people that might have a different viewpoint.

There is one other issue that is not part of this bill that my HOA engages in and that is a nominating committee. You cannot decide that you want to run for the board and put your name in; you have to go through a nominating committee. Unfortunately, the members of the nominating committee are already board members, delegates, members of the compliance committee, or members of the design review committee. Every step of the way, the appeal process is the same group of faces. If you are a member of a community, you should have the same rights as everyone else to get your name on the ballot and run for the board without having to pursue acceptance by a nominating committee.

Wallace Riddle, Private Citizen, Las Vegas, Nevada:
I strongly support this bill as submitted by Assemblywoman Allen. There are a few changes I would like to recommend. I would like to use *Nevada Revised Statute* (NRS) 116.31034 as an example for the mailing and return of ballots to the Board. I would also like to see a definition of the mailing of ballots plainly set forth in Section 8(a). I would like there to be a Section 8(d) that states only votes that are returned may be counted. NRS 116.3106 refers to the recall of a board member. I would recommend the usage of the policies stated there. If ballots are counted to elect an individual, the same procedure should be used for recall. Thirty-five percent of the people in my HOA cast a ballot and the majority will either recall or not recall an individual. That does not seem fair to the individual homeowners. If you vote to elect an individual, you should vote to remove them on the same procedures.

Sandy Ambrose, Private Citizen, Las Vegas, Nevada:
I am sure there is concern about the wording "without prior consent." There may need to be language put into the bill that would define what is proper and what is not proper. The *Twin Rivers* appellate decision [*Committee for a Better Twin Rivers v. Twin Rivers Homeowners' Association*, 383 N.J. Super. 22 (App. Div. 2006)] is a very important document with regard to freedom of speech. In that decision, they have mandated that while freedom of speech is an amendment right, it is not absolute. There are limitations that the Board may have of time, place, and manner in which freedom of speech can be provided.

In Section 9 subsection 6, defines "an official publication," but the Board members also provide information on an intermittent basis. If the bill does not expound on the definition of an official publication, it gives the implication that it is a regularly circulated newsletter or publication. When they send out ballots, which are "an official publication", they can send flyers that provide information. These flyers are not "an official publication."

Board members often give oral presentations to explain their position, and their presentation may not be in a written publication or official newsletter. If you do not provide some way of allowing members of an association to give an opposing view, then you are only getting one side of the story. An example can be an executive board meeting. A board member can stand up and provide graphs and documents and provide experts to show their position on it. There is no remedy if you do not provide language in the bill for oral presentation by the opposing side. Inherent with this are problems that come up when you have one Board presenting its opinion when there may be 20 members of an association who have opposing views. How do you relegate whose opposing view gets to be presented? Publication can get rather large if you have to have everybody's position posted. In an oral presentation, whose opinion should be presented? I am happy with the bill, but as I have stated, there are some inherent problems that may come along with it. There needs to be something done with the censorship because you need to limit the language someone can use so that it is not slanderous.

Gary Randall, Private Citizen, Las Vegas, Nevada:
I am very much in favor of this bill. We had a situation in my HOA where the homeowners were required to vote for one issue against another rather than a yes or no vote on each issue. The Board was allowed to set forth their position with that ballot, which resulted in people voting for the position they wanted. There was no opportunity at that time for opposition to be voiced. We feel this should not be limited to an official publication such as a newsletter or website.

Chairman Anderson:
I will now move to those in opposition.

Bob Sidell, Representing Value Alliance, Las Vegas, Nevada:
We have a concern with the portion of the bill that relates to the delegate system. The reality is that the system is not working the way it is supposed to, however going from one extreme to another may not be the best solution. To go from a delegate system to a one person one vote rule may cause more difficulty than we already have. We believe there is a midpoint that will satisfy all HOAs. The idea of a cookie cutter solution does not exist in relation to HOAs; there are some as small as 20 homes and some as large as

20,000 homes. The implementation of their Covenants, Conditions, and Restrictions (CC&Rs) differ because they have different problems. The more complacent a community gets and the better it is being managed, the happier everybody is. Complacency is infectious, and that infection happens at different rates with a small community as opposed to a large one. The idea of going from black to white may not solve the problem, but there are infinite shades of grey. Our suggestion is to have the portion of the bill referring to the elimination of the delegate system be addressed again with the idea in mind of not simply eliminating the system, but fixing it. If there is a delegate, the delegate votes, but if there is no delegate, the individual homeowner's votes would count. That is the direction we believe it should take.

Assemblyman Mabey:
What problem would you foresee if each person had a vote and we did away with the delegate system?

Bob Sidell:
An example would be in a very large association with a very small minority who are always vocal. Because of the complacency of one-on-one voting, a contentious issue does not even bring the voters out. The vocal minority could exercise a lot of effort to push a particular issue. True to form, a 5,000 member association may end up with 300 or 400 total votes. The vote will probably be represented by a majority of the dissidents. Unfortunately, the majority of homeowners are silent, especially when things are good. Presently votes may count in favor toward an issue that only affects a very small percentage of the association and is detrimental to most of it. Unfortunately, that is the reality of what exists. Sociologists have been fighting it for years, and I do not know how we will ever get around it. The major concern is that with one-on-one voting, a very small minority can create problems that are detrimental to the majority of homeowners in that association.

Assemblyman Mabey:
It seems like it could be just the opposite.

Bob Sidell:
It very easily could be. It would be great if a contentious issue would bring out the vast majority. The problem is that HOAs are divided between the homeowners and the Board. People seem to forget that the Board is made up of volunteers that are actually giving their time to guarantee that the CC&Rs are going to be protected. When things are going well, nobody cares. The only people who care are the ones who have an axe to grind and they do not necessarily represent the majority.

Assemblyman Horne:
I have seen where people are quiet and unhappy, so we should not be adopting the position that we should keep things the same because there are just a few malcontents that are making the noise because the others would be making the same noise if they were unhappy. When you said that there should be a middle ground found instead of going from one extreme to the other, you admitted there were some problems with this. Did you contact the sponsor of the bill and propose a middle ground?

Bob Sidell:
Unfortunately, Value Alliance is relatively new. There are so many bills we are involved in that we did not have the chance. We would be delighted to sit down with Assemblywoman Allen and try to work out a compromise. Going from one extreme to another, regardless of what the issue is, there is always the problem of creating a monster worse than what you are getting rid of. There are some alternatives by restricting the use of delegate voting, like only allowing certain things, not being able to abuse the process, and satisfying the end result without creating any upset. It is a lot easier for an association that has 100 people in it to deal with something, where an association with 5,000 or 6,000 has difficulty. The concept of a delegate system is correct. Unfortunately, over the years it has evolved into a system that does not work. It does not work primarily because there are no built-in restrictions for how it should operate. If we could correct that, there would not be a need to do anything else.

Assemblyman Horne:
Many of the emails I received were from board members who do not believe the system is broken at all, which is also why Assemblywoman Allen brought the bill. It was expressed that proxy voting is not going away. Many of the concerns that the board has can still be addressed in that manner. It is not appropriate that if a vote is not cast, a vote is cast by someone else. If you want to give away your vote, you have to get a proxy, which as I suggested, could be conspicuous language saying you have my vote.

Assemblywoman Allen:
With regard to the specific instance where a neighborhood does not have a delegate, you said that their votes are not cast. I believe that in Summerlin North, the board president gets to cast those votes when there is no delegate.

Bob Sidell:
The original CC&R documents say that any district which does not elect a delegate will have the current president represent them. It does not say that he

will cast the vote. The people in the districts without a delegate are not represented by someone on the Board of Directors. There are no restrictions, and it would be simple for this bill to say that where there is no delegate elected, the individual votes of homeowners in that district will be counted. It would only need a one-line sentence stating that they may be represented, which is necessary for being able to disseminate information to the homeowners. If they are not represented by a member on the Board, they can keep their voting rights. Those are simple compromises that will allow the system to continue to work.

Assemblywoman Allen:
The concept of delegate voting for people, whether there is a delegate or not, is an affront to democracy. You said yourself that the CC&Rs in Summerlin allow for the Board President to cast those ballots.

Bob Sidell:
I did not say he could cast their vote for them, I said that he is allowed to represent them.

Karen Dennison, Representing the American Resort Development Association and Lake at Las Vegas Joint Venture Community, Nevada:
I am concerned with the issue of a time-share project in a master association voting through delegates. For example, Lake Las Vegas has a time-share project but does not generally have delegate voting. It has a one-unit, one-vote system for the commercial and residential owners except for time-share projects. With 13,000 time-share owners who own undivided interest in the time-share project, it is unmanageable for that to be a system of a one time-share interval. You would have to have 52 intervals to make one unit vote. We are asking for a narrow exception to say that if a time-share project is part of a master association, it should be allowed to vote through delegates. Proxies do not work for time-share projects because in past sessions, our legislature has narrowly defined who can receive a proxy. *Nevada Revised Statutes* 116.311 states that if you cannot vote through delegates, you are limited as to who can have your proxy. It limits your options to an immediate family member, another unit owner who resides in the community, or your tenant who resides in the common-interest community. The time-share owner would then have to go outside his time-share project and find someone who resides in the community to give a proxy to. This disenfranchises the project itself. There is more to proxies than voting; there is the idea that the delegate would attend a meeting on behalf of the time-share project itself. The delegate would have an opportunity to speak and be heard on issues relative to the time-share project. For this reason, we are hoping that you could make an exception for time-share projects in the delegate voting process. The other

issues that will be brought up are approval of the commission to foreclose, as well as the right of redemption after foreclosure sale and the community manager bond. I would like to say that Lake Las Vegas is in agreement with the common-interest communities' position on those issues.

Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities, Nevada:

Our commission has considered a number of bills, including this one, and has had a number of legislative commission meetings in open hearing. I would like to preface all of our remarks to echo what Mr. Sidell said. The commission is very aware that there are all different kinds of associations throughout the state. For this reason, the commission believes as a general proposition that the changes in NRS 116 need to be very carefully thought out. There are different types of delegate voting systems. The commission opposes the elimination of delegate voting. We do not propose or support any particular type of delegate voting, but we did ask the ombudsman and the Compliance Division of the Real Estate Division whether they have received complaints regarding delegate voting and they did not. There have not been hearings before the commission dealing with problems about delegate voting. The commission is concerned that the prohibition of delegate voting in all cases may have an adverse affect on different types of associations, particularly mixed use projects. *Nevada Revised Statute* 116.311 states that proxies are limited to one specific meeting and they terminate after that meeting. They cannot substitute for delegate voting. There were abuses in proxy voting, so the solution was to limit proxies to only one particular meeting. Subsection four of NRS 116.31034 allows members of the association to get their name on the ballot and has been in effect since the 1990's.

The commission opposes the idea of approving foreclosures. It is not clear if the commission would approve the amount or just the process and if they would be required to review the declaration or the budget in which the assessment is based, and at what point in the foreclosure process would the commission intervene. The commission is also concerned that they would be required to meet much more frequently at greater cost to the state, or that the enforcement of assessment liens would become seriously delayed. Most importantly, the commission does not believe that, since they are a formal body of the State of Nevada, they should be in the business of approving foreclosures as if the state itself were condoning specific foreclosures. We also suggest that activities related to foreclosures or enforcement of liens that violate law be subject to recourse either through the Nevada Real Estate Division which regulates managers who investigate associations, or the Financial Institutions Division which licenses those who conduct foreclosure sales, because they must be approved though the financial institutions.

As far as the equity of redemption, the commission did not take a position for or against. We would like to note that an equity of redemption for mortgage foreclosures is described in NRS Chapter 21 very specifically with lots of rules and procedures. It concerns the commission that none of the details are here.

As far as the official publications, we agree with what Ms. Ambrose said. There are a number of problems with the present wording because there needs to be a limitation on how one's views are shared. You do not want the association to have to mail out 20 pages of what one person thought. The commission recognizes the need for this and supports the proposition of political free speech in associations.

The commission did not take a position on the manager bonding in Section 10 because it needs greater detail. Some of the master associations of high-rise condos could have several millions of dollars and we would need to know how the bonding is going to work.

Lastly, if the houses of worship are no longer paying assessments to which they agreed, that would throw the burden on the homeowners who would have to pick up any deficit. In the interest of time, my testimony has been limited to our specific concerns (Exhibit F).

Assemblyman Mabey:
Is every house of worship treated the same?

Michael Buckley:
I do not know. That was just an observation I made. The commission has voted on some of these things, but we had not really discussed that because it was just heard this morning.

Chairman Anderson:
It seems that there are as many different ways of handling these issues as there are communities in this state.

Marilyn Brainard, Commissioner, Nevada Commission for Common-Interest Communities:
Ms. Ambrose made the comment that she felt people in associations did not have the chance to speak. We have public comment periods mandated for all of our associations, no matter what the size, so that the homeowners can come and speak before the formal board meeting begins. Ms. Ambrose also talked about asking the association to insert any material that was presented by a homeowner in the official publication. Many associations would choose not to publish their newsletter or magazine because of that burden. Lastly,

Ms. Ambrose made reference to the *Twin Rivers* decision. It has been argued to the New Jersey Supreme Court and is under consideration, but the final ruling has not yet been decided.

[Chairman Anderson left room.]

Assemblywoman Gerhardt:
I had a situation where I was at odds with my HOA because I did not believe that they were applying the rules equally to all of the residents. I went to a board meeting and asked if there was any way that I could communicate with the other homeowners about this particular issue, to see if there were other people who were having the same problem that I was. I was told that the only way I could have a voice in the process was to go knock on doors. I believe that people need to have an opportunity to be heard. As a homeowner who pays dues, I think it is absolutely appropriate to have a means of communicating with the other members. I could be brief and concise and it would not be cost prohibitive.

Marilyn Brainard:
In the association I served on, our Committee Manager takes minutes. In the beginning of our minutes, there is a summation of comments that were made. We do not identify the homeowner, but significant comments are recorded. The minutes are posted within 30 days, so the other homeowners can go online and read them. It is not a verbatim transcription, but the general issues are contained in that section. If that did not solve the problem, you always have the redress, which is why we have the ombudsman's office to work with the board to be sure that is included.

[Chairman Anderson returned to room.]

Assemblywoman Gerhardt:
How long does it typically take for ombudsman to resolve an issue?

Gail Anderson, Administrator, Department of Business and Industry, Real Estate Division, Nevada:
The ombudsman started the intervention conference program on July 31, 2006. A letter goes out six weeks before the conference, inviting homeowners to come in and attempt to resolve their issues. This is a new procedure we started last summer.

Shari O'Donnell, Vice President of Government Affairs and Community Relations, Signature Homes, Nevada, Representing Nevada Commission for Common-Interest Communities:
The right to use proxies in the election or removal of board members was done away with in past Legislative sessions. Elections and removals can only be conducted through secret ballot. In response to Assemblywoman Gerhardt's comment, we did require community managers to keep a thorough log of all violations so that you could request those records and see how many notices went out on a particular violation. It takes six weeks to have a matter reviewed by the ombudsman because of the due process involved. That timeframe could be shortened if we shortened the due process.

Assemblywoman Gerhardt:
Anecdotally, I have heard that a year to a year and a half is the norm.

Kevin Ruth, Representing Community Association Management Companies through Executive Officers, Nevada:
We represent over 340,000 homes in hundreds of communities. Everything that has been put forth by the commission in opposing the bill, CAMEO supports. We have also provided the Committee proposed amendments (Exhibit G).

Chairman Anderson:
Have you shared this with Assemblywoman Allen?

Kevin Ruth:
No, sir. It was just put together this morning. Our lobbyist did approach Assemblywoman Allen yesterday to indicate that we would be testifying in opposition.

Randy Eckland, Representing the Howard Hughes Corporation and the Summerlin Community Association Management Team, Nevada:
I believe in the delegate system of the government, therefore I must respectfully oppose A.B. 396. Since arriving in Summerlin in 1992, our delegate system has served our community very well. We have completed successful day to day operations, a major amendment process, and the smooth transition of 15,000 homes to resident control. Before residents were entitled to begin serving on the board, they were naturally eager to engage in the community government system, and the neighborhood delegate system gave them the opportunity to do that. They met regularly and it was an immediate and effective resource that engaged them in government in a positive manner. I have found that neighborhood delegates typically attend more community meetings to help familiarize themselves with the many sides of an issue. They

also tend to vest themselves more in the community government processes, and as a result they demonstrate a higher level of stewardship and responsibility. The neighborhood delegate involvement also broadens their knowledge and perspective as they discuss issues with fellow delegates and residents. The delegate system has also been instrumental in the growth of an expanded and well rounded volunteer governmental base, which is vital to any community association striving for harmony and effectiveness. Many of our early delegates eventually assumed leadership roles on the respected boards of the compliance advisory, design review, and finance committees. Not all communities have had the success that our delegate system has, and I can certainly see what the benefits would be of retooling or change. I am committed to work over the next two years to develop workable solutions. If we are given an opportunity to fix what is not working in this environment, it would be a better approach than simply doing away with it to the detriment of those areas that have used it in a good manner.

There were also misperceptions as relating to the Summerlin North Community association and the proxy to the president of the board. In my experience, the neighborhoods which did not have the ability to elect their own delegate were still returning ballots whenever an issue was brought to vote. To make sure the neighborhood was heard, the president would cast ballots for anybody who took the time to return them. There was no casting of any ballots that were not returned or any votes that were unheard.

David Stone, Owner, Nevada Association Service:
I would like to briefly address Section 7 and Section 8. Section 7 deals with getting permission from the commission. The ombudsmen's office already has a process in place regarding foreclosures and I do not think an extra step to the commission will provide any additional level of assurance. Last year, my office started thousands of collection accounts and foreclosed on only two homes. One of the homes was already in foreclosure by the lender and the other home had been abandoned by the homeowner. This is not a problem that truly exists. Section 8 is vague and does not give any timeline for the right of redemption, who is responsible for paying the mortgage, property taxes, or ongoing assessments. It does not say who needs to pay money in order to redeem the property or how to address the issue if the lender is already in foreclosure. What happens if the lender forecloses during the right of redemption period? Are any of the rights lost by any of the individuals? It needs to be cleaned up and answered those questions.

Chairman Anderson:
I have a letter from Judy Farrah in opposition of Section 7 through Section 10 that needs to be inserted into the record (Exhibit H).

Let me close the hearing on A.B. 396.

Let us open the hearing on A.B. 399.

Assembly Bill 399: Revises the provisions relating to the Office of the Ombudsman for Owners in Common-Interest Communities. (BDR 10-026)

Assemblywoman Francis O. Allen, Assembly District No. 4:
[Read from prepared testimony (Exhibit I).]

Chairman Anderson:
Dispute resolution centers are something that I have supported in the past. Would this be moving it to someone who has the training? What are the qualifications established? It appears the office gets to establish what the criteria is going to be, so is this going to take the legislature out of the process of setting forth the duties and responsibilities of the ombudsman? It is not going to be an immediate solution but a rather prolonged one.

Assemblywoman Allen:
I am open to an interim study on how to best give homeowners this resolution. The Office of the Ombudsman would select at random from a list of licensed private ombudsmen. The legislature would have oversight of it, but in actuality, instead of only having one investigator in Carson City and two in Southern Nevada, this would multiply.

Assemblyman Segerblom:
In law, we use the alternative mediation processes regularly and they are fantastic. I would encourage the concept of using mediation.

David Thomas, Resident of Summerlin Community, Nevada:
I am a resident of Summerlin community and also an attorney. I have practiced for 18 years and have represented more HOAs than I have residents. About eight years ago I got involved with youth sports in Summerlin. It became remarkable to me the number of people who came up to me and had complaints. I heard testimony earlier today that it might be 1 to 2 percent of the community that had complaints about the HOA. I do not profess to be an expert because I do not go to meetings, but I know when I was at the soccer fields and baseball fields, I had complaints from about 10 percent of the kids' parents. The complaints I heard from this HOA are not the normal complaints

about reasonable restrictions. No one has ever come to me and said that the HOA will not allow them to paint their house pink or put a garbage sculpture in their front yard. It seems to be more along the lines of people planting trees without prior approval and having to tear them out. Another example is doing brickwork and yard work and having to tear it out. One person even said their HOA did not like the contractor they used. Most recently, someone put up a Greenbay Packers flag Sunday morning and took it down Sunday night and there were complaints about that. These do not seem to be reasonable complaints from the HOA. When I found out there was talk about changing a law that would give the HOA more power, I was concerned. One of my biggest concerns is that the HOA attorneys feel like they need more power. I do not feel they need more power, they just want more power. I am concerned because of the number of contacts I have made with people. HOA's are necessary, but I am concerned about giving them control and authority over everything in the streets, only because of the people I have dealt with and the stories they have. I have always been concerned that the HOA is taking dues and giving them to an attorney and making some of these people's lives miserable. My personal opinion is that the amount of authority that the HOA has to govern their residents is fine. These are things that need to be handled between neighbors. I am concerned about the number of times people say they have been threatened with an attorney or an attorney has actually been retained.

Chairman Anderson:
Do you perceive that there may be a quicker resolution to HOA's without the use of ombudsmen?

David Thomas:
I believe that is the intent, but I have been involved in two cases where the people have felt like the ombudsman was going to take too long and that it was not going to be resolved. Another common thread with the people who have come to me, is that there was no complaint from the neighbors. Some people even had written documents from neighbors saying that they had no problem with the brickwork or the trees. If the neighbors are not concerned, I do not know why the HOA is.

Chairman Anderson:
The purpose of living in a common-interest community is to make sure people maintain their homes.

David Thomas:
HOA's are absolutely necessary for that, but I have never heard from people that they do not feel like repairing their house or watering their grass.

Assemblywoman Allen:
When the ombudsman's office was originally created by the legislature, it was done to prevent the homeowner from having to retain expensive attorneys and go through a lengthy court battle. We created this ombudsman office where someone can go and get dispute resolution. Now, we as a state are failing in that obligation.

Chairman Anderson:
Let me now move to those in opposition.

Kevin Ruth, Representing Community Association Management Companies through Executive Officers, Nevada:
We are in opposition to A.B. 399. The concept of privatizing what is already in existence may be a good thing down the road. However, we as an organization have seen significant improvement in the system in the past six to nine months. The new ombudsman who has been on the staff for that period of time has instituted a new conferencing concept which we support. Issues should be resolved in a more expeditious way. I am not sure if we are trying to remedy and remove the Alternative Dispute Resolution (ADR) process which is in place right now or if we are trying to deal with the intervention process which is taken care of through the real estate division and not through the ombudsman. We feel that creating a private ombudsman is not in the best interest of HOAs at this time, nor the homeowners. We also have significant issues with the funding. It does not make sense that the aggrieved party would be required to put 10 percent of the estimated fees forth, while the respondent would be required to pay the remaining 90 percent. Once the ombudsman comes up with a determination, that all could be flip-flopped based on whether or not the homeowner was found to be incorrect in their assertions. I am confident that the common-interest community commission and the real estate division have some issues with this also.

Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities, Nevada:
Read from prepared testimony (Exhibit J).

We believe that these changes need to be very carefully thought out and have input from a lot of different people. The ombudsman reports that of the people who participate in her conferences, she believes about 50 percent of them are resolved. She does not keep formal statistics on those because she wants it to be a very informal process.

Assemblywoman Gerhardt:
You said that during the public comment portion they were overwhelmingly in support of the commission's position. How many people are you talking about?

Michael Buckley:
It depends on the meeting.

Assemblywoman Gerhardt:
What is an average?

Michael Buckley:
Only one person showed up for our meeting last week.

Assemblywoman Gerhardt:
Is that an average?

Michael Buckley:
No. It depends on what we are talking about. We had a workshop dealing with reserve study preparers in Carson City last August that had about 20 people. I would say 10-20 people come to regular meetings.

Assemblywoman Gerhardt:
How many people are we talking about in Clark County that are part of common-interest communities.

Michael Buckley:
I do not have that number. I think there are 200,000 to 300,000 units in the state and 2,600 associations, most of them in the south.

Chairman Anderson:
Before adopting regulations, we require information on the number of meetings held and the number of people who attend. It is not unusual to see that there are as few as two people who show up and sometimes as many as 100. It depends on the particular topic being discussed. I was surprised to see how frequently no one shows up, although everybody maintains that it is going to change their lifestyle.

Marilyn Brainard, Commissioner, Nevada Commission for Common-Interest Communities:
Assemblywoman Allen proposes a market-based solution in privatization, which would be a tremendous idea in many aspects of government. However, in looking at the privatization for the ombudsman, I am deeply concerned. By creating multiple people, how would oversight and consistency be

accomplished? Part of the reason we have only one ombudsman is that we like to know that every case is treated equally. I cannot even imagine how creating the oversight for a private ombudsman would be accomplished. Our current ombudsman would be forced into an administrative role when so far her strength has been getting people to resolve their problems amicably. That is what we hope will continue so the private program would be a big concern. I do not know how we could continue to hold these meetings without putting a further strain on the resources of our state government. I would like to point out, in referring to the other side of our legislative process, that Senator Schneider removed the language similar to Assemblywoman Allen's Section 10, realizing that it would be grossly unfair to put the burden on an association. It would be impossible to have the supporting regulations in place by July 1, knowing that the Legislative Counsel Bureau (LCB) must approve all language. Overall, I feel that the parts of this bill that would be considered would have many egregious, unintended, and unfavorable consequences.

Judy Farrah, Chairman of the Community Associations Institute of Nevada, and Representing Legislative Action Committee:
If you brought this bill forward in 2001 or 2003, I probably would have been in support of it because the program was not working. However, we are seeing a significant change in the division and the ombudsman's program. We now have administrative law judges who have been hired by the division to handle these particular types of disputes. We need to give them a chance to do what they have finally been able to put together over the last few months, and hopefully this program will be successful. I have submitted my comments in writing as well (Exhibit K).

Michael Trudell, Manager, Caughlin Ranch Homeowners Association, Nevada:
I am one of the people that attended the commission hearings last week, and I appreciated the opportunity to be able to speak to the commissioners about our concerns. Recently, Caughlin Ranch HOA had an incident where we really needed the ombudsman's office to help with a matter where the reform board that had been elected did not want to conform to the requirements to have a recall election after a recall petition had been submitted to the state. If it was not for the ombudsman's office staff being available and acting quickly, we would have had serious consequences in our HOA. Within two weeks after the meeting on January 10 where the board of directors refused to set a special meeting date for the recall ballot to be counted, the ombudsman's office had assisted me in preparing a removal election plan and approving that plan with other items. We were able to hold that recall election. One of the problems with the process is that there are laws in place which indicate how you are to go about any kind of a complaint. Part of that process is that you must file an intervention affidavit with the ombudsman's office. The gentleman who spoke

earlier indicated that he had spoken to people but they did not want to file with the ombudsman's office because they thought it would be ineffective. If homeowners do not file the affidavit, the ombudsman's office does not have the authority to act. If they do not follow the procedures that are currently in place, the failure of the system is blamed, but it is not because the system does not work; it is because people fail to understand how to use the system properly.

Chairman Anderson:
Oftentimes a group of homeowners is paying for an attorney, so an individual homeowner is at a dramatic disadvantage because he is going to have to engage someone on his own.

Michael Trudell:
At times, that is the issue. We have had very good success with the ombudsman's office and the State's staff.

Chairman Anderson:
Is there anyone else wishing to be on the record for A.B. 399?

Hearing closed on A.B. 399.

It is my intention to give A.B. 396 to Assemblywoman Allen. If you have any suggestions on A.B. 396, please share them with her and Ms. Chisel. Please be cognizant of the concerns that have been raised relative to foreclosures, the placing of foreclosures within the HOA for nonpayment of assessments and how those situations are handled. Also we need to try and find a compromise on the voting process that can be worked out. Assemblywoman Allen, I believe we have offers from Ms. Dennison, Mr. Buckley, Mr. Sidell, and the Hughes Corporation to help work on language.

If there is any amended language that needs to be put forward on A.B. 399, I would also suggest that be done as soon as possible.

Let me open the hearing on Assembly Bill 431.

Assembly Bill 431: Establishes provisions governing condominium hotels. (BDR 10-1056)

William Horne, Assembly District No. 34, Clark County, Nevada:
The purpose of this legislation is to create a new section in statute to deal with the unique situation of common-interest communities, particularly condominium hotels. The law currently rests in NRS Chapter 116, but it does not fit cleanly. The bill you have before you without the amendments is just a skeleton. The

amendments (Exhibit L) are supposed to be part of the bill, but because of time constraints and drafting, they have put out a skeleton bill instead. The bill without the amendments does not make very much sense in what we are trying to do in making a separate Chapter 116B for hotel condominiums. Many of the provisions in Chapter 116 have been placed in Chapter 116B. There are additional provisions that deal with the unique character of hotel condominiums. There are approximately 2,200 hotel condominiums in Clark County alone, and about 6,000 currently under construction in Clark and Washoe Counties. These properties, unlike typical HOAs, are mixed use. They are not designed for single family residences and are not the typical condominiums that we have grown accustom to. These sit on hotel properties. In a typical HOA, a large number of residents are the owners of the condos or single family dwellings. In hotel condominiums, many of the unit owners may not live there. They rent them out to visitors who come and go, but the property is managed by the hotel. The reason this legislation was brought was because many of the common elements in a typical HOA are different in a hotel condominium property. This is going to provide some flexibility and control for hotel operators while also giving the same protections for the unit owners in the property. There is also an executive summary of the amendment (Exhibit M) which should give you a brief overview of what this legislation does. No one has contacted me in opposition or with concerns on this proposal.

Sam McMullen, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada:

As Assemblyman Horne said, this is basically a new animal in terms of common-interest communities. Common-interest communities have multiple interests in certain pieces of property within a parcel or unit. Consequently, they have to interact, which is why we have NRS Chapter 116. In the hotel condo situation, there is a difference in common elements, which are called shared components and owned by the hotel unit. Mandy Shavinsky, who is also with Snell and Wilmer, will be doing most of the speaking to give you a quick summary of the details of the bill and how it changes NRS Chapter 116. Approximately 90 percent of this amendment is exact language from NRS Chapter 116. In respect to proxies, reserves, declarations, construction defects, and the initiation of law suits, this bill reads exactly the same as Chapter 116.

Mandy Shavinsky, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada:

As Assemblyman Horne indicated, condominium hotels are very unique and new products to Nevada. They do not fit squarely within the framework of NRS Chapter 116, which was designed to help govern master planned communities such as Summerlin North and other traditional condominiums. Our thought is

that NRS Chapter 116 does not adequately address situations where you have more than one use, specifically hotel use that is taking place in a condominium hotel. Assembly Bill 431 provides the framework for that. Transient use is permitted in these types of developments, and as result of the hotels, it is really the primary use of these projects. It is possible but extremely unlikely that there will be full-time residents living in these types of projects. Most people live in single family subdivisions, and although we enjoy having the benefits of hotel casinos in our state, we do not want to live in them full-time. As Assemblyman Horne said, we took what worked from NRS Chapter 116 and left many of the same protections in place. We have also built in the concept of a hotel unit which is owned by a hotel operator. The hotel operator manages the hotel on-site. They have to maintain certain quality levels and standards within the condominium hotel in order to make the hotel an attractive destination for the unit owners. Operating and soon to be operating condominium hotels are often associated with hotels such as Hyatt, MGM, and other well known chains. Purchasers and guests in those projects are going to expect a level of quality that may not be possible in a traditional condominium situation where the HOA governs common elements. Essentially, the hotel and residential unit owners are all stake holders, and there is a mutuality of interest that exists in promoting and making the hotel condominium successful that is not present with HOA's.

Assembly Bill 431 has many of the same safeguards as NRS Chapter 116, and the common-interest community commission would continue to have jurisdiction over these types of communities so there would be some avenue of redress for homeowners who do not feel their voice is being heard. The ombudsman would also have jurisdiction over these communities. The same types of consumer protections that are currently in NRS Chapter 116 will also be available here, such as the provision of a public offering statement, which is a statement of statutorily mandated disclosures that homeowners must be provided with. The same five-day rescission right will exist, which is the right of someone who has contracted to purchase one of these units to rescind their purchase within five days of the execution of the purchase agreement. There will also be a reserve requirement for major components as there is in NRS Chapter 116. We believe this legislation will create structure and predictability for, not just the unit owners who have purchased and wish to rent their units out under the structure, but also for the developers that have come in and the hotel operators that are looking to this product as the new wave of hotel and resort development in Nevada.

Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities, Nevada:

We support the concept of having a separate chapter for hotel condos.

Bruce Arkell, Representing the Nevada Association of Land Surveyors:
We have a couple of minor amendments to Section 71 and Section 77 of the mock-up (Exhibit N). The amendments basically take out language that violates licensure laws, and one provides for a vertical datum so that you can find the units from space. The last one allows for a better definition of the units.

Karen Dennison, Representing the American Resort Development Association and Lake at Las Vegas Joint Venture Community, Nevada:
I would like to put on the record that we are in favor of a separate NRS Chapter for condominium hotels for many of the reasons that Mandy Shavinsky pointed out to you. We have not yet had an opportunity to review the amendment, but we will do so and work with the others in support.

Sam McMullen:
I would also be happy to work on this bill. If there are any questions or concerns, please direct them to me.

Chairman Anderson:
Is there anyone else who needs to get on the record? [There were none.]

Let me close the hearing on A.B. 431.

It is the intent of the Chairman to assign A.B. 431 to Assemblyman Horne.

[Meeting adjourned at 10:48 a.m.]

RESPECTFULLY SUBMITTED:

_____
Kaci Kerfeld
Committee Secretary

APPROVED BY:

_____
Assemblyman Bernie Anderson, Chair

DATE: _____

EXHIBITS

Committee Name: Committee on Judiciary

Date: April 3, 2007 **Time of Meeting: 7:43 a.m.**

Bill	Exhibit	Witness / Agency	Description
	A		Agenda
	B		Attendance Roster
A.B. 371	C	Nevada Legal Press	Email to Assemblyman Goedhart
A.B. 396	D	Francis Allen, Assemblywoman District 4	Prepared testimony
A.B. 396	E	Francis Allen, Assemblywoman District 4	Proposed amendment mock-up
A.B. 396	F	Michael E. Buckley, Nevada Commission for Common Interest Communities	Prepared testimony
A.B. 396	G	Kevin Ruth, Cameo, Inc.	Proposed amendments
A.B. 396	H	Judy Farrah, Capital Consultants Management Corporation	Comments on A. B. 396
A.B. 399	I	Francis Allen, Assemblywoman District 4	Prepared testimony
A.B. 399	J	Michael E. Buckley, Nevada Commission for Common Interest Communities	Prepared testimony
A.B. 399	K	Judy Farrah, Capital Consultants Management Corporation	Comments on A. B. 399.
A.B. 431	L	William Horne ,Assemblyman District 34	Proposed amendment
A.B. 431	M	William Horne ,Assemblyman District 34	Executive summary of proposed condominium hotel legislation from Snell & Wilmer
A.B. 431	N	Bruce Arkell, Nevada Association of Land Surveyors	Proposed amendments to A. B. 431

AMENDMENTS TO
UNIFORM COMMON INTEREST OWNERSHIP ACT

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-SEVENTEENTH YEAR
IN BIG SKY, MONTANA
JULY 18 – 25, 2008

WITH PREFATORY NOTE AND COMMENTS

December 8, 2008

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DRAFTING COMMITTEE ON AMENDMENTS TO UNIFORM COMMON INTEREST OWNERSHIP ACT

The Committee appointed by and representing the National Conference of Commissioners on Uniform State Laws in amending this Act consists of the following individuals:

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AMENDMENTS TO UNIFORM COMMON INTEREST OWNERSHIP ACT

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a minimum heat in their units of 55 degrees. The teenage son of the Owner of Unit C turns off all the heat after his last run on Sunday, and on Monday night, the pipes in Unit C burst. A finder of fact might properly conclude that the son of the owner of Unit C was grossly negligent.

SECTION 3-116. LIEN FOR ~~ASSESSMENTS~~; SUMS DUE ASSOCIATION; ENFORCEMENT.

(a) The association has a statutory lien on a unit for any assessment ~~levied against~~ attributable to that unit or fines imposed against its unit owner. Unless the declaration otherwise provides, reasonable attorney's fees and costs, other fees, charges, late charges, fines, and interest charged pursuant to Section 3-102(a)(10), (11), and (12), and any other sums due to the association under the declaration, this [act], or as a result of an administrative, arbitration, mediation, or judicial decision are enforceable in the same manner as unpaid assessments under this section. If an assessment is payable in installments, the lien is for the full amount of the assessment from the time the first installment thereof becomes due.

(b) A lien under this section is prior to all other liens and encumbrances on a unit except:

~~(i)~~(1) liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances ~~which~~ that the association creates, assumes, or takes subject to~~;~~;

~~(ii)~~(2) except as otherwise provided in subsection (c), a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent~~;~~ or, in a cooperative, the first security interest encumbering only the unit owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent~~;~~; and

~~(iii)~~(3) liens for real estate taxes and other governmental assessments or charges against the unit or cooperative.

(c) A ~~The~~ lien under this section is also prior to all security interests described in

subsection (b)(2) ~~clause (ii) above~~ to the extent of both the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien and reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien. ~~This subsection~~ Subsection (b) and this subsection ~~does~~ do not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association. [~~The~~ A lien under this section is not subject to ~~the provisions of~~ [insert appropriate reference to state homestead, dower and curtesy, or other exemptions].]

~~(c)~~(d) Unless the declaration otherwise provides, if two or more associations have liens for assessments created at any time on the same property, those liens have equal priority.

~~(d)~~(e) Recording of the declaration constitutes record notice and perfection of the lien. No further recordation of any claim of lien for assessment under this section is required.

~~(e)~~(f) A lien for unpaid assessments is extinguished unless proceedings to enforce the lien are instituted within ~~[3]~~ [three] years after the full amount of the assessments becomes due.

~~(f)~~(g) This section does not prohibit actions against unit owners to recover sums for which subsection (a) creates a lien or prohibit an association from taking a deed in lieu of foreclosure.

~~(g)~~(h) A judgment or decree in any action brought under this section must include costs and reasonable attorney's fees for the prevailing party.

~~(h)~~(i) The association upon ~~written~~ request made in a record shall furnish to a unit owner a statement setting forth the amount of unpaid assessments against the unit. If the unit owner's interest is real estate, the statement must be in recordable form. The statement must be furnished within [10] business days after receipt of the request and is binding on the association, the

executive board, and every unit owner.

~~(i)~~(j) In a cooperative, upon nonpayment of an assessment on a unit, the unit owner may be evicted in the same manner as provided by law in the case of an unlawful holdover by a commercial tenant, and the lien may be foreclosed as provided by this section.

~~(j)~~(k) The association's lien may be foreclosed as provided in this subsection and subsection (p):

(1) ~~In~~ in a condominium or planned community, the association's lien must be foreclosed in like manner as a mortgage on real estate [or by power of sale under [insert appropriate state statute]];

(2) ~~In~~ in a cooperative whose unit owners' interests in the units are real estate ~~(Section 1-105)~~, the association's lien must be foreclosed in like manner as a mortgage on real estate [or by power of sale under [insert appropriate state statute]] [or by power of sale under subsection ~~(k)~~(l)]; [or and]

(3) ~~In~~ in a cooperative whose unit owners' interests in the units are personal property ~~(Section 1-105)~~, the association's lien must be foreclosed in like manner as a security interest under [insert reference to Article 9, Uniform Commercial Code][;and]

[(4) ~~In the case of~~ in a foreclosure under [insert reference to state power of sale statute], the association shall give the notice required by statute or, if there is no such requirement, reasonable notice of its action to all lien holders of the unit whose interest would be affected].]

[(l)~~(k)~~ ~~In a cooperative, if~~ If the unit owner's interest in a unit in a cooperative is real estate, the following requirements apply ~~(Section 1-105)~~:

(1) The association, upon ~~non-payment~~ nonpayment of assessments and compliance with this subsection, may sell that unit at a public sale or by private negotiation; and

at any time, date, and place. ~~Every aspect of the sale, including the method, advertising, time, place, and terms must be reasonable.~~ The association shall give to the unit owner and any ~~lessees~~ lessee of the unit owner reasonable ~~written~~ notice in a record of the time, date, and place of any public sale or, if a private sale is intended, or of the intention of entering into a contract to sell and of the time and date after which a private disposition may be made. The same notice must also be sent to any other person ~~who~~ that has a recorded interest in the unit which would be cut off by the sale, but only if the recorded interest was on record seven weeks before the date specified in the notice as the date of any public sale or seven weeks before the date specified in the notice as the date after which a private sale may be made. The notices required by this subsection may be sent to any address reasonable in the circumstances. ~~Sale~~ A sale may not be held until five weeks after the sending of the notice. The association may buy at any public sale and, if the sale is conducted by a fiduciary or other person not related to the association, at a private sale.

(2) Unless otherwise agreed, the ~~debtor~~ unit owner is liable for any deficiency in a foreclosure sale.

(3) The proceeds of a foreclosure sale must be applied in the following order:

~~(i)~~(A) the reasonable expenses of sale;

~~(ii)~~(B) the reasonable expenses of securing possession before sale; the reasonable expenses of holding, maintaining, and preparing the unit for sale~~;~~, including payment of taxes and other governmental charges; and premiums on ~~hazard and liability~~ insurance;; and, to the extent provided for by agreement between the association and the unit owner, reasonable attorney's fees, costs, and other legal expenses incurred by the association;

~~(iii)~~(C) satisfaction of the association's lien;

~~(iv)~~(D) satisfaction in the order of priority of any subordinate claim of

record; and

~~(v)~~(E) remittance of any excess to the unit owner.

(4) A good faith purchaser for value acquires the unit free of the association's debt that gave rise to the lien under which the foreclosure sale occurred and any subordinate interest, even though the association or other person conducting the sale failed to comply with ~~the requirements of~~ this section. The person conducting the sale shall execute a conveyance to the purchaser sufficient to convey the unit and stating that it is executed by ~~him~~ the person after a foreclosure of the association's lien by power of sale and that ~~he~~ the person was empowered to make the sale. Signature and title or authority of the person signing the conveyance as grantor and a recital of the facts of ~~non-payment~~ nonpayment of the assessment and of the giving of the notices required by this subsection are sufficient proof of the facts recited and of ~~his~~ the authority to sign. Further proof of authority is not required even though the association is named as grantee in the conveyance.

(5) At any time before the association has disposed of a unit in a cooperative or entered into a contract for its disposition under the power of sale, the unit owners or the holder of any subordinate security interest may cure the unit owner's default and prevent sale or other disposition by tendering the performance due under the security agreement, including any amounts due because of exercise of a right to accelerate, plus the reasonable expenses of proceeding to foreclosure incurred to the time of tender, including reasonable attorney's fees and costs of the creditor.]

~~(f)~~(m) In an action by an association to collect assessments or to foreclose a lien for ~~unpaid assessments~~ on a unit under this section, the court may appoint a receiver to collect all sums alleged to be due and owing to a unit owner before commencement or during pendency of the action. The receivership is governed by [insert state law generally applicable to

receiverships]. The court may order the receiver to pay any sums held by the receiver to the association during pendency of the action to the extent of the association's common expense assessments based on a periodic budget adopted by the association pursuant to Section 3-115.]

(n) An association may not commence an action to foreclose a lien on a unit under this section unless:

(1) the unit owner, at the time the action is commenced, owes a sum equal to at least [three] months of common expense assessments based on the periodic budget last adopted by the association pursuant to Section 3-115(a) and the unit owner has failed to accept or comply with a payment plan offered by the association; and

(2) the executive board votes to commence a foreclosure action specifically against that unit.

(o) Unless the parties otherwise agree, the association shall apply any sums paid by unit owners that are delinquent in paying assessments in the following order:

(1) unpaid assessments;

(2) late charges;

(3) reasonable attorney's fees and costs and other reasonable collection charges; and

(4) all other unpaid fees, charges, fines, penalties, interest, and late charges.

(p) If the only sums due with respect to a unit are fines and related sums imposed against the unit, a foreclosure action may not be commenced against the unit unless the association has a judgment against the unit owner for the fines and related sums and has perfected a judgment lien against the unit under [insert reference to state statute on perfection of judgments].

(q) Every aspect of a foreclosure, sale, or other disposition under this section, including the method, advertising, time, date, place, and terms, must be commercially reasonable.

Comment

1. Section 3-116(a) was amended in 1994 to delete the language "from the time the assessment or fine becomes due." The deleted clause was intended to make clear that the lien was enforceable at the time the assessment became due. Commentators have observed, however, that the language caused confusion with respect to priority issues. The intention of the statute, as demonstrated by the Comments, was that the inchoate statutory lien was the functional equivalent of real estate taxes except with respect to the special priorities identified in subsection (b) of the section. The deletion of the language as suggested makes clear that the lien arises immediately upon the effective date of the statute for old common interest communities and upon recording of the declaration for new common interest communities.

As a result of this deletion, it is clear that in the absence of an exception in a title insurance policy for common charges, a title insurer would be liable for post-insurance obligations which have a priority established prior to the time the policy was issued. This, however, is no different than in other inchoate liens such as real estate taxes and mechanics liens, all of which have become standard exceptions in the title industry.

2. To ensure prompt and efficient enforcement of the association's lien for unpaid assessments, such liens should enjoy statutory priority over most other liens. Accordingly, subsection (b) provides that the association's lien takes priority over all other liens and encumbrances except those recorded prior to the recordation of the declaration, those imposed for real estate taxes or other governmental assessments or charges against the unit, and first security interests recorded before the date the assessment became delinquent. However, as to prior first security interests the association's lien does have priority for six months' assessments based on the periodic budget. A significant departure from existing practice, the six months' priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders. As a practical matter, secured lenders will most likely pay the six months' assessments demanded by the association rather than having the association foreclose on the unit. If the lender wishes, an escrow for assessments can be required. Since this provision may conflict with the provisions of some state statutes which forbid some lending institutions from making loans not secured by first priority liens, the law of each State should be reviewed and amended when necessary.

In cooperatives, the association has legal title to the units and depending on the election made in the declaration pursuant to Section 2-118(i) may have power to create, assume, or take subject to security interests in the units which have priority over the interest of unit owners. Obviously, the cooperative association's lien should not have priority over an interest which the association itself has given, assumed, or taken subject to and subsection (b) expressly so provides.

The special reference to cooperatives in subsection (b)~~(ii)~~(2) merely recognizes that in a cooperative both the association and the unit owner have an interest in a unit.

3. Units may be part of two common interest communities. For example, a large real estate development may consist of one or more condominiums which are also part of a larger planned community. In that case, the planned community association might assess the

condominium units for the general maintenance expenses of the planned community and the condominium association would assess for the direct maintenance expenses of the building itself. In such a situation, subsection ~~(c)~~(d) provides that unpaid liens of the two associations have equal priority regardless of the relative time of creation of the two regimes and regardless of the time the assessments were made or became delinquent.

4. Subsection ~~(f)~~(g) makes clear that the association may have remedies short of foreclosure of its lien that can be used to collect unpaid assessments. The association, for example, might bring an action in debt or breach of contract against a recalcitrant unit owner rather than resorting to foreclosure.

5. The rights of the association against a unit upon nonpayment of an assessment on that unit depends on whether the common interest community is a condominium or planned community on the one hand, or a cooperative on the other.

In the typical cooperative the association will have a substantial underlying mortgage on all or a substantial portion of the real estate in the cooperative and a large part of each unit owner's periodic assessment will go toward payment of that particular unit's proportionate share of the mortgage. If the unit owner fails to pay his assessment on time, the association may be forced into default on its own mortgage payments with consequent possible foreclosure of the underlying mortgage and loss by all unit owners of their interests in the cooperative. Therefore, in the cooperative context it is essential that the cooperative association have a fast and effective remedy for failure of a unit owner to pay his assessment. The act provides in subsection (i) that upon nonpayment the cooperative unit owner may be evicted in the same manner as an unlawfully holding over commercial tenant. Those rules will ordinarily be the most rapid and efficient rules in the State as to eviction of tenants.

If the unit owner's interest is real estate, subsection ~~(j)~~(k)(2) then offers the State two alternatives as to nonjudicial foreclosure of a cooperative association's lien. The first alternative is power of sale under any existing state statute authorizing power of sale under mortgages. If there is no power of sale statute or if the legislature chooses to adopt a special power of sale provision for foreclosure of the lien on cooperative units, the State can choose the 2d alternative: power of sale under subsection ~~(k)~~(l) of this section.

Subsection ~~(k)~~(l), which is patterned after the power of sale foreclosure provisions of the Uniform Land Transactions Act, is a modern power of sale provision which frees private power of sale foreclosure from many of the costly, time consuming, and inefficiency producing strictures of most existing private power of sale statutes. At the same time, it provides reasonable protection to the unit owner and junior interests.

If the unit owners' interest in a cooperative is personal property, the association's lien is foreclosed as if it were a security interest under Article 9 of the Uniform Commercial Code. Article 9 foreclosure is generally less expensive and faster than either judicial or power of sale real estate foreclosure. This difference in cost and speed of foreclosure, both for association liens and security interests, is one of the major factors to be considered in choosing whether, under Section 1-105, the unit owner's interest in a cooperative will be real property or personal property. Article 9 foreclosure is currently used in foreclosing security interests in mobile homes, and has been accepted in the various States as a permissible method of foreclosure in that

housing area without serious challenge.

In a condominium or planned community, there is not likely to be a substantial underlying mortgage for which unit owners are assessed. Therefore, failure to pay assessments on time will have less serious consequences for the association than in the case of cooperatives. The section provides that the association lien in a condominium or planned community is to be foreclosed according to the rules generally applicable to real estate mortgages in the State rather than setting out a special faster method of foreclosure in the statute.

6. New subsection ~~(f)~~(m) makes clear that the courts have authority to appoint receivers upon request by associations to aid in collection of common charges.

7. Few issues are more contentious in common interest communities than the prospect of unit owners losing their homes as a consequence of non payment of common charges – and the loss of all or most of their equity – when the association forecloses. The reaction in state legislatures in recent years has been widespread.

At the same time, it is crucial that the association be able to secure timely payment of common charges in order to provide services to all the residents of the common interest community.

In an effort to balance these competing interests, the 2008 amendments provide additional safeguards governing foreclosure of liens for unpaid common charges. These new procedures may be summarized as follows:

First, Section 3–116(n) bars foreclosure for sums that are less than 3 months of common charges;

Second, Section 3–116(n) also requires the association board, to first, offer the delinquent owner a payment plan which the owner rejects, and second, expressly approve each foreclosure action;

Third, Section 3–116(o) requires that payments of delinquent assessments be applied first to principal rather than to interest and fees, in order to avoid the usual practice of accruing additional interest and late charges as the monthly fees remain unsatisfied while the attorneys fees and interest are paid first.

Fourth, Section 3–116(p) bars any foreclosure for fines alone unless the association first secures a personal judgment against the unit owner.

Finally, Section 3–116(q) requires that if a foreclosure does go forward, any sale of a unit must be commercially reasonable. In the first reported case of foreclosure arising in a state that has adopted this Act, the court required that the sale be reasonable. See *Will v. Mill Condominium Owners Association et al*, 176 VT 380, 848 A2d 336 [2004].

These special procedures would comprise an overlay on existing state foreclosure procedures, whether judicial or non-judicial. Taken together, they respond in a concise but responsible way to the widespread reports of abuses in this field. Hopefully, they will also be

viewed by the various States as a responsible and balanced response to the issues confronting elected officials, defaulting unit owners and homeowners association directors with a fiduciary responsibility to maintain the property.

8. Associations must be legitimately concerned, as fiduciaries of the unit owners, that the association be able to collect periodic common charges from recalcitrant unit owners in a timely way. To address those concerns, the section contains these 2008 amendments:

First, subsection (a) is amended to add the cost of the association's reasonable attorneys fees and court costs to the total value of the association's existing 'super lien' -- currently, 6 months of regular common assessments. This amendment is identical to the amendment adopted by Connecticut in 1991; see C.G.S. Section 47-258(b). The increased amount of the association's lien has been approved by Fannie Mae and local lenders and has become a significant tool in the successful collection efforts enjoyed by associations in that state.

Second, subsection (f) has been amended to emphasize that the association has a variety of other remedies available against a unit owner in addition to the foreclosure remedy. In many cases, an action for sums due may be less costly, less disruptive and more efficient than a foreclosure action in collecting the funds properly due the association.

9. Section 3-116 rejects more extreme provisions favoring defaulting unit owners espoused in various forums. For example, extensive provisions were adopted by North Carolina regarding fines enforcement and collection which may pose significant impediments to the financial well being of unit owner associations. See, e.g., 2205 North Carolina Session Act No. 422). Similarly, the section does not adopt the extensive borrower protections contained in the Uniform Non-Judicial Foreclosure Act. That act contains provisions dealing with repetitive and detailed default notices, mandated meetings before foreclosure, a period of limitation on foreclosures, mandated judicial supervision of foreclosures, extensive redemption rights after foreclosure, and the like. In those cases where foreclosure is supervised by a judge, those procedures are not likely to be of significant benefit to defaulting to unit owners, but will impose significant transaction costs on associations in non-judicial foreclosure states; there is no reason to distinguish common interest community foreclosures from every other procedure.

10. The issue of how the association protects itself from non-payment of assessments may be of concern in a state with a homestead exemption. Either direct foreclosure of the association's statutory lien for unpaid assessments, or foreclosure of a perfected judgment lien which the association might have secured in lieu of foreclosure, may conflict with existing homestead statutes. Further consideration of this issue in those states, in order to reconcile conflicting statutes, would then be appropriate.

11. In requiring a delay for 3 months in commencement of a foreclosure proceeding, subsection 3-116(n)(1) imposes some risk on the association. Since the association's lien has only a limited priority over that of a first mortgage, anything which delays the commencement and completion of a foreclosure by the association, but does not result in the unit owner bringing his or her account current, may be seen as simply raising the cost to the association, and, therefore, to all of the other unit owners who are paying their common charges on time.

12. It may be that the reaction of some legislators to this Section will depend on the

extent to which foreclosure actions in the respective states are subject to judicial supervision. In states where non-judicial foreclosure is either not available or not used in association lien foreclosures, the active role played by the court may minimize the need for certain of the borrower protections in this section.

SECTION 3-117. OTHER LIENS.

(a) In a condominium or planned community:

(1) Except as otherwise provided in paragraph (2), a judgment for money against the association [if recorded] [if docketed] [if [insert other procedures required under state law to perfect a lien on real estate as a result of a judgment]], is not a lien on the common elements, but is a lien in favor of the judgment lien holder against all of the other real estate of the association and all of the units in the common interest community at the time the judgment was entered. No other property of a unit owner is subject to the claims of creditors of the association.

(2) If the association has granted a security interest in the common elements to a creditor of the association pursuant to Section 3-112, the holder of that security interest shall exercise its right against the common elements before its judgment lien on any unit may be enforced.

(3) Whether perfected before or after the creation of the common interest community, if a lien, other than a deed of trust or mortgage~~(~~, including a judgment lien or lien attributable to work performed or materials supplied before creation of the common interest community~~)~~, becomes effective against two or more units, the unit owner of an affected unit may pay to the lien holder the amount of the lien attributable to ~~his~~ the unit, and the lien holder, upon receipt of payment, promptly shall deliver a release of the lien covering that unit. The amount of the payment must be proportionate to the ratio ~~which~~ that the unit owner's common expense liability bears to the common expense liabilities of all unit owners ~~whose~~ the units of which are subject to the lien. After payment, the association may not assess or have a lien against that unit owner's unit for any portion of the common expenses incurred in connection with that lien.

West's Nevada Revised Statutes Annotated
Title 10. Property Rights and Transactions (Chapters 111-120A)
Chapter 116. Common-Interest Ownership (Uniform Act) (Refs & Annos)
Administration and Enforcement of Chapter
General Provisions

N.R.S. 116.623

116.623. Petitions for declaratory orders or advisory opinions: Regulations; scope; contents of petition; filing; period for response

Effective: October 1, 2009
Currentness

1. The Division shall provide by regulation for the filing and prompt disposition of petitions for declaratory orders and advisory opinions as to the applicability or interpretation of:

(a) Any provision of this chapter or chapter 116A or 116B of NRS;

(b) Any regulation adopted by the Commission, the Administrator or the Division; or

(c) Any decision of the Commission, the Administrator or the Division or any of its sections.

2. Declaratory orders disposing of petitions filed pursuant to this section have the same status as agency decisions.

3. A petition filed pursuant to this section must:

(a) Set forth the name and address of the petitioner; and

(b) Contain a clear and concise statement of the issues to be decided by the Division in its declaratory order or advisory opinion.

4. A petition filed pursuant to this section is submitted for consideration by the Division when it is filed with the Administrator.

5. The Division shall:

(a) Respond to a petition filed pursuant to this section within 60 days after the date on which the petition is submitted for consideration; and

(b) Upon issuing its declaratory order or advisory opinion, mail a copy of the declaratory order or advisory opinion to the petitioner.

Credits

Added by Laws 2009, c. 491, § 5.

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End of Document

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STATE OF NEVADA

DEPARTMENT OF BUSINESS AND INDUSTRY

IN THE MATTER of the Petition of Prem Investments, LLC., a Nevada limited liability company, Rutt Premsrirut, Manager, for an application for Advisory Opinion and Declaratory Order pursuant to NAC §232.040 Petition for declaratory order or advisory opinion	Docket No.

COMES NOW, Petitioner Prem Investments, LLC., a Nevada limited liability company, Rutt Premsrirut, Manager ("Petitioner" or "Prem Investments") and hereby applies by Petition to the Nevada Department of Business and Industry for an Advisory Opinion and Declaratory Order concerning the applicability of a statute. This application for Petition for Advisory Opinion and Declaratory Order is made pursuant to NAC §232.040, Petition for declaratory order or advisory opinion; Authorization; filing; contents. This Petition is made to the Director of the Nevada Department of Business and Industry pursuant to NAC §232.040(2)(b). In support of this Petition, Prem Investments, by and through its counsel, states as follows:

I

PETITIONER

Prem Investments is not a party in any administrative, civil or criminal action concerning the matters contained in this Petition. Prem Investments is in the business of purchasing single family residences ("Real Property") through foreclosure auctions held by the first mortgage lender of said Real Property. Prem Investments has been the recipient of demands by Nevada collection agencies

licensed under NRS §649 and purporting to represent Nevada common interest communities ("homeowners' associations") in the collection of homeowners' associations' liens placed upon the Real Property. Said liens comprise debts which were incurred by the prior owner of the Real Property but which have been extinguished pursuant to NRS §116.3116 by the first mortgage lender's foreclosure auction. Regardless that the liens have been legally extinguished and the debt is not owed by Petitioner, Nevada collection agencies are demanding and collecting said lien amounts from Petitioner and refusing to clear title of the Real Property unless payment is made.

All correspondence can be mailed to Prem Investments at: 520 S. Fourth Street, Second Floor, Las Vegas, NV 89101, with copy to Adams Law Group, Ltd., at 8681 W. Sahara Ave., Suite 280, Las Vegas, NV 89117.

II.

THE FACTS

Homeowners' associations and their collection agents are enforcing and collecting extinguished association liens and instituting wrongful foreclosure proceedings against the Real Property of Petitioner, and other owners of real property including lenders, government mortgage insurers and investors who take title to single family residences through foreclosure auctions. In Nevada, pursuant to NRS §116.3116, once a first mortgage lender forecloses on a unit located within a homeowners' association, an association's lien is extinguished but for a limited and finite portion of the lien called the "super priority lien amount." However, the practice of homeowners' associations and their collection agents is to regularly violate Nevada law and charge to the new owner (who acquires title at the auction) the entire lien amount, not just the limited, super priority lien amount.

The scheme, which has purported to net Nevada homeowners' associations and collection agencies tens of millions of dollars over the last few years, generally unfolds as follows:

- A homeowner, owning property within an association, becomes delinquent in the payment of his mortgage. Simultaneously, the homeowner stops paying his association assessments.

- The association assesses fines, late fees, and penalties against the homeowner and, most notably, employs a collection agency to collect the past due amounts. Even though the association assessments are often less than $100 per month, the associations and collection agencies add thousands of dollars of "collection" fees onto the homeowner's bill.

- Knowing that these fees constitute a statutory lien on the homeowner's property, the associations and collection agencies are secure in knowing that their many thousands of dollars in "collection" fees will get paid, or else the homeowner's title will remain clouded.

- Then, due to the homeowner's inability to pay his mortgage, the homeowner's lender ultimately forecloses on the property. At the foreclosure auction, the lender, lenders' mortgage insurer or an investor will take title to the property.

- Once this happens, under Nevada law, the association's lien is extinguished by the foreclosure auction, but for the limited, "super priority lien amount" which equals a maximum of 9 times the association's monthly assessments.

- However, instead of informing the new owner that the association's lien has been extinguished but for the super priority lien amount, the associations through their collection agencies represent that they have the legal right to collect from the new owner all monies owed by the original homeowner, including the thousands of dollars of "collection" fees added onto the original homeowner's bill.

- Knowing that title is clouded by the maintaining of the lien and also knowing that the new owner cannot sell the property without clear title, the associations and collection agencies demand vastly more amounts of money than Nevada law requires the new owner to pay.

- Ultimately, in order to clear title and to prevent the association from foreclosing its unlawful lien amount, the new owner pays the improperly demanded amounts and gets the dubious distinction of having paid to Nevada collection agencies thousands of dollars which he did not owe.

This alleged scheme is purported to have been conducted thousands of times resulting in the overpayment by lenders, government mortgage insurers and investors of tens of millions of dollars.

III.

THE ISSUES

The reason for requesting this order and opinion is to determine whether the foreclosure by a first mortgage lender on a property located within a Nevada common interest community extinguishes an existing homeowners' association lien against said property. More particularly, the issues upon which the advisory opinion and declaratory order are sought are the following:

1. Under NRS §116.3116, a homeowners' association has a lien on a unit for any assessment levied against that unit or any fines imposed against the unit's owner from the time the assessment or fine becomes due. Pursuant to NRS §116.3116, what portion of the lien, if any, is superior to the unit's first mortgage lender's security interest ("super priority lien") and may the sum total of the super priority lien amount, whether it be comprised of assessments, fees, costs of collection, or other charges, ever exceed 9 times the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS §116.3115, plus any charges incurred by the association on a unit pursuant to NRS §116.310312 (unit repair expenses)?
2. Pursuant to NRS §116.3116, does a "super priority lien" exist in the absence of a homeowners' association's failure to file a complaint with a court to enforce the lien, i.e., the failure to institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3?

IV.

RELEVANT LAW AND HISTORY

A. Introduction of the Uniform Common Interest Ownership Act

The Uniform Common Interest Ownership Act ("UCIOA") was originally promulgated in 1982 by the National Conference of Commissioners on Uniform State Laws ("Uniform Law

Commissioners" or "ULC"). In 1991, Nevada passed the UCIOA which is embodied in Nevada Revised Statutes §116. As of October 31, 2009, there were 2,961 registered Nevada common interest communities ("homeowners' associations") subject to NRS §116 having a total of 472,777 units within them.[1] UCIOA is a comprehensive act that governs the formation, management, and termination of a common interest community, whether that community is a condominium, planned community, or real estate cooperative. It also provides for disclosure of important facts about common interest property at sale to a buyer, including resale disclosure for any sale after the initial sale by the developer of the property; for warranties of sale; for a buyer's recision rights in a sale contract; and for escrow of deposits made to secure a sale contract. Importantly, it also governs the creation, treatment, foreclosure and extinguishment of homeowners' associations' liens on units within their communities.

B. The Legislative History & the Super Priority Lien

The UCIOA governs liens against properties located within homeowners' associations and, regarding association liens against units, generally states as follows:

a. Homeowners associations have a statutory lien on any unit of real property located within their associations for any assessment imposed against a unit or fine imposed against the unit's owner from the time the assessment or fine becomes due;

b. However, the associations' liens are junior to the first security interest of the unit's first mortgage lender except for a certain, limited and specified portion of the lien as defined in §3-116 which remains senior to the first security interest of the unit's first mortgage lender, provided that the associations had instituted an "action" to enforce their liens (the "Super Priority Lien Amount").

[1] Executive Summary of the Ombudsman, Reporting Period: July 1, 2009 through October 31, 2009

Thus, in a break with traditional lien priority law, the UCIOA granted the association a lien priority over first mortgages recorded before any assessment delinquency. However, as shall be noted below, the associations' lien priority is only available to a certain and limited extent.

The original language of the 1982 UCIOA regarding §3-116 and super priority liens is as follows:

> (a) The association has a lien on a unit for any assessment levied against that unit or fines imposed against its unit owner from the time the assessment or fine becomes due. Unless the declaration otherwise provides, fees, charges, late charges, fines, and interest charged pursuant to Section 3-102(a)(10), (11), and (12) are enforceable as assessments under this section. If an assessment is payable in instalments, the full amount of the assessment is a lien from the time the first instalment thereof becomes due.
>
> (b) A lien under this section is prior to all other liens and encumbrances on a unit except (i) liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances which the association creates, assumes, or takes subject to, (ii) a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent, or, in a cooperative, the first security interest encumbering only the unit owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent, and
>
> (iii) liens for real estate taxes and other governmental assessments or charges against the unit or cooperative. The lien is also prior to all security interests described in clause (ii) above to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien. This subsection does not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association. [The lien under this section is not subject to the provisions of [insert appropriate reference to state homestead, dower and curtesy, or other exemptions]. *(See Exhibit "1")*

Thus, the "super priority" portion of the homeowners' associations' liens were capped "to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding an action to enforce the lien." While an underlying association lien may have been for a higher amount, the only amount which could achieve "super priority" status over the first mortgage lender was an amount equaling 6 times the monthly assessments.

Interestingly, the Super Priority Lien Amount was intended to be a fixed amount, i.e., one that a lender could approximate prior to lending funds to a borrower who was purchasing within a common interest community. This was so that the lender could escrow, from the borrower funds, the predetermined Super Priority Lien Amount in case the borrower failed to pay the assessments. As noted in the comments section of the 1994 draft of the UCIOA:

> To ensure prompt and efficient enforcement of the association's lien for unpaid assessments, such liens should enjoy statutory priority over most other liens. Accordingly, subsection (b) provides that the association's lien takes priority over all other liens and encumbrances except those recorded prior to the recordation of the declaration, those imposed for real estate taxes or other governmental assessments or charges against the unit, and first security interests recorded before the date the assessment became delinquent. However, as to prior first security interests the association's lien does have priority for six months' assessments based on the periodic budget. A significant departure from existing practice, the six months' priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders. As a practical matter, secured lenders will most likely pay the six months' assessments demanded by the association rather than having the association foreclose on the unit. **If the lender wishes, an escrow for assessments can be required.** *(See Exhibit "2," Comments, UCIOA 1994, page 159-160.)*

Thus, since the lender would know what the assessments were prior to lending, and since the lender would know, pursuant to §3-116 of the UCIOA, that the Super Priority Lien Amount was limited to 6 months of assessments, it could require the borrower to escrow, prior to closing, exactly that amount of funds for which the lender might be liable, i.e., the Super Priority Lien Amount. The lender, therefore, had protection if it had to pay the Super Priority Lien Amount, and the association was assured of payment of a maximum figure equal to 6 months of assessments if the borrower/homeowner defaulted on his obligations to his association. Thus, the "equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders" was accomplished.

C. Nevada Revised Statutes §116.3116

In 1991, Nevada adopted the 1982 version of the UCIOA. The provisions relating to homeowners' association liens were embodied in NRS §116.3116. On October 1, 2009, NRS §116.3116 was amended by the Nevada legislature in two important ways. First, it increased the

Super Priority Lien Amount to a figure equaling 9 times (formerly 6 times) the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS §116.3115 (see Nevada Assembly Bill 204). In calculating the Super Priority Lien Amount, it also allowed to be added any charges incurred by the association on a unit pursuant to NRS §116.310312 (repair expenses of a unit) (see Nevada Assembly Bill 361). The most recent adoption of NRS §116.3116 states in pertinent part:

> 1. The association has a lien on a unit for any construction penalty that is imposed against the unit's owner pursuant to NRS 116.310305, any assessment levied against that unit or any fines imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due.
>
> (2) A lien under this section is prior to all other liens and encumbrances on a unit **except**:
>
> (b) A first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent or, in a cooperative, the first security interest encumbering only the unit's owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent;
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> The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien.

The figure equaling 9 times the association's monthly assessment amount has been dubbed the "Super Priority Lien Amount" because it is that figure which remains senior or superior to the first security interest holder's trust deed. It is only the Super Priority Lien Amount, not all association lien amounts, which is super to the first mortgage holder's trust deed. Any amounts greater than the Super Priority Lien Amount still remain a lien against the owner's unit, but it is a lien which is junior to the first security interest holder. The "junior" portion of the lien, therefore, is extinguished by a foreclosing first mortgage lender and the "super priority" portion of the lien survives extinguishment by the foreclosing first mortgage lender.

D. Necessity for the Institution of an Action

As a condition precedent to the establishment of a super priority lien, homeowners' associations need to file "an action to enforce the lien...." Nevada and Massachusetts have nearly identical language in their homeowners' association super priority lien statutes regarding the necessity for the institution of an action to enforce the lien:

NRS 116.3116	**MA ST 183A s 6**
The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien....	This lien is also prior to the mortgages described in clause (ii) above to the extent of the common expense assessments based on the budget adopted pursuant to subsection (a) above which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien....

Citing nearly identical language as that of the Nevada statute, the Massachusetts courts have held that the institution of a lawsuit (i.e., a civil action) is a condition precedent for homeowners' associations' achievement of super priority status for any portion of its lien amount. The Massachusetts courts have held:

> The condominium lien achieves "super priority" status over the first mortgage when a condominium association institutes "an action to enforce the lien." Thus, Section 6(c) provides that: [t]his lien is also prior to the mortgages described in clause (ii) above to the extent of the common expense assessments based on the budget adopted pursuant to subsection
>
> (a) above which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien...
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> ***Accordingly, the institution of an action by a condominium association is a condition precedent to achieving "super-priority" status for the condominium lien. However, even when the association files such an action, the condominium lien is given a "super-priority" status only to the extent of unpaid condominium fees for the preceding six months.***
>
> ***It is uncontested by the parties that a lawsuit is required before a lien for unpaid condominium fees achieves a "super-priority"***

> ***status***. See also In re Stern, 44 B.R. 15, 19 (Bankr.D.Mass.1984). ("the establishment of the lien is not dependent on the commencement of a lawsuit, which is only a step necessary to elevate the status of the lien to a position superior to other encumbrances, other than municipal liens and first mortgages.")...
>
> In this regard, M.G.L. ch. 183A, § 6(c) specifically provides that, without the commencement of an enforcement action by a condominium association, a lien for unpaid condominium fees is "prior" to all other liens and encumbrances "except ... (ii) a first mortgage on the unit recorded before the date on which the assessment sought to be enforced became delinquent ..." (emphasis added). ***That exception makes the lien junior at least until an action is commenced. Indeed, if the lien was anything but junior to the first mortgage, there would be no reason to require that an action be filed in order to grant that lien super-priority status.*** *Trustees of MacIntosh Condominium Association v. F.D.I.C., et.al. 908 F.Supp. 58 at 63 (1995).*

Thus, as a "condition precedent" to elevate a portion of a homeowners' association's lien (in Nevada, an amount equaling 9 times the monthly assessments) from "junior" status to "super priority" status, a homeowners' association must file an "action" to enforce the lien. Nevada Rules of Civil Procedure 2 states, "There shall be one form of action to be known as 'civil action.'" Nevada Rules of Civil Procedure 3 states, "A civil action is commenced by filing a complaint with the court." Therefore, until a homeowners' association files a complaint with the court to enforce its lien, no amount of its lien can achieve "super priority" status. While the lien remains a lien on the owner's unit, it is in "junior" status to the first security holder's deed of trust. Thus, until the filing of a complaint with the court to enforce its lien, upon the first mortgage holder's foreclosure, the association's junior lien is extinguished in its entirety.

So in first addressing question 2 above, "Pursuant to NRS §116.3116, does a "super priority lien" exist in the absence of a homeowners' association's failure to file a complaint with a court to enforce the lien, i.e., the failure to institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3?" the answer must be no. Pursuant to NRS §116.3116, a homeowners' association's filing of a complaint with the court to enforce its lien is a condition precedent for any portion of its lien to achieve "super priority" status.

E. Collection Costs and the Super Priority Lien Amount Limit

Even if a homeowners' association does file a complaint with the court to enforce its lien, the lien is only given a "super-priority" status to the extent of a maximum amount equal to 9 times the monthly assessment amount adopted by the association in its last budget *(see NRS 116.3116(2), "The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien.... ").* All other portions of the lien which exceed that limit are junior to the first mortgage lender *(see NRS 116.3116 (2)(b), "A lien under this section is prior to all other liens and encumbrances on a unit except... A first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent.... ").*

It is important to note, however, that any association penalties, fees, charges, late charges, fines and interest are enforceable as assessments are enforceable *(see NRS 116.3116(1)), "... any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS 116.3102 are enforceable as assessments under this section.... ").* In other words, penalties, late fees, and collection charges may be included within the Super Priority Lien Amount, as long as the total Super Priority Lien Amount does not exceed an amount which equals 9 times the association's monthly assessment amount (plus unit repair expenses under NRS 116.310312). Again, as the statute states, *"The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien.... ") (NRS 116.3116(2).*

Indeed, it is critical to make clear that while assessments, late fees, charges, interest, and costs of collecting, etc., may all be included within the Super Priority Lien Amount, in no instance

may the sum total of the super priority portion of the lien exceed 9 times the monthly assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115, plus any charges incurred by the association on a unit pursuant to NRS 116.310312 (repair expenses). With the exception of the addition of repair expenses pursuant to NRS 116.310312, the Super Priority Lien Amount is a finite number which is not to be exceeded. It is a ceiling. It is a limit. It may, however, contain within it more than just assessments.

In 1991, both Nevada and Colorado adopted the UCIOA with language mirroring UCIOA Section 3-116 (1982 version). As noted by the Colorado Supreme Court, "The Colorado Common Interest Ownership Act was originally adopted in 1991, effective July 1, 1992. Ch. 283, sec. 1, §§ 38-33.3-101 to -319, 1991 Colo. Sess. Laws 1701-57. It was adopted, among other reasons, to provide stability to the finances of common interest communities by granting them a super-lien for unpaid assessments, and to provide uniformity and predictability to lenders in order to promote the availability of financing." *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 450 (Colo.App.,2008).* A comparison of the two statutes is as follows:

NRS 116.3116 - NV Super Priority Language	**CO ST s 38-33.3-316 - CO Super Priority Language**
The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien...	... a lien under this section is also prior to the security interests described in subparagraph (II) of paragraph (a) of this subsection (2) to the extent of: (I) An amount equal to the common expense assessments based on a periodic budget adopted by the association under section 38-33.3-315(1) which would have become due, in the absence of any acceleration, during the six months immediately preceding institution by either the association or any party holding a lien senior to any part of the association lien created under this section of an action or a nonjudicial foreclosure either to enforce or to extinguish the lien.

The Colorado Court of Appeals and the author of a Wake Forest Law Review article quoted by the Colorado courts both concluded that although the assessment portion of the super priority lien is limited to a finite number of months, because the assessment lien itself includes "fees, charges,

late charges, attorney fees, fines, and interest," these charges may be included as part of the Super Priority Lien Amount. The Colorado language is the same as NRS §116.3116, which states that "fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS §116.3102 are enforceable as assessments." Therefore, as NRS §116.3116 states that assessments are enforceable through liens, so are collection charges, late charges, fines, fees, etc., enforceable through liens. However, while such charges may be included in the Super Priority Lien Amount, as noted by the Colorado Supreme Court, the maximum amount of the super priority lien is capped:

> We conclude that the plain language of the statute supports Sunstone's position. Within the meaning of subsection (2)(b), a "lien under this section" may include any of the expenses listed in subsection (1), including "fees, charges, late charges, attorney fees, fines, and interest." Thus, although the maximum amount of a super priority lien is defined solely by reference to monthly assessments, the lien itself may comprise debts other than delinquent monthly assessments.
>
> We note that our view matches that of a commentator who has examined the uniform act on which § 38-33.3-316 was based. This commentator has concluded that, under the uniform act, the super priority lien may comprise debts other than delinquent assessments:
>
> A careful reading of the ... language reveals that the association's Prioritized Lien, like its Less-Prioritized Lien, may consist not merely of defaulted assessments, but also of fines and, where the statute so specifies, enforcement and attorney fees. The reference in section 3-116(b) to priority "to the extent of" assessments which would have been due "during the six months immediately preceding an action to enforce the lien" **merely limits the maximum amount of all fees or charges for common facilities use or for association services, late charges and fines, and interest which can come with the Prioritized Lien.** *First Atlantic Mortg., LLC v. Sunstone North Homeowners Ass'n 121 P.3d 254, 255 -256 (Colo.App.,2005).*

Thus, the words "to the extent of" (found in both Nevada's and Colorado's §3-116) limit the maximum amount of all fees, charges, costs and assessments which can comprise the super priority lien to an amount which does not exceed 9 times (6 times in Colorado) the association's monthly assessment amount. In Nevada and Colorado, collection costs and attorney's fees are not added on top of the 9 month amount, but may be incorporated within that amount, provided the Super Priority Lien Amount does not exceed 9 times the association's monthly assessments.

The Colorado Supreme Court recently punctuated the above point in its 2008 case of *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 450 (Colo.App.,2008).*

> The association then has a super-priority lien over the lender's otherwise senior deed of trust in the event of a foreclosure commenced by the association or the lender, which lien is limited to delinquent assessments accruing within six months of the initiation of foreclosure proceedings. § 38-33.3-316(2)(b)(I). Further, the association's super-priority lien includes interest, charges, late charges, fines, and attorney fees **so long as the total does not exceed the limit**. *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 451 (Colo.App.,2008)*

So long as the total of all assessments, fees, costs and other charges do not exceed the limit of an amount equal to 9 times (6 times in Colorado) of monthly assessments, the super priority lien includes interest, charges, late charges, etc. The Colorado Supreme Court, applying Colorado Code Section 38-33.3-116 (which is nearly identical to Nevada's NRS 116.3116,) made clear that the 6 or 9 month assessment total is a super priority limit which cannot be exceeded. This was "... to provide uniformity and predictability to lenders in order to promote the availability of financing." *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 450 (Colo.App.,2008).*

Nowhere is this distinction made clearer than by the very law review article cited by the Colorado courts. James Winokur, in his treatise, "Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Ownership Act," 27 Wake Forest L. Rev.353, states as follows:

> In its most heralded break with traditional law, UCIOA grants the association a lien priority over first mortgages recorded before any assessment delinquency "to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding an action to enforce the lien." Any excess of total assessment defaults, in addition to other lienable fines or costs over this six-month ceiling remains a lien on the property. The portion of the association lien securing this excess will be junior to the first mortgage on the unit, but senior to other mortgages and encumbrances not recorded before the declaration. Thus, although the association's lien is a single lien, its varying priority effectively separates the association's rights in a given unit into what may be conceived of as two liens, which are hereinafter referred to as the "Prioritized Lien" and the "Less-Prioritized Lien."
>
> A careful reading of the quoted language reveals that the association's Prioritized Lien, like its Less-Prioritized Lien, may consist not merely

> of defaulted assessments, but also of fines and, where the statute so specifies, enforcement and attorney fees. The reference in section 3-116(b) to priority "to the extent of" assessments which would have been due "during the six months immediately preceding an action to enforce the lien" merely limits the maximum amount of all fees or charges for common facilities use or for association services, late charges and fines, and interest which can come within the Prioritized Lien. So, for example, if a unit owner fell three months behind in assessments, the Prioritized Lien might include--in addition to the three months of arrearages--the other fees, charges, costs, etc. enforceable as assessments under UCIOA. However, for any assessments or other charges to be included within the Prioritized Lien, there must have been a properly adopted periodic budget promulgated "at least annually" by the association from which the appropriate six months assessment ceiling can be computed. *(James Winokur, Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Ownership Act, 27 Wake Forest L. Rev.353. See Exhibit "3").*

The following examples may assist:

Case 1: A homeowner's assessments adopted through the association's last budget are $100 per month. He is 4 months delinquent ($400). The association has charged $80 in late fees and $375 in costs of collecting. The association has incurred no repair costs under NRS 116.310312. Thus, the total amount of the homeowner's delinquency is $855. Because the association has a lien for assessments under NRS 116.3116, and because any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS 116.3102 are enforceable as assessments, and because the association lien is prior to all first security interests only to the extent of the assessments for common expenses during the 9 months immediately preceding institution of an action to enforce the lien, assuming the institution of an "action" by the association, the maximum super priority lien amount is $900 (9 x $100 of monthly assessments). Thus, the full $855 is included in the super priority lien. Mathematically, $855 (the association lien) is prior to the first mortgage lien to the extent of $900 (9 times the monthly assessments).

Case 2: A homeowner's assessments adopted through the association's last budget are $100 per month. He is 12 months delinquent ($1,200). The association has charged $240 in late fees and $1,600 in costs of collecting. The association has incurred no repair costs under NRS 116.310312. Thus, the total amount of the homeowner's delinquency is $3,040. Because the association has a lien for assessments under NRS 116.3116, and because any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of

> subsection 1 of NRS 116.3102 are enforceable as assessments, and because the lien is prior to all first security interests only to the extent of the assessments for common expenses during the 9 months immediately preceding institution of an action to enforce the lien, assuming the institution of an "action" by the association, the maximum super priority lien amount is still $900 (9 x $100 of monthly assessments). Mathematically, $3,040 (the association lien) is prior to the first mortgagelien only to the extent of $900 (9 times the monthly assessments). Thus, $900 is the Super Priority Lien Amount and the remaining $2,140, while still a lien against the unit, is junior to the first mortgage. This analysis is consistent with the holdings of the Colorado Supreme Court and James Winokur's *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Ownership Act, 27 Wake Forest L. Rev.353*. Winokur described the $900 portion of the lien as the "Prioritized Lien" (i.e., super priority lien) and the $2,140 portion as the "Less Prioritized Lien" (i.e., junior lien).

Thus, the Super Priority Lien Amount does not change from neighbor to neighbor depending upon costs of collection. It is always an amount equal to 9 times the association's monthly assessment. The only time the Super Priority Lien Amount can change is when the assessments change in the association's budget or when the association incurs repair expenses for a unit pursuant to NRS §116.310312.

F. The Connecticut Amendment

As stated above, in 1991, Nevada and Colorado adopted the UCIOA with language mirroring UCIOA Section 3-116 (1982 version). Connecticut also adopted a version of the UCIOA, but with a significant and fundamental amendment to §3-116. This amendment was adopted by Connecticut in 1991 (see C.G.S. Section 47-258(b) as amended by No. 91-359 of the Public Acts of 1991). A comparison of the three statutes as originally enacted is as follows:

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NV Super Priority Language	CO Super Priority Language	CT Super Priority Language
The lien is also prior to all security interests described in paragraph (b) to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien. This subsection does not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association.	... a lien under this section is also prior to the security interests described in subparagraph (II) of paragraph (a) of this subsection (2) to the extent of: (I) An amount equal to the common expense assessments based on a periodic budget adopted by the association under section 38-33.3-315(1) which would have become due, in the absence of any acceleration, during the six months immediately preceding institution by either the association or any party holding a lien senior to any part of the association lien created under this section of an action or a nonjudicial foreclosure either to enforce or to extinguish the lien.	The lien is also prior to all security interests described in subdivision (2) of this subsection to the extent of (A) an amount equal to the common expense assessments based on the periodic budget adopted by the association pursuant to subsection (a) of section 47-257 which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce either the association's lien or a security interest described in subdivision (2) of this subsection **and (B) the association's costs and attorney's fees in enforcing its lien.**

As can be observed, Connecticut added a new provision to UCIOA's Section 3-116, which Nevada and Colorado did not adopt. While Nevada and Colorado's super priority lien was limited to the extent of an amount equal to just 6 months of assessments only, the Connecticut legislature intentionally permitted adding the association's costs and attorney's fees on top of the 6 month assessment figure. This is a fundamental distinction between Connecticut's law, and the laws of the states of Nevada and Colorado (and other states like Alaska, Minnesota, West Virginia, and New Jersey).

However, unlike in Connecticut, in the states of Nevada and Colorado, consistent with the original language of the 1982 UCIOA, while the Super Priority Lien Amount may include collection costs and charges, the sum total of all assessments, fees, and collection costs may not exceed the figure equaling 6 times (now 9 times in Nevada plus unit repair costs) the monthly assessments. As previously mentioned, any amounts which are over that limit still constitute a lien on the homeowner's unit, but it constitutes a lien which is junior to the first mortgage (i.e., a less prioritized lien which may be extinguished by a first mortgage holder's foreclosure).

In July of 2008, the National Conference of Commissioners on Uniform State Laws held its annual conference where it incorporated Connecticut's costs and fees amendment into the Uniform Law Commissioners' 2008 revised version of the UCIOA. Under the 2008, revised UCIOA (which has not been adopted in Nevada,) the UCIOA super priority lien now consists of both six months of assessments and attorney's fees and costs:

> (c) A The lien under this section is also prior to all security interests described in subsection (b)(2) clause (ii) above to the extent of both the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien and reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien. *2008 Amendments to the UCIOA*

As noted in the comments section on Page 198 of the 2008 Amendments to the UCIOA, "First, subsection (a) is amended to add the cost of the association's reasonable attorneys fees and court costs to the total value of the association's existing 'super lien' – currently, 6 months of regular common assessments. This amendment is identical to the amendment adopted by Connecticut in 1991; see C.G.S. Section 47-258(b). The increased amount of the association's lien has been approved by Fannie Mae and local lenders and has become a significant tool in the successful collection efforts enjoyed by associations ***in that state***." *(See Exhibit "4").*

It is vital to note, however, that in 2009 Nevada had the opportunity to adopt the newly revised UCIOA, but chose not to. The October 1, 2009, revisions to NRS §116.3116 are conspicuously absent of the Connecticut amendment. Instead, the Nevada legislature increased the super priority lien cap to an amount equal to 9 times the association's monthly assessments, up from 6 times, and also added unit repairs costs under NRS §116.310312 to the super priority lien.

Because Nevada and Colorado (and other states like Alaska, Minnesota, West Virginia, and New Jersey) adopted the unaltered super priority language of the original1982 UCIOA, and did not adopt the Connecticut amendment, the current state of the law regarding super priority lien amounts in states which did not adopt the Connecticut amendment is as the Colorado courts have held: "The reference in section 3-116(b) to priority "to the extent of" assessments which would have been due "during the six months immediately preceding an action to enforce the lien" **merely limits the**

maximum amount of all fees or charges for common facilities use or for association services, late charges and fines, and interest which can come with the Prioritized Lien..." *First Atlantic Mortg., LLC v. Sunstone North Homeowners Ass'n 121 P.3d 254, 255 -256 (Colo.App.,2005),* and "... the association's super-priority lien includes interest, charges, late charges, fines, and attorney fees **so long as the total does not exceed the limit**." *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 451 (Colo.App.,2008).*

Again, collection costs are not added on top of the 9 month amount (as in Connecticut,) but may be incorporated within that amount (as in Nevada, Colorado, Alaska, Minnesota, West Virginia, and New Jersey). While the Nevada legislature may, at some point in the future, wish to adopt the Connecticut amendment, the current law in Nevada is as stated by the Colorado courts and James Winokur's commentary.

V.

CONCLUSION

This Petition requested action in two areas:

1. Pursuant to NRS §116.3116, what portion of a homeowners' association lien, if any, is superior to the unit's first mortgage lender's security interest ("super priority lien") and may the sum total of the super priority lien amount, whether it be comprised of assessments, fees, costs of collection, or other charges, ever exceed 9 times the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS §116.3115, plus any charges incurred by the association on a unit pursuant to NRS §116.310312 (unit repair expenses)?

2. Pursuant to NRS §116.3116, does a "super priority lien" exist in the absence of a homeowners' association's failure to file a complaint with a court to enforce the lien, i.e., the failure to institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3?

As the existing law makes clear, in Nevada, assessments, late fees, costs of collecting and other charges may be included in the Super Priority Lien Amount. However, as the plain language of NRS §116.3116 states, and as noted by the Colorado courts and James Winokur's commentary, there is a ceiling on the Super Priority Lien Amount of 9 times (6 times in other states) the association's monthly assessment amount for common expenses based on the periodic budget adopted by the association (plus repair expenses pursuant to NRS §116.310312). In addition, the total amount of assessments, late fees, costs of collecting and other charges may not exceed that

ceiling in order to be considered a "super priority lien" rather than a "junior" lien. With the exception of the repair expenses pursuant to NRS §116.310312, the Super Priority Lien Amount is limited to a finite number, i.e., an amount which cannot exceed a figure equaling 9 times the monthly assessments which immediately preceding institution of an action to enforce the lien.

Additionally, as a "condition precedent" to elevate a portion of a homeowners' association's lien from "junior" status to "super priority" status, a homeowners' association must file an "action" to enforce the lien. Nevada Rules of Civil Procedure 2 states, "There shall be one form of action to be known as 'civil action.'" Nevada Rules of Civil Procedure 3 states, "A civil action is commenced by filing a complaint with the court." Thus, until a homeowners' association files a complaint with the court to enforce its lien, no amount of its lien can achieve "super priority" status. Therefore, while the lien remains a lien on the homeowner's unit, it is in "junior" status to the first security holder's deed of trust. Thus, until the filing of a complaint with the court to enforce its lien, upon the first mortgage holder's foreclosure, the association's junior lien is extinguished in its entirety. Pursuant to NRS §116.3116, a homeowners' association's filing of a complaint with the court to enforce its lien is a condition precedent for any portion of its lien to achieve "super priority" status.

Dated this 25 day of June, 2010.

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DISTRICT COURT

CLARK COUNTY, NEVADA

A-10-630298-C
14

NEVADA ASSOCIATION SERVICES, INC.; RMI MANAGEMENT, LLC; ANGIUS & TERRY COLLECTIONS, LLC, Plaintiffs, v. STATE OF NEVADA, DEPARTMENT OF BUSINESS AND INDUSTRY, FINANCIAL INSTITUTIONS DIVISION; GEORGE E. BURNS, individually and in his official capacity as Commissioner of State of Nevada, Department of Business and Industry, Financial Institutions Division, Defendants.	Case No. Dept. No. **EX PARTE APPLICATION FOR TEMPORARY RESTRAINING ORDER AND MOTION FOR PRELIMINARY INJUNCTION**

A-10-630298-C
EPAP
Ex Parte Application
1077804

Plaintiffs Nevada Association Services, Inc. ("NAS"), RMI Management, LLC ("RMI"), and Angius & Terry Collections, LLC ("Angius & Terry"), by and through their attorneys of record, Holland & Hart LLP, hereby submit this Ex Parte Application for Temporary Restraining Order[1] and Motion for Preliminary Injunction.

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[1] In accordance with NRCP 65, Plaintiffs are providing a copy of this Application and Motion to Daniel Ebihara, Esq., Deputy Attorney General and counsel for the FID.

This Application and Motion is made pursuant to NRS 33.010 and NRCP 65, and is based on the attached Memorandum of Points and Authorities and supporting documentation, the papers and pleadings on file in this action, and any oral argument this Court may allow.

DATED this 1st day of December 2010

HOLLAND & HART LLP

By _____
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MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF EX PARTE APPLICATION FOR TEMPORARY RESTRAINING ORDER AND MOTION FOR PRELIMINARY INJUNCTION

I.

INTRODUCTION

In this Application for Temporary Restraining Order and Motion for Preliminary Injunction, Plaintiffs NAS, RMI, and Angius & Terry ask this Court to enjoin enforcement of a Declaratory Order and Advisory Opinion Regarding Collection Agency Fees from Homeowner Association Liens Following Foreclosure (the "Opinion"), unlawfully issued by Defendant State of Nevada, Department of Business and Industry, Financial Institutions Division (the "FID"). A copy of the Opinion is attached hereto as **Exhibit "1"**. ***In short, the Opinion was considered and issued without jurisdiction, in blatant violation of NRS 116.615, NRS 116.620, NRS 116.623, and NAC 232.040.***

Plaintiffs are collection agencies that work on behalf of several homeowners' associations ("HOAs") in the State of Nevada. Among other things, Plaintiffs pursue past due charges from delinquent homeowners on behalf of HOAs. This is a task of particular importance in the foreclosure crisis currently overwhelming the Nevada housing market. Indeed, without such collection agencies and the ability to pursue collection costs from the delinquent homeowners, HOAs would have little or no ability (or financial means) to pursue the never-ending list of delinquent charges from homeowners, thereby significantly increasing the costs to those homeowners who do pay their bills.

The Nevada Legislature appreciated the importance of permitting HOAs to recover from delinquent homeowners and thus granted HOAs a "super-priority" lien under NRS 116.3116(2), which is a lien on real property, senior to even the first position deed of trust. Despite the importance of granting HOAs the ability and the means to recover past due charges, several real estate speculators or "flippers," who have made hefty sums of money by flipping foreclosure properties, have filed storms of litigation in the past year disputing the interpretation of the super-priority lien statute, undoubtedly with the goal of fattening their bottom line.

Indeed, Plaintiffs have been named as defendants in several such lawsuits, including actions by or directly related to the Petitioner requesting the Opinion (Rutt Premsrirut) and by Mr. Premsrirut's attorneys (Puoy Premsrirut and James Adams). These various actions include an arbitration brought by Mr. Adams and Ms. Premsrirut against Plaintiffs that currently is involved in heavy briefing in arbitration before the Nevada Real Estate Division, are focused in large part on obtaining a judicial statutory interpretation of NRS 116.3116(2) to determine whether and to what extent collection costs are included in the super-priority lien.

Despite Mr. Premsrirut's and Mr. Adams' clear knowledge that the interpretation of NRS 116.3116(2) is a hotly-contested issue in any number of lawsuits and arbitrations, they engaged the FID *ex parte* and requested that he issue an advisory opinion on these matters, providing absolutely no notice to any party with a competing viewpoint. Thus, without considering Plaintiffs position or any opposing views, on or about November 18, 2010, George E. Burns, Commissioner (the "Commissioner") of the FID issued the Opinion. Plaintiffs have since been informed that the Commissioner intends to immediately enforce this advisory Opinion and institute disciplinary proceedings—including license revocation proceedings—against any collection agency that does not follow it immediately. However, the following issues are among the many problems with the attached Opinion:

- The Commissioner had and has no jurisdiction to interpret the provisions of NRS Chapter 116. In fact, NRS 116.615, NRS 116.620, and NRS 116.623 specifically states that the Real Estate Division has exclusive jurisdiction to issue advisory opinions concerning applicability or interpretation of NRS Chapter 116.

- The request made to the Commissioner to render an advisory opinion violated NAC 232.040(2). This regulation specifically requires that the original and a copy of the petition be forwarded to the "chief who is authorized to Administer or enforce the statute or regulation or to issue the decision." The Commissioner clearly did not forward the petition to the Real Estate Division, which possesses express jurisdiction over the rendering of advisory opinions involving interpretation sof NRS Chapter 116. ***See*** NRS 116.615, NRS 116.620, and NRS 116.623.

- The request made to the Commissioner to render an advisory opinion violated NAC 232.040(4). Parties with an interest in current legal proceedings may ***not*** file a petition for a declaratory order or an advisory opinion concerning a question or matter involved in those legal proceedings.

- The opinion squarely contradicts the order of District Court Judge Jackie Glass in ***Korbel Family Trust v. Spring Mountain Ranch Master Ass'n***, Eighth Judicial District Court Case No. A-06-523959-C, which has been recognized as the industry standard for several years now.

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- The advisory opinion was sought improperly, in an attempt to influence a pending arbitration before the Nevada Real Estate Division. When presenting its petition to Commissioner Burns, counsel for the petitioner purposefully did not advise the parties to the arbitration that this opinion was being sought. As a result, the Commissioner issued his unlawful advisory opinion based on an incomplete record and a one-sided view of the law presented to him.

- To this day, Plaintiffs have been unable to obtain a copy of the Petition that was submitted to the Commissioner. Both the FID and counsel who submitted said Petition have steadfastly refused to provide a copy, and there is no way at this time to know what kind of *ex parte* communications took place between FID and the Petitioner.

The foregoing issues demonstrate that the Opinion not only fails on substantive grounds but, quite simply, could never have been issued due to the Commissioner's clear lack of jurisdiction. Accordingly, because Plaintiffs demonstrate a likelihood of success on the merits, enforcement of the Opinion will cause irreversible harm to Plaintiffs' businesses, and public policy considerations weigh heavily in favor of injunctive relief, Plaintiffs request the Court grant their Application for Temporary Restraining Order and Motion for Preliminary Injunction.

II.

FACTUAL BACKGROUND

A. The Korbel Case

Some background is necessary in this matter. In 2006, Eighth Judicial District Court Judge Jackie Glass heard and decided ***Korbel Family Living Trust v. Spring Mountain Ranch Master Ass'n***, Eighth Judicial District Court Case No. A-06-523959-C. The principal issue in that case was whether HOA collection fees survived foreclosure based upon the so-called "super priority" lien of NRS 116.3116. Upon a specific request for briefing by Judge Glass, the issue was thoroughly briefed (*see* briefs attached hereto as **Exhibit "2"** and **Exhibit "3"**) and decided by Judge Glass in an Order dated December 22, 2006, a copy of which is attached hereto as **Exhibit "4"**.

While the prevailing counsel who prepared the order did not prepare specific findings, it is clear from the ruling, after specific briefing ordered by Judge Glass (*see* minutes attached

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hereto as **Exhibit "5"**), that Mr. Korbel's challenge under NRS 116.3116 did not prevail. As a result, Judge Glass concluded that the HOA was entitled to recover the following:

- Assessments for common expenses;
- Late fees imposed for non-payment of assessments for common expenses;
- Interest on the principal amount of unpaid assessments for common expenses;
- The HOA's "costs of collection, which may include legal fees and costs, that accrue prior to the date of foreclosure of the first deed of trust"; and
- The transfer fee for conveyance and change of ownership of the property foreclosed upon pursuant to the first deed of trust.

See Exhibit 4. Mr. Korbel did not appeal Judge Glass's decision.

Since then, the ***Korbel*** decision has been relied upon as binding precedent in the industry, including the Federal Home Loan Mortgage Corporation ("Freddie Mac"), arguably one of the largest purchasers of homes through foreclosures in the State of Nevada. For example, attached hereto as **Exhibit "6"** is a request for a super-priority payoff demand from the attorney for Freddie Mac. ***According to Freddie Mac's attorney, Korbel controls the determination of the super-priority lien after a bank foreclosure***:

> Federal Home Loan Mortgage Corporation intends to pay immediately all sums properly due and owing to the Association pursuant to NRS § 116.3116(2), also know as a "super-priority demand." . . . Pursuant to the Clark County District Court's interpretation of the statute (***Korbel vs. Spring Mountain Ranch Master Association***), the amount may include 9 months of pre-foreclosure common area expenses, interest, late fees, and reasonable costs of collection.
>
> . . .
>
> It is the intent of Federal Home Loan Mortgage Corporation to immediately pay all sums which are properly due and owing to the Association at this time, and to arrange for payment of monthly assessments as a new property owner and member of the Association.

Exhibit 6. Indeed, permitting recovery of interest, late fees, and costs of collection (with no numerical cap) is and has been common practice in the industry for years. ***See*** Affidavit of

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Paul P. Terry, Jr., attached hereto as **Exhibit "7"**.

B. The Prem Challenge and Egregious Efforts at Forum Shopping

Earlier this year, the Prem Deferred Trust ("Prem") commenced a civil action against NAS and RMI seeking, among other things, a declaration concerning whether collection fees and costs imposed by HOAs and their collection agents survive as part of the so-called "super priority" lien under NRS 116.3116. The co-trustees of Prem are Rutt Premsrirut and his sister, Attorney Puoy Premsrirut.

The lawsuit was plainly barred by NRS 38.310, which compels arbitration of such claims before the Nevada Real Estate Division. ***See Hamm v. Arrowcreek Homeowners' Ass'n***, 124 Nev. 28, 183 P.3d 895, 902 (2008). Accordingly, NAS and RMI filed a motion to dismiss based upon NRS 38.310 and ***Hamm***. In response, one of the trustees, Rutt Premsrirut (Petitioner seeking the Opinion at issue here), filed an affidavit sworn under penalty of perjury, claiming that Prem was the owner of nine parcels of land. A copy of this Affidavit is attached hereto as **Exhibit "8"**. This sworn attestations were made in attempt by Prem's counsel to persuade the court that foreclosure of these parcels was imminent, which would have allowed the court to hear the matter under NRS 38.310. A review of the pertinent public real estate records, however, demonstrated that Prem ***no longer owned*** eight of the nine properties. In one instance, a parcel was sold the very same day that Mr. Premsrirut signed his affidavit. In other instances, Prem had resold its properties as long as six (6) months prior to execution of the affidavit.

Needless to say, the motion to dismiss was granted. A copy of this Order is attached hereto as **Exhibit "9"**. Prem did not appeal.

In the meantime, James Adams, Esq. commenced a similar lawsuit on behalf of a number of real estate investors entitled ***Higher Ground, LLC, et al. v. Nevada Association Services, Inc., et al.***, Eighth Judicial District Court Case No. A-10-609031-C. That case was dismissed by the Honorable Jennifer P. Togliatti, also under NRS 38.310. A copy of this Order is attached hereto as **Exhibit "10"**. Plaintiffs in that case did not appeal.

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Shortly thereafter, Prem and Mr. Adams joined forces and filed yet another lawsuit, seeking the same relief from a different judge. Even though two similar matters had already been dismissed based upon NRS 38.310 and binding Nevada Supreme Court authority, Mr. Adams and Prem commenced ***Prem Deferred Trust, et al. v. The Signature at MGM Grand, et al.***, Eighth Judicial District Court Case No. A-10-617551-C. This case was dismissed by the Honorable Valerie Adair, also pursuant to NRS 38.310 and ***Hamm***. A copy of the order of dismissal is attached hereto as **Exhibit "11"**. Once again, Prem did not appeal.

Also in the meantime, Prem was fully involved with proceedings before the Nevada Real Estate Division Commission for Common-Interest Communities and Condominium Hotels (the "CIC") concerning collection fees and the "super-priority" lien under NRS Chapter 116. The result of those proceedings was a draft advisory opinion penned by Michael Buckley, Chairman of the CIC. A copy of Mr. Buckley's draft advisory opinion, and proof of Ms. Premsrirut's receipt thereof by email, are attached hereto as **Exhibit "12"**. When Prem saw the draft advisory opinion, the Premsriruts simply sought a different advisory opinion from the FID.

Prem's co-trustee, Ms. Puoy Premsrirut, is now co-counsel with Mr. Adams in Nevada Real Estate Division Case No. 10-87 (the "Higher Ground Arbitration") against Plaintiffs and others. A copy of the Amended Demand for Arbitration is attached hereto as **Exhibit "13"**. That case is currently pending before Arbitrator Persi Mishel. Certain interim rulings were received recently from Mr. Mishel—all but one claim was dismissed, and Plaintiffs are currently in the process of seeking clarification from Mr. Mishel on several issues, including the applicability and scope of NRS 116.3115 to this matter. A final arbitration award has not been issued, and discovery has not even commenced in that matter. ***See*** Exhibit 7.

C. The Advisory Opinion Is Based on Only Prem's Side of the Story.

According to the advisory opinion, Prem Investments, LLC petitioned the Commissioner for an advisory opinion. ***See*** Exhibit 1. Plaintiffs have never seen this petition. Exhibit 7. Mr. Adams, Ms. Premsrirut, and the FID have all refused to provide a copy of this petition to Plaintiffs, and the existence of the petition itself was never disclosed in the ***Higher***

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Ground arbitration. ***Id.*** As such, Plaintiffs were never given an opportunity to be heard in the matter, even though it plainly relates to a pending arbitration before the Real Estate Division. ***Id.***

Plaintiffs are not aware of what was actually argued to the Commissioner. ***See*** Exhibit 7. Plaintiffs are also unaware as to what was presented to the Commissioner and what *ex parte* communications, if any, took place between the parties. ***Id.*** One could only suspect that a very one-sided presentation was made, whatever form it took. Needless to say, as none of the Plaintiffs were made aware of this petition, and had no input during its consideration, Plaintiffs (and likely any collection agency or HOA) were effectively shut out of the process.

D. Prem's Unclean Hands Get Dirtier

In the Higher Ground Arbitration, Mr. Adams and Ms. Premsrirut repeatedly attempted to distance themselves from the ***Korbel*** opinion. However, recently, Plaintiffs became aware of the existence of a joint checking account between Mr. Premsrirut ***and Richard Korbel***. A partially redacted copy of this check is attached hereto as **Exhibit "14"**.

Plaintiffs thus far have been unable to determine the exact nature or length of the relationship between Mr. Korbel and Mr. Premsrirut. However, this relationship was ***not*** disclosed to the parties or the Arbitrator in the Higher Ground Arbitration. Plaintiffs' counsel is currently investigating whether Mr. Korbel's telling absence from the pending litigation and arbitration was essentially an act of plaintiff shopping—based upon a desire by Prem to distance itself from the ***Korbel*** opinion, and to avoid issues of *collateral estoppel*. Notably, in the first Prem lawsuit, Prem's counsel was the Cooper Castle law firm, whieh also represented the Korbel Family Trust in ***Korbel***. ***See*** Exhibit 8.

E. The FID Plans to Enforce the Opinion

On approximately November 22, 1010, Paul Terry, a managing member of Plaintiff Angius & Terry, was advised by a senior auditor at the FID that FID intended to start enforcing the Opinion immediately. ***See*** Exhibit 7. Moreover, Mr. Terry was informed that any collection agency found in violation of the Opinion will be subject to discipline and potential loss of license. ***Id.*** To protect their businesses, Plaintiffs have filed the Complaint in this

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action, seeking an order declaring the Opinion null and void and enjoining any enforcement thereof.

III.

LEGAL ARGUMENT

A. Legal Standard

In Nevada, Rule 65 of the Nevada Rules of Civil Procedure and NRS 33.010 govern the issuance of injunctions. A temporary restraining order or preliminary injunction therefore should be issued when plaintiffs demonstrate "that the nonmoving party's conduct, if allowed to continue, will cause irreparable harm for which compensatory relief is inadequate and that the moving party has a reasonable likelihood of success on the merits." ***Boulder Oaks Community Ass'n v. B&J Andrews Enterprises, LLC***, — Nev. —, 215 P.3d 27, 31 (2009); ***see also*** NRS 33.010. The court may also consider the balance of hardships between the parties. ***Univ. & Comty College Sys. of Nev. v. Nevadans for Sound Government***, 120 Nev. 712, 721, 100 P.3d 179, 187 (2004). Preliminary injunctive relief may be used to preserve the status quo and undo wrongful conditions. ***Leonard v. Stoebling***, 102 Nev. 543, 550-51, 728 P.2d 1358, 1363 (1986).

B. Plaintiffs Will Succeed on the Merits.

An applicant for an injunction must "show a reasonable likelihood of prevailing on the merits." ***Dixon v. Thatcher***, 103 Nev. 414, 416, 742 P.2d 1029, 1030 (1987). Here, Plaintiffs can demonstrate a reasonable likelihood of success on the merits, i.e., demonstrating the Opinion should be not be enforced and should be rendered null and void, on at least three (3) grounds. First and foremost, the Commissioner exceeded his jurisdiction in rending the Opinion and, in doing so, plainly violated NRS 116.615, NRS 116.620, and NRS 116.623. This alone warrants injunctive relief.

Second, Mr. Adams and Mr. Premsrirut's request to the Commissioner to render an advisory opinion—and the Commissioner's consideration thereof—violated NAC 232.040(2 and 4) and was completely inappropriate. Third, the Opinion is based on only one view of the

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interpretation of a hotly-contested statute, which currently is the subject of litigation and arbitration and which likely will end up being decided by the Nevada Supreme Court.

1. The Commissioner Exceeded His Jurisdiction and Violated Nevada Law.

In this matter, Commissioner Burns unquestionably exceeded his statutory jurisdiction and violated Nevada law, Plaintiffs therefore have a strong likelihood of succeeding on the merits of their Complaint. In the Opinion, the Commissioner asserted only that he had jurisdiction to issue his Advisory Opinion under NRS Chapter 649, which governs collection agencies. However, the Commissioner then proceeded to draft an opinion that offered several legal opinions interpreting NRS Chapter 116, the Nevada Common Interest Ownership Act, over which he has absolutely no jurisdiction.

NRS 116.615 provides in pertinent part as follows:

> 1. The provisions of this chapter ***must be administered by the [Real Estate] Division***, subject to the administrative supervision of the Director of the Department of Business and Industry.
>
> 2. The [CIC] and the [Real Estate] Division may do ***all things necessary and convenient to carry out the provisions of this chapter, including, without limitation, prescribing such forms and adopting such procedures as are necessary to carry out the provisions of this chapter.***
>
> 3. The [CIC], or the Administrator with the approval of the [CIC], may adopt such regulations as are necessary to carry out the provisions of this chapter.

NRS 116.615 (emphasis added). In addition, NRS 116.620 states as follows:

> The Attorney General shall render to the [CIC] and the [Real Estate] Division opinions upon all questions of law relating to the construction or interpretation of [NRS Chapter 116], or arising in the administration thereof, that may be submitted to the Attorney General by the [CIC] or the [Real Estate] Division.

NRS 116.620(3).

Finally, advisory opinions concerning NRS Chapter 116 fall within the ***exclusive*** jurisdiction of the Real Estate Division.

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> The [Real Estate] Division shall provide by regulation for the filing and prompt disposition of petitions for declaratory orders and advisory opinions as to the applicability or interpretation of:
>
> (a) ***Any provision of this chapter*** or chapter 116A or 116B of NRS;
>
> (b) Any regulation adopted by the [CIC], the Administrator or the Division; or
>
> (c) Any decision of the [CIC], the Administrator or the [Real Estate] Division or any of its sections.

NRS 116.623(1) (emphasis added). The foregoing language could not be more clear—the Commissioner stepped far beyond his jurisdiction when he signed the unlawful Advisory Opinion. Such an advisory opinion is only permitted by the Real Estate Division.

Despite this clear lack of jurisdiction, staff at the FID have informed Plaintiffs that the Commissioner intends to immediately begin enforcement of this Advisory Opinion and to impose regulatory discipline—which may include immediate license suspension and revocation proceedings—against Plaintiffs and other similarly situated companies. ***See*** Exhibit 7. Neither the Commissioner nor the FID, however, have such authority, due to the clear lack of jurisdiction. Because the jurisdiction for such an opinion and any subsequent actions rests with the Real Estate Division, not the FID, Plaintiffs will most definitely succeed on the merits in this action, i.e., in obtaining declaratory relief to enjoin enforcement of the Opinion and to declare it null and void.

2. The Request for the Opinion Violated Nevada Law.

The Nevada Administrative Code also makes it clear that a party may ***not*** seek an advisory opinion concerning a question that is at issue in a current legal proceeding:

> 1. Except as otherwise provided in subsection 4, an interested person may petition the Director to issue a declaratory order or advisory opinion concerning the applicability of a statute, regulation or decision of the Department or any of its divisions.
>
> . . .
>
> 4. An interested person ***may not file a petition for a declaratory order or an advisory opinion concerning a question or matter that is an issue in an administrative, civil or criminal proceeding in which the interested person is a party.***

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NAC 232.040 (emphasis added). In addition, NAC 232.040(2) specifically provides that an original and copy of any petition must be filed with the "chief who is authorized to administer or enforce the statute or regulation or to issue the decision" or to the "director" if "the statute, regulation or decision is administered or enforced by the director." That obviously did not occur here, as the Director of the FID was petitioned to provide an advisory opinion that plainly was outside the scope of his authority.

Here, the Commissioner set forth NAC 232.040 as establishing the procedure for filing a petition for a declaratory order. ***See*** Exhibit 1 at 2 (incorrectly citing NAC 232.040 as 323.040). The Opinion, however, does not mention the substance of subsection 4, which clearly prohibits a party with an interest in ongoing litigation from requesting an advisory opinion on an issue in that litigation. The arbitration with the Nevada Real Estate Division currently proceeding against Plaintiffs was brought by Mr. Adams and Ms. Premsrirut, the co-trustee of Prem, on behalf of several real estate speculators. It is not hard to see that theletter and spirit of NAC 232.040 were violated here, and that the parties are engaging in a convoluted scheme to seek their desired result by any and all means necessary. However, they simply had no right to request an advisory opinion when the same issues were and are being litigated in arbitration with the Real Estate Division. And, in making his Opinion, the Commissioner plainly violated Nevada law—and his Department's own rules—concerning advisory opinions.

While it certainly would not shocking to find out that Prem and Mr. Adams concealed their interest in the arbitration proceedings from the Commissioner, the Commissioner simply had no authority to render the Opinion when the requesting parties were currently involved in litigation on the same issue. As such, NAC 232.040(2) and (4) provide yet another ground by which the Opinion should be held unenforceable. Plaintiffs, therefore, will succeed on the merits in this action.

3. The Opinion Is Based on a One-Sided View of a Hotly-Contested Statute and Is Contrary to the Only Known Nevada Precedent.

Notwithstanding the clear lack of jurisdiction for the FID's Opinion, the FID Opinion also should be rendered null and void and unenforceable due to the simple fact that it

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was based on only one side of the story, the self-serving argument of real estate speculators. Although the dispute over interpretation of the super-priority lien of NRS 116.3116 affects, at a minimum, homeowners, buyers of homes, sellers of homes, HOAs, collection agencies, and lenders, only real estate speculators, those who flip real estate for substantial profits, have gotten a say in the matter. Tellingly, the Opinion flies in the face of the only known Nevada District Court authority on point—the ***Korbel*** decision. ***See*** Exhibit 4. Indeed, the Opinion does not even mention ***Korbel***, leading to only one conclusion—the Commissioner never was informed of that important authority. ***See*** Exhibit 1.

Despite all of the ongoing litigation on this very matter, Prem took it upon itself to seek a favorable forum on an *ex parte* basis, without notifying any other interested party, in its never-ending efforts to attain its desired result. Indeed, the foregoing matter has been hounded by blatant and egregious forum shopping of the worst sort. More than three years after ***Korbel*** was decided, the various players in this matter filed a lawsuit and lost, filed another lawsuit and lost, and filed a third lawsuit and lost. When they did not like the draft advisory opinion from CIC, they sought a different one from the FID, shutting out Plaintiffs and all others similarly situated in the process. There is no doubt that Prem and Mr. Adams will now wave their result (uncontested as it was) in front of every arbitrator and every court in every case in which they appear in support of their position.

Setting aside the fact that the Commissioner's Advisory Opinion contradicts the ***Korbel*** decision and the draft CIC advisory opinion, that the advisory opinion was sought for an improper purpose, or whether the Commissioner wittingly or unwittingly decided to inject himself into hotly contested litigation, this matter is going to be decided ultimately by the Nevada Supreme Court, not the FID. Whether he intended to do so or not, it is not the business of the Commissioner to influence pending litigation.

Accordingly, due to the Commissioner's clear lack of jurisdiction and the fact that the Opinion analyzes only one, very small, side of the story by a party that will go to any extreme to achieve its desired results, Plaintiffs have a large likelihood of success in enjoining enforcement of the Opinion and declaring it null and void *ab initio*.

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C. Absent a TRO and Preliminary Injunction, Plaintiffs Will Suffer Irreparable Harm

"[A]cts committed without just cause which unreasonably interfere with a business or destroy its credits or profits, may do an irreparable injury and thus authorize issuance of an injunction." ***Sobol v. Capital Mgmt. Consultants, Inc.***, 102 Nev. 444, 446, 726 P.2d 335, 337 (1986). "The right to carry on a lawful business is a property right" and acts which interfere with that will be restrained. ***Guion v. Terra Mktg. of Nev., Inc.***, 90 Nev. 237, 240, 523 P.2d 847, 848 (1974).

Here, despite the clear lack of jurisdiction for the Opinion, staff at the FID have informed Plaintiffs that the Commissioner intends to immediately begin enforcement of this Advisory Opinion and to impose stiff regulatory discipline. ***See*** Exhibit 7. Such actions may include immediate license suspension and revocation proceedings against Plaintiffs. ***See id.*** Any of such actions will be devastating to Plaintiffs. Plaintiffs, as collection agencies for HOAs, obviously rely on their licenses to conduct business on behalf of the HOAs. ***See id.*** Any question as to Plaintiffs' licenses will not only damage, and possibly destroy, Plaintiffs' businesses, but it would also wreak havoc on HOAs' abilities to collect on past due assessments, an act typically done through utilization of collection agencies such as Plaintiffs. ***Id.***

Moreover, for several years, Plaintiffs and others in the industry have been conducting their businesses pursuant to the ***Korbel*** decision. Indeed, even Freddie Mac agrees that it must pay fees pursuant to the ***Korbel*** holding, as the only Nevada authority on point. ***See*** Exhibit 6. A sudden change in how the players in the industry must conduct themselves will create upheaval in the industry, most likely at the expense of HOAs and the homeowners living within those HOAs. In any event, if such an upheaval is to occur, it should occur after a full and thorough analysis of the relevant issues, not after one party dead set on increasing its speculation profits at the expense of all others involved files a secret request for an advisory opinion with an inappropriate state agency.

Therefore, because Plaintiffs will suffer immediate, irreparable harm if the FID enforces the Opinion, injunctive relief is warranted. In other words, Plaintiffs request a

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temporary restraining order and preliminary injunction to maintain the status quo until a court, likely the Nevada Supreme Court, has made a decision on this hotly-contested issue after a full view of the issues based on input from all interested parties.

D. The Public Interest and Potential Hardships Weigh in Favor of Injunctive Relief

In considering preliminary injunctions, courts also weigh the potential hardships to the relative parties and others, and the public interest. ***Univ. & Comty College Sys. of Nev.***, 120 Nev. at 721, 100 P.3d at 187. Here, the potential hardships clearly weigh in favor of granting injunctive relief. As discussed above, Plaintiffs will endure substantial hardships if injunctive relief is not granted enjoining enforcement of the Opinion. Namely, Plaintiffs' licenses are at stake, as is their entire business model. On the contrary, the State's interest is minimal at most. Although the State certainly has an interest in protecting its citizens, the HOA industry has been operating for years under methods that are contrary to the limitations now set forth in the Opinion, with no negative effects on the State's citizens. However, the change suggested by the Opinion will cause great turmoil in the HOA industry. Indeed, whereas any person who believes they have been damaged by the current state of the industry will be able to recover monetary damages for any purported overpayment, the damage to Plaintiffs, in the form of loss of their licenses and businesses, will be irreversible.

From a public interest standpoint, this Opinion has the potential to seriously damage the citizens of Nevada, particularly those living in neighborhoods governed by HOAs. Because the Opinion severely limits the rights of HOAs to recover collection costs, the practical result of the Opinion will be to shift HOA fees, collection costs, and interest back to the HOAs as opposed to the delinquent homeowner. ***The result is that homeowners who live by the rules, pay their mortgages, and pay their HOA fees, will have to absorb these costs by paying increased HOA fees while real estate speculators like Prem will enjoy a "free ride" by not having to pay those fees.*** Hardly a just or equitable result.

Moreover, this action concerns—and has the potential to significantly impact—the role of HOAs during these difficult economic times. With more foreclosures in Nevada than in any other state, HOAs have stepped in to maintain homes that have fallen into disrepair. Dead or

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overgrown landscaping is a common problem, as is unattended pools ripe with algae. Poorly kept residences can create neighborhood blight that depresses surrounding property values that have already been devastated by the worst housing market downturn in Nevada history. If HOAs are unable to recover outstanding lien amounts, which include late fees, collection costs, and interest, their task of maintaining these communities becomes much more daunting. Because the practical result of the Opinion will be that HOAs will not be able to recover any such collection costs, the Opinion will result in a significant burden on HOAs and homeowners.

Accordingly, the public interest and the balance of hardships weigh heavily in favor of granting the injunctive relief requested by Plaintiffs.

E. Any Bond Should be Nominal.

Finally, any bond required should be nominal. Plaintiffs simply seek to maintain the status quo existing in the industry for years. The temporary restraining order and preliminary injunction would cause no injury to Defendants. Instead, this issue should be permitted to run its course in arbitration and in the district court before ultimately being decided by the Nevada Supreme Court.

IV.

CONCLUSION

For the foregoing reasons, NAS, RMI, and Angius & Terry respectfully request the Court grant their Application for Temporary Restraining Order and enjoin Defendants from enforcing the Opinion until such time as the motion for preliminary injunction is heard. Plaintiffs further request that, following a hearing on Plaintiffs' Motion for Preliminary

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Injunction, the Court enter a preliminary injunction enjoining Defendants from enforcement of the Opinion and declaring the Opinion null and void.

DATED this 1st day of December 2010.

HOLLAND & HART LLP

By _____
Patrick J. Reilly (6103)
Jenny L. Routheaux (11258)
3800 Howard Hughes Parkway, 10th Floor
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Attorneys For Plaintiffs

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CERTIFICATE OF SERVICE

Pursuant to Nev. R. Civ. P. 5(b), I hereby certify that on the 1st day of December 2010, I served a true and correct copy of the foregoing **EX PARTE APPLICATION FOR TEMPORARY RESTRAINING ORDER AND MOTION FOR PRELIMINARY INJUNCTION** via email to the person listed below:

Daniel Ebihara, Esq.
Deputy Attorney General
State of Nevada
555 East Washington Street, #3900
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Email: debihara@ag.nv.gov

Susan Thompson
An Employee of Holland & Hart LLP

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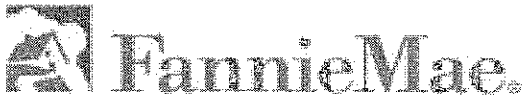

Selling Guide

Fannie Mae Single Family

RA0089

December 1, 2010

Selling Guide: Fannie Mae Single Family

Published December 1, 2010

Fannie Mae Copyright Notice

Table of Contents

All coverages must be in compliance with local, state, and federal insurance laws.

B4-2.1-06, Priority of Common Expense Assessments (04/01/2009)

Introdnction

This topic contains information on priority of common expense assessments.

Priority of Common Expense Assessments

The table below describes the priority of common expense assessments.

If ...	Then ...
the condo or PUD project is located in a jurisdiction that has enacted: • the Uniform Condo Act (UCA), • the Uniform Common Interest Ownership Act (UCIOA), or • other similar statutes that provide for regular common expense assessments, as reflected by the project's operating budget, to have such priority over first mortgage liens.	Fannie Mae allows up to six months of regular common expense assessments for a condo or PUD unit to have limited priority over Fannie Mae's mortgage lien.
Fannie Mae subsequently acquires title to the unit by foreclosure,	Fannie Mae will not be liable for any fees or charges related to the collection of the six months of unpaid assessments that accrued before acquisition of title to the unit.
the condo or PUD project is located in a jurisdiction that allows for more than six months of regular common expense assessments to have priority over Fannie Mae's lien,	Fannie Mae will not purchase a mortgage loan secured by a unit in the project.

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Arbitrator

STATE OF NEVADA

DEPARTMENT OF BUSINESS AND INDUSTRY

REAL ESTATE DIVISION

OFFICE OF THE OMBUDSMAN FOR OWNERS IN COMMON-INTEREST COMMUNITIES AND CONDOMINIUM HOTELS

HIGHER GROUND, LLC, A Nevada limited liability company; RRR HOMES, LLC, a Nevada limited liability company; TRIPLE BRANDED CORD, LLC, Nevada limited liability company; EQUISOURCE, LLC, a Nevada limited liability company; EQUISOURCE HOLDING, LLC, a Nevada limited liability company; APPLETON PROPERTIES, LLC, a Nevada limited liability company; CBRIS, LLC, a Nevada limited liability company; MEGA, LLC, a Nevada limited liability company; SOUTHERN Nevada ACQUISITIONS, LLC, a Nevada limited liability company, VESTEDSPEC, INC., a Nevada corporation; CUSTOM ESTATES, LLC, a Nevada limited liability company; KINGFUTT'S PFM LLC, a Nevada limited liability company; THORNTON & ASSOCIATES, LLC, a Nevada limited liability company; WINGBROOK CAPITAL LLC, a Nevada limited liability company; ELSINORE, LLC, a Nevada limited liability company; MONTESA, LLC, a Nevada limited liability company; EKNV, LLC, a a Nevada limited liability company; on behalf of themselves and as representatives of the class herein defined, Claimants,	NRED Control # 10-87

v.

NEVADA ASSOCIATION SERVICES, INC, a Nevada corporation; RMI MANAGEMENT, LLC, dba RED ROCK FINANCIAL SERVICES, a Nevada limited liability company; HOMEOWNER ASSOCIATION SERVICES, INC., a Nevada Corporation; ALESSI & KOENIG, LLC, a Nevada limited liability company; HAMPTON & HAMPTON, a professional corporation; ANGIUS & TERRY COLLECTIONS, LLC, a Nevada limited liability company; SILVER STATE TRUSTEE SERVICES, LLC, a Nevada limited liability company,

Respondents.

INTERIM AWARD REGARDING ORDER GRANTING IN PART AND DENYING IN PART MOTION FOR SUMMARY JUDGMENT ON CLAIM OF DECLARATORY RELIEF

On October 28, 2010, this arbitrator entered an Order Granting in Part and Denying in Part the Claimants' Motion for Summary Judgment on Claim of Declaratory Relief. He interpreted NRS 116.3116 and found:

1. NRS 116.3116(2) provides for a cap of 9 months on assessments for super priority lien purposes. Therefore, costs and fees related to unpaid assessments are subject to the 9-month cap. This arbitrator granted the Claimants' Motion for Summary Judgment on this issue. Thus, they are the prevailing party regarding this issue.
2. Filing a civil action is not a condition precedent for an HOA's super priority lien to exist. This arbitrator denied the Claimants' Motion for

Summary Judgment on this issue. Thus, the Respondents are the prevailing party of this issue.

There is no Nevada Supreme Court decision addressing these two issues. There are substantial properties involved in this case and the attorneys will be spending substantial time to conduct discovery, prepare the case for arbitration, and arbitration hearings. The parties will be incurring significant expenses for attorneys' fees and costs, and this arbitrator's fees. Therefore, this arbitrator is exercising his discretion under NRS 38.231(1) and pursuant to NRS 38.234 incorporates his Order Granting in Part and Denying in Part the Claimants' Motion for Summary Judgment on Claim of Declaratory Relief into an Interim Award, so that the parties may proceed to the District Court pursuant to NRS 38.234.

Dated the 21 day of March 2011.

Persi J. Mishel, Esq., Arbitrator
2340 Flower Spring St.
Las Vegas, NV 89134
(702) 255-7029

NOTICE

NRS 38.234 provides: "If an arbitrator makes a preaward ruling in favor of a party to an arbitral proceeding, the party may request the arbitrator to incorporate the ruling into an award under NRS 38.236. A prevailing party may make a motion to the court for an expedited order to confirm the award under NRS 38.239, in which case the court shall summarily decide the motion. The court shall issue an order to confirm the award unless the court vacates, modifies or corrects the award under NRS 38.241 or 38.242."

CERTIFICATE OF MAILING

I hereby certify that a copy of the forgoing Interim Award Regarding Order Granting in Part and Denying in Part Motion for Summary Judgment on Claim of Declaratory Relief placed in the United States mail, with proper postage affixed thereto, addressed as follows, on this 21 day of March 2011:

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Persi J. Mishel, Esq.

Community Collateral Damage: A Question of Priorities

*Andrea J. Boyack**

Today's soaring mortgage default rate and the uncertainty and delay associated with mortgage foreclosure proceedings threaten to cause financial tragedies of the commons in condominiums and homeowner associations across the country. Assessment defaults in privately governed communities result in an inequitable allocation of upkeep costs—a phenomenon that current law has failed to prevent. But the collateral damage caused by delayed foreclosures and insufficient recoveries can be minimized by increasing the payment priority of the association lien.

In a majority of states, association liens are completely subordinate to the first mortgage lien. At foreclosure of the mortgage lien, the junior priority assessment lien will be extinguished whether or not there are sufficient proceeds to reimburse for community charges. Assessment delinquencies grow over time, so the longer it takes to complete foreclosure, the greater the costs to the neighborhood. Although several states have adopted a limited lien priority for up to six months' worth of unpaid assessments, foreclosures today take far longer than six months, and the amount ultimately owed to a community can be significant and far exceed that cap. Federal housing policy affects the resolution of the issue because the Federal Housing Administration ("FHA"), Fannie Mae and Freddie Mac only permit qualifying mortgages to be subject to a six-month assessment lien priority. The decelerating pace of foreclosure further exacerbates the already unjustifiable financial impact borne by non-defaulting neighbors. The lien priority status quo fails to adequately protect communities in today's context of widespread, delayed foreclosures and

* Visiting Professor of Law at Fordham University Law School and former Visiting Professor of Law at George Washington University Law School; J.D., University of Virginia School of Law; M.A.L.D., Fletcher School of Law and Diplomacy, Tufts University; B.A., Brigham Young University. I am deeply indebted to both Robert M. Diamond and Professor Dale Whitman for their insight and invaluable input.

under-collateralized mortgage loans. Decreasing the first mortgage lien's priority during a foreclosure delay would mitigate the harm.

Lien priority statutory changes could protect association finances in the future, and such provisions might be applied retroactively as well. In other contexts, states have held that changes to a lien priority regime could apply to existing associations and existing mortgages without unconstitutionally impairing contract or property rights. This has been particularly true where the association's lien was deemed to have been created on the date the community's organizational documents were recorded (prior to any unit's mortgage). Historically, bank lobbyists have opposed any enhanced assessment lien priority. However, supporting property upkeep and making assessments more predictable and collectible would actually benefit lenders by shoring up the value of their collateral. Moreover, increased certainty with respect to homeowner payment obligations would enable more responsible credit underwriting and contribute to economic recovery. Shoring up assessment lien priority would not only ensure a fair allocation of community costs, but also would help to contain the current housing market decline.

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INTRODUCTION

Culpable parties in today's housing crisis are legion,[1] but innocent bystanders are directly and tangibly harmed by the fallout. Nonpayment of upkeep charges by financially strapped owners forces guiltless neighbors to fund the community budget revenue gap. The problem is exacerbated by foreclosure delay, since a property conveyance would replace an insolvent owner with a solvent one. Whether a foreclosure delay results from mortgage lenders' strategic behavior[2] or from procedural missteps by servicers,[3] the result is the same—hard-working,

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1. Mortgage brokers pushed unrealistic loans. Steven Krystofiak, President, Mortgage Brokers Ass'n for Responsible Lending, Statement at the Federal Reserve (Aug. 1, 2006), *available at* http://www.federalreserve.gov/secrs/2006/august/20060801/op-1253/op-1253_3_1.pdf. Appraisers validated unrealistic prices. *See* Jonathan R. Laing, *The Bubble's New Home*, BARRON'S ONLINE (June 20, 2005), http://online.barrons.com/article/SB111905372884363176.html (discussing economist Robert Shiller's forecast of the housing market). Homeowners borrowed money they could not repay, and lenders lent funds while ignoring credit and market risks. Ben Steverman & David Bogoslaw, *The Financial Crisis Blame Game*, BLOOMBERG BUSINESSWEEK (Oct. 18, 2008, 12:01 AM), http://www.businessweek.com/investor/content/oct2008/pi20081017_950382.htm. Secondary market purchasers and investors overly relied on securitization, and regulators and credit rating agencies blessed the entire system in error, negligence, or both. *See, e.g.*, Carol Ann Frost, *Credit Rating Agencies in Capital Markets: A Review of Research Evidence on Selected Criticisms of the Agencies*, J. ACCT., AUDITING, & FIN. (forthcoming 2006), *available at* http://ssrn.com/abstract=941861 (analyzing the criticism of the credit rating agencies); John Patrick Hunt, *Credit Rating Agencies and the "Worldwide Credit Crisis": The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement*, 1 COLUM. BUS. L. REV. 109, 114 (2009) ("It is not plausible to argue that rating agencies have a valuable reputation for rating instruments they have never rated before."); Robert T. Miller, *Morals in a Market Bubble*, 35 U. DAYTON L. REV. 113, 136 (2009) ("Alan Greenspan and his colleagues on the Federal Open Market Committee made some mistakes in the early years of this decade by keeping interest rates very low for a very long time."); Randolph C. Thompson, *Mortgage Backed Securities, Wall Street, and the Making of a Global Financial Crisis*, 5 AM. U. BUS. L. BRIEF 51, 53 (2008) (providing an overview of the "misguided confidence in these debt instruments."); Jeff Madrick, *How We Were Ruined & What We Can Do*, N.Y. REV. OF BOOKS, Feb. 12, 2009, *available at* http://www.nybooks.com/articles/archives/2009/feb/12/how-we-were-ruined-what-we-can-do/ (providing an overview of the securitization and the financial crisis); Ronald Colombo, *A Crisis of Character*, HUFFINGTON POST (May 12, 2009, 4:58 PM), www.huffmgtonpost.com/ronald-j-colombo/a-crisis-of-character_b_202562.html (lamenting the erosion of morals in the modern economy).

2. In a normal housing market, pushing foreclosures through quickly is in a lender's best interest. But in a depressed market, lenders have discovered that a foreclosure with a low prospect of a quick resale actually causes them to lose money. In 2009, lenders canceled up to 50% of foreclosure sales in some parts of the country, and many of these delays were inspired by the desire to avoid upkeep costs (maintenance, community assessments, and property taxes) while awaiting a market rebound. Todd Ruger, *Lenders' Latest Foreclosure Strategy: Waiting*, HERALD TRIB., July 12, 2009, at A1.

3. In early October 2010, three of the largest mortgage lenders in the United States—Bank of America, J.P. Morgan Chase, and Ally Financial—announced moratoriums in the twenty-three states that require court-ordered sales to foreclose on mortgages. This was in reaction to

financially responsible homeowners are forced to pay significant, additional amounts of money merely because of their neighbors' payment defaults, and in the many cases where foreclosure sale proceeds do not even cover the loan,[4] such amounts may never be recovered. The additional burden on the non-defaulting neighbors possibly forces such homeowners into their own financial distress. Allocating the cost of a delinquent owner's upkeep share to the paying neighbors is inefficient and unfair.[5] Furthermore, inequitable cost allocation will ultimately lead to additional owner defaults and further impairment of collateral value for every lender.

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increased judicial scrutiny of sloppy—or even fraudulent—servicer foreclosure procedures. *See* Ariana Eunjung Cha & Brady Dennis, *Judges Revisiting Foreclosure Cases May Help Owners but Clog Market*, WASH. POST, Oct. 5, 2010, at A9 (referencing a Florida case). Within a week of the initial announcements of these servicer-initiated moratoriums, Bank of America expanded its freeze on foreclosures nationwide, and attorneys general in all fifty states begun investigative probes into the extent of servicer misconduct in foreclosure procedures. *See* Ariana Eunjung Cha, Steven Mufson & Jia Lynn Yang, *Momentum Builds for Full Moratorium on Foreclosures*, WASH. POST, Oct. 9, 2010, at A11 (reporting that national civil rights groups had called for a government-mandated national moratorium on foreclosures); Jia Lynn Yang & Ariana Eunjung Cha, *Obama Vetoes Foreclosure Bill as Anger Grows*, WASH. POST, Oct. 8, 2010, at A1 (reporting that federal legislation intended to streamline foreclosure proceedings had been vetoed by President Obama, further lengthening the foreclosure process). While moratoriums have now been lifted, the concern that prompted them hangs over foreclosure proceedings, and the increased servicer scrutiny operates to lengthen the foreclosure timeline. *See* Carrie Bay, *Self-Evident Truth in Market Variables: Longer Foreclosure Timelines*, DSNNEWS.COM (Apr. 12, 2011), http://www.dsnews.com/articles/self-evident-truth-in-market-variables-longer-foreclosure-timelines-2011-04-12 (stating that the time period from default to foreclosure continues to increase across the country).

4. According to the Rasmussen Report, 31% of U.S. homeowners with a mortgage owed more on their homes than their homes were worth at the end of 2010. Peter Schroeder, *Poll: Nearly One-Third of Homeowners Underwater on Mortgage*, THE HILL (Mar. 21, 2011, 1:29 PM), http://thehill.com/blogs/on-the-money/801-economy/151039-poll-nearly-one-third-of-homeowners-underwater-on-mortgages. Deutsche Bank predicts that 48% of American homes could have negative equity by the end of 2011. Mortimer B. Zuckerman, *Housing Crisis Represents the Greatest Threat to Recovery*, U.S. NEWS & WORLD REP. (Jan. 27, 2011), http://www.usnews.com/opinion/mzuckerman/articles/2011/01/27/housing-crisis-represents-the-greatest-threat-to-the-recovery.

5. The concept that an unfair enjoyment of benefits by parties not bearing associated costs (free-riding) is inequitable and "wrong" was articulated by H.L.A. Hart in 1955 and was termed the "principle of fairness." H.L.A. Hart, *Are There Any Natural Rights?*, 64 PHIL. REV. 175, 185–86 (1955). This concept has been favorably cited by John Rawls. JOHN RAWLS, A THEORY OF JUSTICE 96 (rev. ed. 1971). Fair allocation of cost demands that all beneficiaries of a cooperative enterprise bear pro rata responsibility for the costs of such enterprise. This formulation of fair allocation is well-suited to the case of upkeep expenses of a common interest community such as a homeowner association or condominium. Unfair cost allocation in communities creates neighborhood contention and lowers quality of life for members of an association. Michelle Conlin & Tamara Lush, *Neighbor vs. Neighbor as Homeowner Fights Get Ugly*, ASSOCIATED PRESS, July 10, 2011, *available at* http://finance.yahoo.com/news/Neighbor-vs-neighbor-as-apf-2524543580.html?x=0.

Today, defaulting neighbors cause millions of blameless homeowners around the country to face such inequitable and unexpected financial burdens.[6] An increasing number of new developments nationwide have adopted a private governance model.[7] Approximately 62,000,000 people in the United States (20% of the country's population) live in one of the 309,600 privately governed common interest communities ("CICs").[8] Nationally, home loan delinquency rates are now between 10% and 13% of all mortgages.[9] Mortgage defaults are concentrated in certain geographic areas, however, so the mortgage delinquency rate in

6. Numerous media accounts have highlighted the stories of suffering by such non-delinquent neighbors. *See, e.g.*, Christine Dunn, *'Nightmare' Condo Fees After Foreclosure*, PROVIDENCE J., July 6, 2008, at G1 (discussing a Rhode Island foreclosure); Christine Haughney, *Collateral Foreclosure Damage*, N.Y. TIMES, May 15, 2008, at C1 (examining the plight of a Miami woman); Sarah Ryley, *New Manhattan Condos See Rise in Foreclosures*, THEREALDEAL.COM (Mar. 8, 2010, 11:00 AM), http://therealdeal.com/newyork/articles/new-manhattan-condos-see-rise-in-foreclosures--2 (reporting on New York foreclosures); David Sutta, *Condos Demanding Foreclosure On Abandoned Units*, MFI-MIAMI (Apr. 28, 2010), http://www.mfi-miami.com/2010/04/condos-demanding-foreclosure-on-abandoned-units/ (discussing the predicament of a Florida woman).

7. More than 80% of newly built homes across the country are in a CIC. Conlin & Lush, *supra* note 5. The prevalence of condominiums increased markedly over the decade ending in 2005. However, since the housing crisis began, the percentage of occupied housing stock within a condominium has notably declined. *See* JENNIFER COMNEY, CERIS NARDUCI & PETER TATIAN, URBAN INST., STATE OF WASHINGTON, D.C.'S NEIGHBORHOOD 2010 26–29 (Nov. 2010) (showing how Washington, D.C.'s housing stock has followed the national trend).

8. "Common interest community" is defined by the Restatement (Third) of Property to be a "development or neighborhood in which individually owned lots or units are burdened by a servitude" that cannot be avoided by nonuse or withdrawal. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 6.2 (2000). Common interest communities include condominiums and homeowner associations—also known as planned unit developments ("P.U.D.s"). Data regarding the number of U.S. common interest communities and their residents is tracked by the Community Associations Institute ("CAI"). *Industry Data*, CMTY. ASS'NS INST., http://www.caionline.org/info/research/Pages/default.aspx (last visited Aug. 16, 2011) [hereinafter CAI Industry Data]. CAI's data indicate that the number of residents of common interest communities has increased from 2.1 million in 1970 to 62.0 million in 2010. This figure represents 20.2% of the population of the United States, estimated by the U.S. Census Bureau to be 307 million in 2009. *Population Finder*, U.S. CENSUS BUREAU, http://factfinder.census.gov/servlet/SAFFPopulation (last visited Aug. 16, 2011).

9. Based on figures provided by Lender Processing Services, as reported at PR Newswire, Press Release, Lending Process Services, Inc., LPS September 'First Look' Mortgage Report: August Month-End Data Shows More Delinquent Loans Entering Foreclosure Process (Sept. 15, 2010), *available at* www.reuters.com/article/idUS224331+15-Sep-2010+PRN20100915. Another article reporting these figures calculates that this rate indicates more than 7.2 million mortgage loans are behind on their payments. Carrie Bay, *Residential Mortgage Delinquency Rate Surpasses 10%: LPS*, DSNEWS.COM (Feb. 4, 2010), http://www.dsnews.com/articles/mortgage-delinquency-rate-surpasses-10-lps-2010-02-04. The foreclosure rate is ten times pre-crisis levels, and the aggregate number of foreclosure sales in one month (around 100,000 nationwide) is now similar to the number of pre-crisis foreclosure sales for an entire year. Alex Viega, *Foreclosure Rate: Americans on Pace for 1 Million Foreclosures in 2010*, HUFFINGTON POST (July 15, 2010, 5:07 PM), http://www.huffingtonpost.com/2010/07/15/foreclosure-rate-american_n_647130.html.

those areas is much higher.[10] The states with recent growth booms are the ones dealing with the steepest mortgage default rate.[11] Notably, these states also have the highest percentage of citizens residing in privately governed CICs.[12] People who have stopped paying their mortgages have, almost invariably, previously stopped paying their community association assessments.[13] The precipitous rise in mortgage

10. *See* Shayna M. Olesiuk & Kathy R. Kalser, *The 2009 Economic Landscape, The Sand States: Anatomy of a Perfect Housing-Market Storm*, 3 FDIC Q., no. 3, 2009 at 26, *available at* http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_1/Quarterly_Vol3No1_entire_issue_FINAL.pdf (discussing the acute nature of the housing downturn in Arizona, California, Nevada, and Florida); *see also* Dina ElBoghdady, *Foreclosure Activity Rises in Most Major Metropolitan Areas*, WASH. POST, July 30, 2010, at A14 ("The 20 regions with the worst foreclosure rates were in the four states—Florida, California, Nevada and Arizona."); Brad Heath, *Most Foreclosures Pack into Few Counties*, USA TODAY (Mar. 6, 2009, 7:13 PM), http://www.usatoday.com/money/economy/housing/2009-03-05-foreclosure_N.htm (explaining that properties concentrated in a mere thirty-five counties accounted for half of the country's foreclosure actions, and eight counties in Arizona, California, Florida, and Nevada were the source of a quarter of the nation's foreclosures in 2008). As of July 2010, 1 in 200 households in California were in foreclosure; 1 in 171 households in Florida were in foreclosure; 1 in 167 households in Arizona were in foreclosure; and 1 in 82 households in Nevada were in foreclosure. *States with Highest Foreclosure Rates*, CNBC.COM, http://www.cnbc.com/id/29655038/States_with_the_Highest_Foreclosure_Rates (last visited Aug. 16, 2011) (citing data from RealtyTrac's U.S. Foreclosure Market Report).

11. In the last decade, many cities in Arizona, California, Florida, and Nevada have experienced both a double-digit rise in prices as well as a double-digit decline in prices. *See House Price Index*, FED. HOUS. FIN. AGENCY, http://www.fhfa.gov/Default.aspx?Page=87 (last visited Aug. 16, 2011) (providing an index of housing transactions by state); S&P/CASE-SHILLER, HOME PRICE INDICES 2009, A YEAR IN REVIEW 5 (Jan. 2010), *available at* http://www.standardandpoors.com/ (follow "S&P/Case-Shiller Home Price Indices" hyperlink; then follow "S&P/Case-Shiller Home Price Indices: 2009 A Year In Review" hyperlink) (reporting on 2009). Conversely, cities such as Boston, Charlotte, Cleveland, Dallas, and Denver never experienced double-digit price rises nor have they experienced double-digit declines. *See* Heath, *supra* note 10 (explaining that in some parts of the country, "the foreclosure wave was barely a ripple").

12. For example, an estimated 25% or more of Californians reside in a condominium or homeowner association. *See* Carol Lloyd, *Condominium Homeowners Face Rising Condo Fees and Special Assessments*, SFGATE.COM (Aug. 3, 2007), http://articles.sfgate.com/2007-08-03/entertainment/17255445_1_affordable-housing-new-homeownership-inclusionary (reporting on increases in special assessments). Tomas Musil, director of the Shenehon Center for Real Estate at the Opus College of Business at the University of St. Thomas in St. Paul, Minnesota, explains that while "the problem is national in scope, it is more pronounced in Florida, California, Texas, and Colorado," where CIC developments were more popular. Tom Bayles, *After Foreclosure, It's Time for Neighbors to Pay*, HERALD TRIB. (Sept. 23, 2008, 1:26 AM), http://www.heraldtribune.com/article/20080923/ARTICLE/809230372/2055/NEWS?Title=When_foreclosure_is_finished__it_s_time_for_neighbors_to_pay (quoting Musil). The Policy Institute of California asserts that 38% of the housing units in California's "Inland Empire" exist in homeowner association communities. Jim Wasserman, *HOAs Struggle with Gotchas*, ASSOCIATED PRESS, http://www.calhomelaw.org/doc.asp?id=463 (last visited Aug. 16, 2011). Wasserman also points out that more than half of the nation's CIC housing is in five states (California, Florida, Texas, Arizona, and Nevada). Jim Wasserman, *California Eyes HOA Changes*, ASSOCIATED PRESS, (July 8, 2004), *available at* http://www.democraticunderground.com/discuss/duboard.php?az=view_all&address=141x2045calhomelaw.org/doc.asp?id=646.

13. Trevor G. Pinkerton, *Escaping the Death Spiral of Dues and Debt: Bankruptcy and*

default rates therefore indicates an even steeper rise in assessment delinquencies, which will continue until solvent owners replace delinquent owners.[14]

All types of CICs, from high-rise residential condominiums to multiple-zip-code single-home developments, share the same essential service and payment structure: homeowner-elected directors manage common upkeep, and all homeowners contribute their pro rata portion of the common costs.[15] The CIC structure enables more community amenities and upkeep, permitting neighborhoods to self-fund and allowing local governments to avoid raising taxes in response to more housing developments.[16]

Owners in condominiums and homeowner associations expect to be financially independent of their neighbors.[17] Architects of CIC-enabling legislation did not intend to create financial co-dependence nor cause significant financial entanglement because default in a well-functioning market would lead expeditiously to foreclosure and title transfer to a successive solvent homeowner. If a credit-worthy party quickly takes over a defaulting owner's share of upkeep obligations and begins to pay allocated assessments, the community would suffer only limited financial loss due to a member's mortgage default. But it often does not work that way in today's market. Now, contrary to original

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Condominium Association Debtors, 26 EMORY BANKR. DEV. J. 125, 142–43 (2009); Monica Hatcher, *Mediators Foresee Gloom, Doom in Condo Industry*, MIAMI HERALD, Jan. 4, 2009, at 1H; Press Release, PR.com, Concerned Homeowners Association Members Coalition Forms (Feb. 18, 2011), *available at* http://www.pr.com/press-release/299084; Donna Gehrke-White, *Homeowner Associations Step Up Foreclosure Filings*, MIAMI HERALD (Feb. 20, 2011), http://www.miamiherald.com/2011/02/20/2062656/homeowner-associations-step-up.html; Daniel Vasquez, *Should Delinquent Condo Owners Lose Internet, TV Service?*, SUN SENTINEL, Mar. 1, 2011, http://articles.sun-sentinel.com/2011-03-01/business/fl-cable-tv-condocol-20110301_1_delinquent-condo-owners-associations-maintenance-fees.

14. *See infra* notes 80–84 and accompanying text (illustrating that because assessments are the primary source of funding for community associations, delinquent payments usually cause increases in the assessments of all other homeowners to offset this financial imbalance).

15. *See* WAYNE S. HYATT & SUSAN F. FRENCH, COMMUNITY ASSOCIATION LAW: CASES AND MATERIALS ON COMMON INTEREST COMMUNITIES 11 (2d ed. 2008) (discussing the power of an elected board of directors); WAYNE S. HYATT, CONDOMINIUM AND HOMEOWNER ASSOCIATION PRACTICE: COMMUNITY ASSOCIATION LAW 105, 121 (3d ed. 2000) (discussing assessments and other collection devices).

16. *See generally* CLIFFORD TREESE, ROBERT DIAMOND & KATHERINE ROSENBERRY, RESEARCH INST. FOR HOUS. AM., CHANGING PERSPECTIVES ON COMMUNITY ASSOCIATION MORTGAGE UNDERWRITING AND CREDIT ANALYSIS 3 (Nov. 2001), *available at* http://www.housingamerica.org/RIHA/RIHA/Publications/48502_ChangingPerspectivesonCommunityAssociationMortgageUnderwriting.pdf (discussing methods that communities utilize to minimize taxes); CAI Industry Data, *supra* note 8 (indicating the number of residents of common interest communities).

17. *See infra* notes 97–100 and accompanying text (discussing the negative aspects of economic entanglement).

intent and expectations, foreclosure is slow in coming and sometimes deliberately or negligently delayed, and community assessments can accrue and remain unpaid for months or years.[18] Furthermore, the sheer number of owners who are currently in default on their payment obligations—some ten times higher than pre-crisis—means that an association could be suffering from widespread assessment delinquency, both increasing its budgetary shortfall and decreasing the number of owners shouldering the burden of bridging that gap.[19] Paying additional upkeep costs harms homeowners. Furthermore, uncertainty in association funding threatens the viability of the community itself.

In the context of today's lengthy mortgage foreclosure timelines, neighbors in CICs have become truly financially interdependent, and the failure of some owners to pay their fair share of common costs requires a greater financial contribution by the others.[20] During the months or years that mortgage foreclosure on a unit is threateued or pending, the association still must pay for upkeep, utilities and necessary repairs; its only source of revenue is increased assessment payments by those owners who are still able to pay.[21] Increased assessments, triggered by chronic non-payments, essentially result in forced inter-neighbor loans. Because foreclosure of the first mortgage wipes away the association's junior lien for assessments,[22] these forced loans typically end up being forced inter-neighbor permaneut subsidies.

Requiring owners to pay their neighbors' debts is wrong, inefficient, and destabilizing for the hundreds of thousands of CICs in the United

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18. Shuang Zhu & R. Kelley Pace, The Influence of Foreclosure Delays on Borrower's Default Behavior 3 (Apr. 19, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=1717127; *see also* Brent Ambrose, Richard Buttimer, Jr. & Charles Capone, *Pricing Mortgage Default and Foreclosure Delay*, 29 J. OF MONEY, CREDIT & BANKING 314, 319–20 (1997) (providing an overview of foreclosure delay).

19. RealtyTrac's Year-End 2010 U.S. Foreclosure Market Report shows a total of 3,825,637 foreclosure filings (including default notices, scheduled auctions, and bank repossessions) reported on a record 2,871,891 U.S. properties in 2010, an increase of nearly 2% from 2009 and an increase of 23% from 2008. Press Release, RealtyTrac, Record 2.9 Million U.S. Properties Receive Foreclosure Filings in 2010 Despite 30-Month Low in December (Jan. 12, 2011), *available at* http://www.realtytrac.com/content/press-releascs/2010-year-end-foreclosure-report-6309. The report also shows that nearly 2.23% of all U.S. housing units (1 in 45) received at least one foreclosure filing during the year, up from 2.21% in 2009, 1.84% in 2008, 1.03% in 2007, and 0.58% in 2006. *Id.* Today, at least 8 million Americans are behind on their mortgage payments, and the threat of further housing price decline (the so-called "double dip") has been called the "greatest strategic threat to the recovery of the economy." Zuckerman, *supra* note 4.

20. *See infra* Part I.B.2 (discussing the communal burden of assessment default in a CIC).

21. *See infra* notes 80–84 and accompanying text (discussing the importance of assessment payments to meet an association's budgetary needs).

22. *See infra* notes 187–97 and accompanying text (explaining the treatment of an assessment lien during first mortgage foreclosure).

States and the millions of homeowners who live in them.[23] The current system forces people who completely lacked the ability to foresee, control, or avoid their neighbors' defaults to bear increasing costs due to irresponsible mortgage lending. These same owners end up effectively subsidizing their neighbors' mortgage lenders whose collateral they pay to maintain, insure, and protect through association expenditures. Current laws fail to protect innocent, non-defaulting owners from being forced to provide their own private mortgage lender and neighbor bailouts. These bailouts are not ultimately reimbursed by the federal government or paid back by the home's foreclosing lender or foreclosure buyer. If neighbors refuse to privately fund deficiencies, lack of association funding for maintenance, insurance, and management of common property will eventually lead to a deterioration of the housing stock.[24]

Several states have responded to the dual problem of under-funded associations and inequitable cost allocation by providing for a capped amount of assessment deficiency (typically six months of unpaid assessments) to be repaid at or after foreclosure of the first mortgage on defaulting homes.[25] Often, this is not enough. Such limited obligations fail to adequately protect associations and their paying members from the costs of neighbor delinquency, in terms of both short-term uncertainty and ultimate association recoveries.[26] Changing the lien priority regime—to allow the first mortgagee's priority to decrease as foreclosure is delayed—is a better solution. Freeing post-foreclosure assessment claims from a dollar-capped limit would permit an association to ultimately recover the lenders' share of upkeep costs.

Decreasing a lender's priority based on the interval between mortgage default and foreclosure would likely incentivize more expeditious foreclosure sales. At first glance, this seems to run against conventional wisdom and current politics. Although lenders could choose to delay foreclosure and pay collateral carrying costs, increased lender costs pre-foreclosure could lead to faster foreclosures and faster home loss for defaulting borrowers. Even so, making lenders bear the costs of maintaining their collateral and encouraging transfer of title to

23. Hart, *supra* note 5, at 185–86; CAI Industry Data, *supra* note 8; *see also infra* Parts I.B & II.B.1 (illustrating how assessement deliquencies can lead to housing devaluation).

24. For example, one Florida CIC was a "dreamy little spot" with affordable amenities before the foreclosure crisis and before "the rats started chewing through the toilet seats in vacant units and sewage started seeping from the ceiling." Conlin & Lush, *supra* note 5; *see also infra* Parts I.B.2–3 (discussing how some states have adopted the Uniform Common Interest Ownership Act, which gives assessment liens a limited priority upon foreclosure).

25. *See infra* Part II.A.1.a (describing the six-month limited priority lien).

26. *See infra* Part II.A.1.d (discussing the inadequacy of limited priority liens).

solvent owners is the only way to contain a community's financial distress.[27] Whether foreclosure delays are caused by default volume, inadequate lender documentation, faulty procedure, predictions regarding resale, or the lender's desire to retain the defaulted loans as performing on the balance sheet, equity demands that the procrastination costs be allocated to the mortgagee rather than to the community as a whole. Lender funding of the upkeep of their own collateral avoids unjust enrichment and places costs on the parties who could have reasonably foreseen and prevented the assessment delinquencies in the first place—the lenders who should have been underwriting their potential borrowers.[28] Creating a legal means for ultimate recovery and reimbursement of neighbor-funded budget deficiencies will shore up the finances of communities and non-defaulting homeowners and help stabilize the housing market.

Part I of this Article explains the negative externalities of foreclosures and defaults in the context of CICs, as well as the limited remedies currently available to community associations under disparate state statutes. Part II.A discusses some attempted and proposed solutions to the problem of assessment nonpayment and foreclosure delay, including judicial attempts to resolve the issue through application of equity and legislative efforts to increase limited lien priority coverage. Finally, Part II.B advocates a more nuanced and targeted approach to solving the problem: capping the community's losses by allowing the first mortgage lien's priority to gradually erode during the assessment default period.

While foreclosure procedure must be closely monitored and stringently followed to protect mortgage borrowers, promoting foreclosure sales within such procedural limits helps combat negative externalities created by defaulting community members. Laws that incentivize prompt, procedurally perfect foreclosures and allow for open-ended assessment lien priority would ultimately benefit homeowners, communities, and mortgage lenders. Systematic erosion

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27. *See infra* Part II.B.2 (explaing how a community stands to benefit from an expedited foreclosure process). Furthermore, foreclosure delays result in a "free ride" for mortgagors and their lenders during the time that assessment obligations are not paid on behalf of the defaulted property. *See* Hart, *supra* note 5, at 182 (articulating the idea of "moral property"). While public policy might justify giving defaulting homeowners reasonable time to relocate, economically and philosophically, there is no justification for substantial foreclosure delays that create "collateral damage" on the surrounding community, due to upkeep costs being allocated inequitably. There is no equitable reason to give either cost-free occupancy to borrowers or cost-free collateral preservation to their lenders. In fact, the very definition of "fair allocation" would demand otherwise. *See* RAWLS, *supra* note 5, at 96 (articulating moral principles).

28. *See infra* notes 378–79 and accompanying text (discussing why shifting the financial burden to the lender would be beneficial to individuals and the economy as a whole).

of mortgage priority during foreclosure delay promotes equitable allocation of upkeep costs and efficient property transfers, and keeps lenders from getting a free ride. Compared to other potential solutions, first mortgage lien priority erosion is the best way to remedy the inequitable and community-destabilizing status quo.

I. THE PROBLEM OF PRIVATE GOVERNANCE AND MEMBER DEFAULTS

A. Negative Externalities of Default

A property owner's failure to meet assessment payment obligations creates significant negative externalities.[29] Widespread payment defaults destabilize communities, depress property values, lower local property tax revenue, and impose additional costs on public agencies that provide municipal services.[30] Although the problem of contagious declines in property values and neighborhood upkeep is often couched in terms of the spillover effect of foreclosures,[31] the most significant external harm arises not from the foreclosure sale itself, but from the default in homeowner payment obligations that preceded it.[32] Below-market foreclosure sales may temporarily reduce real estate market pricing of real estate in the immediate vicinity of the foreclosed parcel.[33] But the adverse neighborhood effect of a property in limbo (foreclosure is pending while upkeep is lacking) is both more tangible and longer-lasting.[34] The true risk of contagion, therefore, comes from default and delay rather than from the ultimate property transfer.

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29. *See, e.g.*, ALLAN MALLACH, BROOKINGS INST., METRO. POL'Y PROGRAM, ADDRESSING OHIO'S FORECLOSURE CRISIS: TAKING THE NEXT STEPS 35 (June 2009), *available at* http://www2.safeguardproperties.com/pub/Alan_Mallach.pdf (reporting on the consequences of Ohio foreclosures).

30. *See* City of Cleveland v. Ameriquest Mortg. Sec., Inc., 621 F. Supp. 2d 513, 536 (N.D. Ohio 2009) (involving a lawsuit brought by the City of Cleveland against several lending institutions), *aff'd en banc*, 615 F.3d 496 (6th Cir. 2010), *cert. denied*, 131 S. Ct. 1685 (2011); *see also* JOINT CTR. FOR HOUS. STUDIES HARV. U., AMERICA'S RENTAL HOUSING: THE KEY TO A BALANCED NATIONAL POLICY 3 (2008), *available at* http://www.jchs.harvard.edu/publications/rental/rh08_americas_rental_housing/rh08_americas_rental_housing.pdf (describing the destabilization of certain communities).

31. In a May 5, 2008 speech, for example, Chairman of the Federal Reserve Ben Bernanke warned that "high rates of delinquency and foreclosure can have substantial spillover effects on the housing market, the financial markets, and the broader economy." Ben S. Bernanke, Chairman, Fed. Reserve, Speech at Columbia Business School 32nd Annual Dinner (May 5, 2008) (transcript available at http://www.federalreserve.gov/newsevents/speech/Bernanke20080505a.htm).

32. *See infra* Part I.A.2 (discussing constructive abandonment).

33. *See infra* notes 38–39 and accompanying text.

34. *See infra* Part II.A.2 (describing the effects of a prolonged foreclosure).

1. Lower Comparable Sales Valuation

In general, property sells at foreclosure for a significant amount below an arm's-length market transaction.[35] Because the market traditionally prices homes based on comparable sales within the same community, any below-market sale creates a drag on neighboring values and sale prices.[36] In addition, mortgage default and foreclosure increases the supply of homes for sale in the given neighborhood, and increasing supply with static demand lowers market prices as well. Research published by Fannie Mae in 2006, focusing on the effect of subprime foreclosures, estimated that 41 million properties in the United States faced declining property values due to foreclosure of nearby parcels, resulting in an aggregate loss of $200 billion in value.[37] The study found that homes within one-eighth of a mile of a foreclosed property experience a 0.9% decline in value after the foreclosure sale.[38] More recent empirical studies have questioned this figure—particularly in terms of the geographic scope and duration of the foreclosure effect—arguing that the depreciation is closer to 0.5%, can quickly rebound, and that the farther away a "good standing" home resides from a foreclosed home, the smaller the psychological and market pricing impact of the foreclosure sale.[39]

Interestingly, while neighboring homeowners may decry falling property values, the downward price pressure of foreclosure sales may actually help rather than hurt the housing market as a whole. Housing prices in this country are likely still inflated above market

35. *See* John Y. Campbell, Stefano Giglio & Parag Pathak, *Forced Sales and House Prices* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 14866, 2009), *available at* http://econ-www.mit.edu/files/3914 (showing that foreclosure sales prices averaged 27% lower than the appraised value for the home). The depressed purchase price at foreclosure, however, is almost never cause to avoid the sale. *See, e.g.*, B.F.P. v. Resolution Trust, 511 U.S. 531, 545 (1994) ("We deem, as the law has always deemed, that a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with.").

36. *See* John Harding, Eric Rosenblatt & Vincent Yao, *The Contagion Effect of Foreclosed Properties*, 66 J. URB. ECON. 164, 172 (2009) (providing statistics). For a description of comparative sales methodology, see James Kimmons, *The Sales Comparison Method of Real Estate Appraisal and Valuation*, ABOUT.COM, http://realestate.about.com/od/appraisaland valuation/p/compare_method.htm (last visited Aug. 16, 2011) (discussing factors to consider in comparing properties).

37. Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single Family Mortgage Foreclosures on Property Values*, 17 HOUS. POL'Y DEBATE 57, 57 (2006).

38. *Id.*; *see also Chart of the Day: Foreclosure Contagion*, PORTFOLIO.COM (Jul. 18, 2008, 12:00 AM), http://www.portfolio.com/views/blogs/odd-numbers/2008/07/18/chart-of-the-day-foreclosure-contagion/#ixzz10I33 (discussing the effects of foreclosure on neighboring property values).

39. Harding et al., *supra* note 36, at 164–65.

"equilibrium"—meaning that the ratio of a home's value based on rental income is well below the comparable sale value of a given home.[40] Even though rents have gone up and prices have gone down, in many cases rents still cannot cover purchase-money mortgage payments, suggesting that real property prices have not yet decreased sufficiently to reach a stable, rent-neutral level.[41] There is, therefore, a systemic (market stability-based) upside to this particular aspect of foreclosure "contagion."

2. Constructive Abandonment

Comparable sales values of homes are notoriously finicky and fragile, and the foreclosure-related value losses likely represent unsustainable prior gains due to housing speculation.[42] Far more long-lasting and tangible costs arise from homeowners defaulting on their property upkeep obligations. Our system of homeownership involves both rights and responsibilities of homeowners,[43] and when owners abandon their homes, either literally, by ceasing to reside there, or figuratively, by ceasing to maintain the property, the community suffers tangible and permanent losses in value,[44] homes and neighborhoods deteriorate, and

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40. *See* Suzanne Stewart & Ike Brannon, *A Collapsing Housing Bubble?*, 29 REG. 15, 16 (2006) ("A reading well below or above 100 indicates a market that is out of equilibrium: if the reading is below 100, renting is a bargain."). In 2005, the average rental value of homes was only 70% of the purchase price nationwide and was the lowest since the Office of Federal Housing Enterprise Oversight ("OFHEO") began the index in 1985—with the next-lowest annual ratio (1989) being roughly 91%. *Id.* The rental-sale price disequilibrium was far more pronounced in certain areas of the country, such as California, Nevada, Arizona, and Florida, where home prices in the prior decade had increased by over 99%. *See* OLESIUK & KALSER, *supra* note 10 (providing statistics); *see also* Anthony Sanders, *The Subprime Crisis and its Role in the Financial Crisis*, 17 J. HOUS. ECON. 254, 254 (2008) (providing statistics).

41. *See, e.g.*, Emma L. Carew, *To Woo A Renter: Homeowners Who Punt on Selling Face Challenge as Tenants Get Choosier*, WASH. POST, Aug. 15, 2009, at E1 (providing an example from the Washington, D.C. area); *see also* Stewart & Brannon, *supra* note 40, at 16.

42. *See* Andrea J. Boyack, *Lessons in Price Stability from the U.S. Real Estate Market Collapse*, 2010 MICH. ST. L. REV. 925, 933–34 (2010) (discussing speculation and overpricing).

43. Owners of real property are obligated to pay property taxes, are required to protect against hazards and nuisance on their properties, and face liabilities related to environmental hazards thereon. Real property cannot be abandoned. *See* RESTATEMENT (FIRST) OF PROP. § 504 cmt. a (1944) (explaining why easements may be abandoned more easily than other land interests); *see also, e.g.*, Pocono Springs Civic Ass'n v. MacKenzie, 667 A.2d 233, 235 (Pa. Super. Ct. 1995) (discussing the law of abandonment in Pennsylvania). Property law requires that some entity always hold seisin, because the holder of seisin is the gatekeeper, or responsible party, with respect to that parcel of realty. *See* THOMAS W. MERRILL & HENRY E. SMITH, PROPERTY: PRINCIPLES AND POLICIES 201 (2007) (discussing the role of gatekeeper as it relates to adverse possession).

44. *See* Ivana Kottasova, *A House Dies and a Block Sinks*, BROOK. INK (Mar. 9, 2011), http://thebrooklynink.com/2011/03/09/23899-a-house-dies-and-a-block-sinks/ ("Vacant properties are often not maintained properly and show signs of physical distress . . . . That itself causes property values to go down—and then the area becomes less attractive for residents." (quoting Josiah

the absence of a vigilant gatekeeper for the property allows vandalism and other crime to increase.[45] A defaulting homeowner facing imminent or even eventual mortgage foreclosure has little incentive to invest anything in the home and, thus, will forego many socially desirable activities: painting shutters, cleaning gutters, mowing the lawn, or fixing broken appliances or cabinets.[46]

The mere drop in home value itself can start the trend toward owner constructive abandonment because once a property is "upside-down" or "underwater" (more is owed on a mortgage loan than the property is worth), any improvements or maintenance made on a home effectively becomes "sweat debt" (value created for the lender) rather than "sweat equity" (value created for the owner). Some commentators have suggested that a typical borrower will consider walking away from a mortgage when the home value falls below 75% of the amount owed on the mortgage.[47] More than 5 million homeowners in the United States

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Madar)). The negative externalities caused by failure of an owner to exercise adequate property oversight are among the many justifications for the doctrine of adverse possession. *See* John G. Sprankling, *An Environmental Critique of Adverse Possession*, 79 CORNELL L. REV. 816, 816 (1994) (advocating an environmental reform of the adverse possession doctrine).

45. *See, e.g.*, John Cutts, *Neighborhood Cleanup Might Improve Cheap Houses for Sale Numbers*, REAL ESTATE PRO ARTICLES (July 7, 2010, 10:15 AM), http://www.realestateproarticles.com/Art/19024/278/Neighborhood-Cleanup-Might-Improve-Cheap-Houses-for-Sale-Numbers.html (discussing foreclosures in San Antonio); Seth Slabaugh, *High Vacancy Rates in Inner-City Muncie*, STAR PRESS (Feb. 26, 2011), http://pqasb.pqarchiver.com/thestarpress/access/2276988201.html?FMT=ABS&FMTS=ABS:FT&date=Feb+26%2C+2011 (reporting on the numerous vacancies in Muncie, Indiana); Yepoka Yeebo, *Coping With Chicago's Foreclosure 'War Zones,'* HUFFINGTONPOST.COM (Mar. 2, 2011, 9:49 AM), http://www.huffingtonpost.com/2011/03/02/chicago-vacant-reo-property_n_829343.html (lamenting vacancies in Chicago).

46. *See* Steve Vitali, *HOA's are Important to Our Valley Communities*, LAS VEGAS REV. J. (Mar. 12, 2011), http://www.lvrj.com/real_estate/hoas-are-important-to-our-valley-communities-117848853.html?ref=853 (describing efforts by the Nevada legislature); Tammy Leonard, Home Appreciation, Default Risk and Neighborhood Upkeep 3 (June 10, 2009) (unpublished manuscript), *available at* http://www.utdallas.edu/~muurdoch/NeighborhoodChange/Tammy/Appreciation_Default_Upkeep_v11.pdf (examining the relationship between houshold maintenance expenditures and default risk). Some homeowners who have defaulted on their mortgages and know that they will ultimately lose their home in foreclosure affirmatively and permissively create waste—some homeowners rip out fixtures and actively destroy improvements on the real property. *See Report: Owners of Foreclosed Homes Steal Appliances, Leave Houses in Disarray*, FOXNEWS.COM (Feb. 4, 2009), http://www.foxnews.com/story/0,2933,487884,00.html (reporting that some homeowners retaliate against lenders by damaging and looting their homes prior to foreclosure sales); James Thorner, *In home foreclosure, if it's not nailed down...*, ST. PETERSBURG TIMES (Feb. 19, 2008), http://www.sptimes.com/2008/02/19/Business/hi_home_foreclosure__.shtml (reporting that, in Florida, 20% of owners strip their houses prior to foreclosure); James Walsh, *Monsey, NY—House Demolished Just Before Auction for Mortgage Default*, VOS IZ NEIAS? (Feb. 4, 2009, 8:41 AM), http://www.vosizneias.com/26875/2009/02/04/monsey-ny-house-demolished-just-before-auction-for-mortgage-default/ (reporting a situation where homeowners destroyed their entire house before a foreclosure sale).

47. David Streitfeld, *No Aid or Rebound in Sight: More Homeowners Just Walk Away*, N.Y.

reached this "tipping point" of underwater valuation by the third quarter of 2009.[48]

According to the Rassmussen Report, 31% of U.S. homeowners with a mortgage owed more on their homes than their homes were worth as of the end of 2010.[49] Deutsche Bank predicted that 48% of American homes could have negative equity by the end of 2011.[50] Along with the numerous defaults on home mortgages caused by the inability to pay, more and more borrowers who are financially able to pay are strategically defaulting on their mortgages.[51] When the lender holds 100% (or more) of the current value of a home, many homeowners feel that there is no financial incentive to continue to pay the mortgage or, for that matter, the community association assessments.[52]

3. Government Rescue Efforts

The negative externalities of homeowner constructive abandonment have been cited to justify policies and programs aimed at helping homeowners facing foreclosure.[53] Many of these programs create additional incentives for lenders to pursue loan modifications or permit

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TIMES, Feb. 3, 2010, at A1.

48. *Id.*; *see also* Thompson, *supra* note 1, at 55 ("Housing prices peaked in the United States in early 2005 and began declining in 2007. Foreclosures then increased in the United States at record levels throughout 2006, continuing throughout 2008."); *Negative Equity Report for Q3*, CALCULATED RISK (Nov. 24, 2009, 4:00 PM), http://www.calculatedriskblog.com/2009/11/negative-equity-report-for-q3.html ("Nearly 10.7 million, or 23 percent, of all residential properties with mortgages were in negative equity as of September, 2009.").

49. Peter Schroeder, *Poll: Nearly One-Third of Homeowners Underwater on Mortgage*, THE HILL (Mar. 21, 2011, 1:29 PM), http://thehill.com/blogs/on-the-money/801-economy/151039-poll-nearly-one-third-of-homeowners-underwater-on-mortgages. Previously, in the first quarter of 2010, Zillow.com had estimated that 23% of homes in the United States were worth less than mortgage loan amounts secured by the property. Brian Louis, *U.S. Mortgage Holders Owing More Than Homes Are Worth Rise to 23% of Total*, BLOOMBERG (May 10, 2010, 3:31 AM), http://www.bloomberg.com/news/2010-05-10/u-s-mortgage-holders-owing-more-than-homes-are-worth-rise-to-23-of-total.html.

50. Zuckerman, *supra* note 4.

51. *See* Gail Marks-Jarvis, *Ethics of Strategic Default are Really Hitting Home*, CHI. TRIB., Oct. 7, 2010, at 7.1 ("Morgan Stanley recently estimated that about 18 percent of defaults will be strategic.").

52. Underwater homeowners have no incentive to pay property taxes either, but counties are always first in line to collect unpaid tax amounts from foreclosure proceeds. There is no cap on the amount of unpaid property taxes that a county can collect from the purchase price at a foreclosure sale.

53. *See* CONGRESSIONAL OVERSIGHT PANEL, EVALUATING PROGRESS ON TARP FORECLOSURE MITIGATION PROGRAMS, APRIL OVERSIGHT REPORT (2010) [hereinafter APRIL OVERSIGHT REPORT] (discussing the Home Affordable Modification Program ("HAMP") and its successes and failures over the first year); *see also* David Streitfeld, *Program to Pay Homeowners to Sell at a Loss*, N.Y. TIMES, Mar. 7, 2010, at A1 (stating that the Obama Administration's latest program "will allow owners to sell for less than they owe and will give them a little cash to speed them on their way").

short sales in lieu of foreclosure.[54] To the extent that loan modifications create true incentives for owners to remain invested in their property by reassuming the gatekeeper role and paying upkeep costs and the like, such modifications would help eliminate the property value losses discussed above and should be promoted as sound policy. To the extent that short sales would streamline the process of replacing insolvent owners with financially capable "gatekeepers," short sale incentives would also benefit the community and deserve to be encouraged.[55] Unfortunately, however, these government efforts have mostly failed to create viable mortgages and ensure homes are held by owners able to meet their assessment obligations. Even with payment reductions and government assistance, more than three-quarters of the mortgage loans that were modified under the Home Affordable Modification Program ("HAMP") remained underwater in April 2010.[56] The initiative for expedited short sales likewise has been mostly unsuccessful.[57]

One obstacle to greater success through loan modifications and/or short sales is the problem of junior liens.[58] Not only do many financially imperiled homes today have subordinate liens from second mortgages and home equity lines, but the community association in any CIC will have a lien securing its rights to recover unpaid assessments.[59] Junior lienors, including community associations, can stymie modification plans by withholding consent to proposed changes to the senior loan.[60] A community association's board might lack the

54. Short sales are tri-party agreements amongst a defaulting mortgage borrower, the mortgage lender, and a third-party purchaser, whereby the purchaser agrees to buy the property for less than the outstanding loan amount, and the lender agrees to accept payment of the buyer's purchase price in full satisfaction of the borrower's mortgage loan.

55. Streitfeld, *supra* note 53, at A1.

56. APRIL OVERSIGHT REPORT, *supra* note 53, at 39.

57. Andrew Jeffrey, *Housing Market: Foreclosure Relief Programs Under Fire*, MINYANVILLE (Mar. 14, 2011, 10:00 AM), http://www.minyanville.com/businessmarkets/articles/foreclosure-forelcosure-relief-program-homeowners-loan/3/14/2011/id/33322.

58. Loan modifications without junior lienor consent can result in a complete loss of priority for the senior lienholder. Short sales are made subject to all junior liens, if these are not paid off or voluntarily released, as part of the sale. *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 871–76 (5th ed. 2007) (discussing the relationship between junior and senior liens); *see also* Robert Kratovil & Raymond J. Werner, *Mortgage Extensions & Modifications*, 8 CREIGHTON L. REV. 595, 610 (1975) (stating that an original clause in the record granting the senior lienor the ability to increase the interest rate on the giving of any extension will not be sufficient for priority for that increased interest over junior lienors, due to prejudice).

59. Many properties in default have other junior lienors as well, including second purchase money mortgages or home equity lines of credit. In many, but not all, states, second mortgages are junior in priority to the association's lien.

60. Loan modifications occurring without the consent of junior lienors are vulnerable to priority loss should a court determine that the modification adversely impacts the secured position of the junior lienor. Many loan modifications, however, have been upheld as non-prejudicial to a

authority to engage in debt forgiveness with respect to delinquent assessments, since this effectively imposes more costs on the remainder of the community and violates the payment allocation provisions of the CIC's governing documents.[61] The argument that in a bad mortgage debt situation, both a borrower and a lender should compromise by giving up value (in terms of lost equity and lost loan proceeds) is compelling.[62] But no similar logic supports a claim that non-party neighbors should be forced to bear losses due to other people's poorly conceived loans. This is one reason the "Helping Families Save their Homes Act of 2009" was voted down in the U.S. Senate: the proposed law would have given bankruptcy judges the ability to mandate massive write-downs on unpaid assessment liens, essentially blocking the already limited ability of associations to collect delinquent assessments and continue to perform their essential functions.[63] If the government truly wants to encourage short sales or modifications in privately governed communities, it must ensure that the workout (a) ultimately stabilizes the community and (b) is not forcibly financed by the non-delinquent neighbors.

Government programs that encourage property to be efficiently conveyed to solvent and responsible owners ameliorate the harm caused

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community association. *See, e.g.*, Dime Sav. Bank of N.Y., F.S.B. v. Levy, 615 N.Y.S.2d 218, 220 (Sup. Ct. 1994) (holding that a modification extending the first mortgage loan term remained a first priority lien, and short sales required cooperation of junior lienors (or full repayment of such obligations) to transfer unencumbered title to the proposed buyer).

61. *See* ROBERT G. NATELSON, LAW OF PROPERTY OWNERS ASSOCIATIONS 437 (1989) (discussing the impact of association conduct on the value individual condominium units); *see also* HYATT & FRENCH, *supra* note 15, at 319, 567–68 (stating that homemakers of a community generally rely on uniform enforcement of covenants that are in furtherance of the original developmental scheme).

62. This argument is often used to promote modifications and short sales. *See* David Benoit, *Bank Of America Begins Mortgage Principal Reduction Program in Arizona*, FOX BUS. (Mar. 2, 2011), http://www.foxbusiness.com/industries/2011/03/02/bank-america-begins-mortgage principal-reduction-program-arizona/ (discussing Arizona's program "using federal money to get Bank of America to lower the amount borrowers owe on their mortgages"); Dave Clarke, *U.S. Regulators Strike Deal on Mortgage Risk Rule*, REUTERS, Mar. 1, 2011, *available at* http://www.reuters.com/article/2011/03/01/financial-regulation-qrm-idUSN0113980220110301 (examining banking regulator's provision forcing services to modify loans if it would save the lenders and borrowers money); Abigail Field, *What the Mortgage Mess Settlement Proposal Really Means*, DAILY FIN. (Mar. 9, 2011, 12:20 AM), http://www.dailyfinance.com/story/credit/what-the-mortgage-mess-settlement-proposal-really-means/19872233/ ("Servicers have to show their math when announcing if a modification is denied."); David McLaughlin & Lorraine Woellert, *Attorney Generals Push for Loan Reductions, Seek Bank Accord*, BLOOMBERG (Mar. 8, 2011, 12:01 AM), http://www.bloomberg.com/news/2011-03-07/foreclosure-settlement-said-to-be-sought-by-states-u-s-within-two-months.html (discussing how state attorneys general are pushing for reduced balance settlements between lenders and borrowers).

63. H.R. 1106, 111th Cong. §§ 202–03, 532 (2009) (defeated in a Senate vote on April 30, 2009).

by owner payment defaults.[64] But most government attempts to mitigate the damage caused by mortgage defaults have failed to adequately address the problems caused by upkeep reduction, and, in fact, some have exacerbated the spillover effects of default. For example, although purporting to help homeowners, foreclosure moratoriums can perpetuate the constructive abandonment maintenance problem.[65] Forced loan modifications—to the extent they merely postpone the inevitable and leave a borrower unable (or unwilling) to pay assessments—do the same.[66] Any government interference that slows foreclosure may (at least in the short-run) help an individual defaulting mortgagor and might, in a temporarily "down" market, even help the mortgage holder ultimately recover more on its loan, but in CICs, these benefits are funded by the neighbors. Keeping an ultimately doomed mortgage loan on this sort of life support increases current and carrying costs borne by neighboring owners, increases CIC assessment levels, and drives down property values.

64. Unlike HAMP and the initiative promoting short sales, the Neighborhood Stabilization Program of the Department of Housing and Urban Development ("HUD") has focused on infusing money into communities directly, buying abandoned homes, renovating them, and contributing to the community's upkeep and property values. This HUD program is effectively the antithesis of foreclosure moratoriums: it encourages sales of constructively abandoned properties to prevent communities from hearing the negative externalities such properties cause. HUD provided $6 billion in two rounds of Neighborhood Stabilization Program funding, some of which was supplemented by state funds to create successful and effective localized programs. For example, $5.6 million in federal funds combined with $30 million in resources from the Twin Cities Community Land Bank created an entity able to buy up 250 blighted and defaulting properties in targeted neighborhoods. These properties were rehabilitated (updated to green standards) and sold to "responsible homeowners." Shaun Donovan, *Fighting Foreclosures and Strengthening Neighborhoods*, U.S. DEP'T OF HOUS. AND URBAN DEV. BLOG (Sept. 3, 2010), http://portal.Hud.gov/portal/page/portal/HUD/press/blog/ (discussing the effectiveness of The Neighborhood Stabilization Program as an example of a fairer and more forward-looking approach to the contagion effects of mortgage defaults in communities).

65. Moratoriums can perpetuate the tenure of owners who are unwilling or unable to bear the costs of ownership, including paying community assessments, property taxes, and basic property upkeep costs, delaying the conveyance of property owning responsibilities to an owner willing to assume such responsibilities. *See, e.g.*, Jennifer Slosar, *Chicago Coupe Deals with Toxic Mold, Unresponsive Bank*, CHI. J. (Oct. 6, 2010), http://www.chicagojournal.com/News/10-06-2010/Chicago_couple_deals_with_toxic_mold,_unresponsive_bank ("As the foreclosure process stretches past the two-year mark, they are struggling to maintain the empty unit and stanch the bleeding in their homeowners association fund from lost assessments."); *see also* Zhu & Pace, *supra* note 18, at 12–17 (stating that foreclosure delays encourage mortgage default and lack of owner upkeep and investment in the property, all of which drives down the value of homes and drives up costs of financing and "may impede the recovery of the housing market").

66. This is because the longer a non-payment problem persists in a community, the more costs are inequitably borne by paying neighbors. If a modification merely delays an ultimate, inevitable foreclosure, it is unlikely that a neighbor will bring his or her association assessments current in the interim, and the threat of permissive and affirmative waste remains.

Foreclosure rescue efforts have mostly failed to create viable long-term mortgage loans, and the most worrisome contagious effects of homeowner defaults remain, since true losses arise not from foreclosure sales themselves, but from a chronic reduction in neighborhood upkeep and inequitable upkeep costs.[67] This fact reinforces the main contention of this Article: delaying foreclosure and allowing property to deteriorate is a lose-lose scenario, avoidable only by ensuring that properties are owned by people who are able and willing to maintain the property and pay association assessments. This is particularly true in CICs where there are additional, direct and compelling cost externalities with respect to payment defaults, so the contagion effect is more pronounced.[68]

B. Financial Entanglement

1. The CIC Ownership, Assessment, and Services Model

The CIC structure is a privatized governance solution to the collective action and free-rider problems often termed the "tragedy of the commons."[69] Widespread private property ownership in the United States has minimized the number of publicly maintained "commons,"[70] and until recently, federal, state, or local governments maintained most of those areas that could not be divided and privatized.[71] In the past

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67. Harding et al., *supra* note 36, at 165, 172, 178; *see also supra* Part I.A.2 (discussing the notion of constructive abandonment).

68. *See infra notes* 83–88 and accompanying text (describing why delayed foreclosure is particularly harmful in CICs).

69. Garret Hardin, *The Tragedy of the Commons*, 162 SCI. 1243, 1244–45 (1968); *see also* Thrainn Eggertsson, *Open Access versus Common Property*, in TERRY L. ANDERSON & FRED S. MCCHESNEY, PROPERTY RIGHTS: COOPERATION, CONFLICT AND LAW, 74–82, 84–85 (2003) (discussing the tragedy of subsequent empirical studies as a result of Garret Hardin's *The Tragedy of the Commons*); James E. Krier, *The Tragedy of the Commons, Part II*, 15 HARV. J.L. & PUB. POL'Y 325, 325 (1992) (acknowledging Garret Hardin as having addressed the problem of coordinating human behavior as it affects environmental quality); Mark A. Lemley, *Property, Intellectual Property and Free Riding*, 83 TEX. L. REV. 1031, 1037 (2005) ("The tragedy of the commons is a specific example of the more general preoccupation of the economic literature on real property with the internalization of externalities and with the use of property law to achieve that end.").

70. Throughout U.S. history, the government has aggressively sought to sell land to private owners. This was the impetus behind Thomas Jefferson's Land Ordinance Act, for example. *Land Ordinance of 1785*, *in* DOCUMENTS OF AMERICAN HISTORY 123–24 (Henry S. Commager ed., 1940); *see* Richard P. McCormick, *The "Ordinance" of 1784?*, 50 WM. & MARY Q. 112, 116–17 (1993) (discussing the scheme for selling and disposing of land acquired under the Ordinance as a reason why it was not adopted in its original form).

71. *See, e.g.*, 39 AM. JUR. 2D *Highways, Streets, and Bridges* § 212 (2011) (discussing usage rights for public property adjacent to private property); 59 AM. JUR. 2D *Parks, Squares, and Playgrounds* § 23 (2011) (discussing the proper use of property such as parks and squares); *see also* Lemley, *supra* note 69, at 1038 (discussing government regulation of property rights due to

century, courts began to routinely hold that community covenants creating payment obligations for common area upkeep were servitudes running with the land.[72] This judicial interpretation enabled the rise of private governance and assessment systems across the United States. In privately governed neighborhoods, common space and amenities are maintained by an association, which assesses each owner a share of the upkeep costs.[73] The association provides sufficient governance to solve the tragedy of the commons by controlling overuse and creating a mechanism for maintenance and shared costs,[74] which in turn permits communities to avoid the economic downside of public goods, meaning that a neighborhood can enjoy better amenities at lower prices.[75] The association is essentially a mini-government, performing public functions: upkeep of common areas and amenities, rule-making, and dispute resolution.[76] Association assessments are therefore, to some extent, the equivalent of property taxes, a mechanism to fund common

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negative externalities).

72. Neponsit Prop. Owners Ass'n, Inc. v. Emigrant Indus. Sav. Bank, 15 N.E.2d 793, 797 (N.Y. 1938). Prior to *Neponsit*, covenants to pay money were viewed as personal, not running with the land because they did not adequately "touch and concern" real property. The *Neponsit* characterization of this covenant as creating a real property servitude, however, spurred the growth of suburban communities across the country. Enforcing payment obligations as servitudes on real property is now *de rigueur*. *See, e.g.*, Regency Homes Ass'n v. Egermayer, 498 N.W.2d 783, 788–93 (Neb. 1993) (holding that a covenant to pay dues to a community association to maintain recreational facilities is a real covenant that runs with the land).

73. Most associations' governing documents explicitly provide for assessment funding of association obligations. HYATT, *supra* note 15, at 108 ("Generally, covenants in the declaration provide authority for the association to collect assessments from each owner."). Even in situations where governing documents for community associations have failed to provide for assessments, courts find the power to assess implicit in the structure of a CIC. *See, e.g.*, Fogarty v. Hemlock Farms Cmty. Ass'n, 685 A.2d 241, 244 (Pa. Commw. Ct. 1996) ("[A]bsent language in the deed covenant prohibiting HFCA from levying special assessments for capital improvements, the [property owners] may be assessed their proportionate costs to construct the new improvements."); Meadow Run & Mountain Lane Park Ass'n v. Berkel, 598 A.2d 1024, 1027 (Pa. Super. Ct. 1991) (finding that inherent in the duty to provide maintenance is the power to assess costs to property owners). *But see, e.g.*, Bd. of Dirs. of Carriage Way Prop. Owners Ass'n v. W. Nat'l Bank of Cicero, 487 N.E.2d 974, 978–79 (Ill. App. Ct. 1985) ("[T]he [association] cho[o]s[ing] to continue to maintain the common areas does not render the [property owners] unjustly enriched."); Wendover Road Prop. Owners Ass'n v. Kornicks, 502 N.E.2d 226, 231 (Ohio Ct. App. 1985) (declining to apply quasi-contract or unjust enrichment theories to require a property owner to pay assessments when the deed conveying the property did not provide for such an assessment).

74. *See* HYATT, *supra* note 15, at 29–32 ("The community association allows innovation, provides for responsibility and obligation, and provides the necessary power to meet these responsibilities.").

75. CAI INDUSTRY DATA, *supra* note 7; *see* TREESE ET AL., *supra* note 16, at 6 (noting that common upkeep also allows a community to take advantage of cost savings from economies of scale).

76. *See* TREESE ET AL., *supra* note 16, at 6 (discussing the municipal responsibilities the associations now assume).

costs, and are treated as such by the income tax laws of at least two states.[77]

For condominiums, a private governance and assessment system is not only beneficial, it is essential. Once states passed statutes allowing fee simple ownership of a three-dimensional "box" of space,[78] multiple individuals could become owners of distinct units within one building. But having many owners within one building mandates certain jointly-held property: the roof, lobby, elevators, hallways, laundry rooms and, in some buildings, water, sewer, trash, electricity, and gas, as well as hazard insurance on the building itself. The mechanism of private community governance provides and pays for all such commons equitably and efficiently.[79]

Typically, CIC governing documents explicitly vest the association with broad authority to assess members according to budgetary needs,[80] and courts have found that even when an association's documents lack explicit authorization, assessment power is implied.[81] As long as the assessments are authorized, it is clear that the obligation to pay assessments is both an *in personam* obligation of a homeowner and an *in rem* affirmative covenant that runs with the land and is binding on all successor owners of the property.[82] The obligation to pay assessments is the most vital obligation in a privately governed community because

77. In New Jersey, the correlation of community assessments and property taxes has been acknowledged by the legislature, which now permits a portion of community assessment payments to offset local property tax assessments. N.J. STAT. ANN. §§ 40:67-23.2-23.3 (West 1993); *see also* K. Kennedy & B. Lambert, *New Developments in Municipal Services Equalization*, 3 J. CMTY. ASS'N L. 1 (2000) (illustrating that the New Jersey Municipal Services Act, which requires a municipality to provide certain public services to private communities, provides a framework for the eradication of the double taxation of these communities). Recently, Pennsylvania's legislature followed suit, passing a law that allows a unit owner in a CIC to deduct 75% of association assessments from state income taxes. H.R. 675, 2009 Gen. Assemb. Reg. Sess. (Pa. 2009). On the other hand, many of the community-provided services supplement local governmental functions rather than replace them and instead operate to replace individual upkeep costs. The trend toward municipal services equalization legislation—refunding members of a CIC local government taxes for items paid for by the association—is discussed in TREESE ET AL., *supra* note 16, at 3.

78. Under the common law, real property is owned in a column of space defined with respect to a two-dimensional real property mapping description, indicating a closed figure on the face of the earth.

79. *See* Robert C. Ellickson, *Cities and Homeowner Associations*, 130 U. PA. L. REV. 1519, 1522–23 (1982) (discussing the method of assessments and distribution of costs amongst property owners).

80. Associations meet their budget requirements through a combination of regular assessments, special assessments, and transfer fees.

81. HYATT, *supra* note 15, at 105–09. *See, e.g.*, *supra* note 73 (discussing whether an association has the authority to demand assessments from its members).

82. HYATT, *supra* note 15, at 105–17.

assessments are a community's "lifeblood" and its primary (and sometimes only) funding source.[83] As Wayne Hyatt, author of the seminal treatise on CICs, explains, "when one member of the community chooses not to pay the assessments, everyone in the community pays the price through increased assessments, decreased services, and declining community appearance and quality of living."[84]

Two aspects of association assessments are important for purposes of this discussion: their collectability and their durability. The ability to collect delinquent assessments is of crucial importance in a context—such as today—where increasing mortgage defaults indicate an even steeper increase in assessment delinquency.[85] In addition to the ability to assess charges, associations have the power to place a lien on a member's real property to secure the assessment payment obligation.[86] In some states, such liens arise and are perfected on the date the association's documents are recorded in the land records.[87] In other states, the lien arises and is perfected automatically at the time an assessment comes due.[88] Still, in other states, perfection of an assessment lien requires filing a notice of the lien in the appropriate land records.[89] Whether this lien has payment priority over a first mortgage can determine whether an association will be able to ultimately collect. Assessment liens are generally junior in priority to first mortgage liens on the units,[90] and junior interests are extinguished upon the foreclosure of a senior priority lien.[91]

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83. *Id.* at 105, 121.

84. *Id.* at 121.

85. Association assessment defaults are nsually well in advance of loan payment delinquencies. *See* Pinkerton, *supra* note 12, at 142–43 (discussing how dnes and debts create a "death spiral").

86. HYATT, *supra* note 15, at 120–21.

87. For example, in Colorado, a perfected association lien exists as of the date of filing the declaration. COLO. REV. STAT. § 38-33.3-316 (2009). Although this perfected lien could be essentially an "empty bucket" securing no indebtedness, it has statutory priority relating back to the date the community was created. First mortgages on units in such states, however, enjoy a special statutory super-priority over the pre-existing association lien.

88. Under the Uniform Common Interest Ownership Act § 3-116 (1994) (amended 2008), recording of the declaration creating a common interest community constitutes record notice and perfection of the lien for all future assessments. *See also infra* note 190 and accompanying text (explaining that the Uniform Common Interest Ownership Act takes the position that assessment liens are considered automatically perfected with the date of perfection relating back to the date the association was formed).

89. *See, e.g.*, F.N. Realty Servs., Inc. v. Or. Shores Recreational Club, Inc., 891 P.2d 671, 674 (Or. Ct. App. 1995) (finding that an association lien arises only upon recordation of notice of lien).

90. *See infra* Part I.C.2 (noting that liens on real property enjoy a priority based on the order in which they were perfected).

91. NELSON & WHITMAN, *supra* note 58, at 872–73 ("[I]f a junior lienor is forced to satisfy

CICs are contractually bound to maintain the property and provide other services mandated by the documents creating the servitude regime.[92] State and local laws may mandate the provision of other services and/or a certain level of association reserves, in addition to document-based requirements.[93] The FHA will only insure loans secured by units in communities with sufficient reserve funding.[94] Although reserve requirements support an association's future financial health, increasing the required reserves means that the association must collect additional funds today. Raising the reserve requirement can exacerbate the problem of increasing assessments for paying members in an environment of widespread payment defaults.[95] The upkeep and reserve funding obligations of the association are not contingent on the condition of the economy or the payment participation of all members, and assessments are the association's sole source of income.[96]

2. Tragedy of the Financial Commons

The legal structure of CICs was an attempt to solve the tragedy of the commons by establishing a government that could manage common resources, preventing overuse and under-maintenance.[97] Such a private consortium democracy with governance obligations and powers theoretically can create a better neighborhood for all. But since the homeowners in CICs jointly bear funding responsibilities for essential

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the senior mortgage in order to protect his or her position, the amount required for such satisfaction will be more than could have been contemplated at the time the junior interest was acquired.").

92. HYATT, *supra* note 14, at 43.

93. States require reserve studies by condominiums and homeowner associations to ensure adequate reserves are collected. *See, e.g.*, VA. CODE ANN. § 55-514.1 (2002) and § 55-79.83.1 (1993) (requiring a condominium's executive organ or a homeowner association's board of directors to conduct a study to determine the necessity and amount of reserves required at least once every five years and review the results of that study at least annually).

94. Reserve requirements are 60% of the annual budget for established condominiums and 100% of the budget for new projects. Letter from Brian D. Montgomery, Assistant Sec'y for Hous., Fed. Hous. Comm'r, to All Appr. Mortgagees and All FHA Roster Appraisers (June 12, 2009) (on file with author).

95. *See, e.g.*, Josh Brown, *Condo Assessments are the Breaking Point for Some*, VA. PILOT (Sept. 20, 2009), http://hamptonroads.com/2009/09/condo-assessments-are-breaking-point-some (explaining that a homeowner faced loss of home through association foreclosure because of an inability to pay an assessment increase to fund the increased reserve requirement mandated by statute).

96. Some associations charge user fees, but most association costs are covered exclusively by assessments paid by unit owners. *See* HYATT & FRENCH, *supra* note 14, at 319 (stating that the most common approach to financing the operations of community associations is the assessment of a share of common expense); HYATT, *supra* note 14, at 121 (noting that assessments are generally the primary funding source).

97. MERRILL & SMITH, *supra* note 43, at 772.

commons upkeep, the fiscal fortunes of the members of a community are intertwined. A change in the economic fortunes of one owner can therefore impact the other owners. Defaults of members on payment obligations cause a direct and devastating impact on the other members of the community who must fund the difference. Sam Chandan, chief economist at the real estate research firm Reis, explained the connection between the upside of joint maintenance and the downside of economic entanglement:

> What motivated people to go into the condo market in a way that led to overbuilding was the expectation that it would be easier than owning a home on a maintenance basis. The downside is that your fate is tied to 50 to 100 other people who may stop making their condo payments.[98]

Although the possibility of member assessment default had long been understood, before 2006, no one anticipated that so many highly leveraged mortgages taking so long to foreclose would eventually put a huge strain on community associations.[99] But today's delinquency rate for assessments has caused many of these associations to fail.[100] Their failure leaves the community without its expected amenities and upkeep and leaves the commons to its natural economic "tragedy" because local municipalities need not provide public services that were previously left to private associations to fund and provide.

Most courts have held that CIC associations cannot declare bankruptcy as long as they retain the power to assess for budgetary shortfalls.[101] Thus, solvent owners must fund their delinquent neighbors' deficiencies. Delinquency levels in some parts of the country have seen astronomical increases since 2005. One management firm in the Boston area reported a 150% increase in delinquent assessments from 2006 to 2007.[102] Vulnerability to increased assessments to fund neighbor shortfalls and the inability of an

98. Haughney, *supra* note 6, at C1 (quoting Chandan).

99. The closest precedent is New England in the late 1980s and early 1990s when many associations were left with debilitating budgetary shortfalls as many owners defaulted on their mortgages and other payment obligations. It was this regional crisis among CICs that led Massachusetts to adopt a six-month lien priority for CIC association liens. *See infra* note 213 (explaining that the six-month super priority in UCIOA was meant to solve this same issue, but the authors of that model legislation did not foresee that in today's climate of extensive and long-delayed foreclosure, six months would generally be inadequate).

100. *See* Pinkerton, *supra* note 12, at 125 (discussing the "crushing" nature of association debt).

101. *See infra* Part I.B.4 (explaining why it is unfeasible for condominium associations to file for bankruptcy).

102. Sacha Pfeiffer, *Delinquencies at Condos Can Cost Neighbors*, BOS. GLOBE, Oct. 16, 2007, at C1.

association to perform contractually required maintenance in the face of member default causes a significant adverse impact on the value of properties within a CIC.[103]

Where available, statistics regarding the problem of assessment delinquencies underscore the magnitude of the problem. According to a study cited by *The Miami Herald*, more than 60% of Florida condominiums and homeowner associations reported in March 2010 that at least half of their units were at least two months behind in paying their assessments.[104] Losing half of the required revenue completely hamstrings the operation of these associations. For example, Parkview Point Condominium in Miami Beach suffered a large enough loss of assessment revenue that it was unable to pay water bills for the building, and the unit owners nearly had their water cut off before solvent owners were able to raise funds to pay the arrearage.[105] The lobby ceiling repairs, however, were stopped mid-repair, leaving wiring and ducts exposed.[106] On the nation's other coast, Gas Lamp City Square in downtown San Diego awaits pending foreclosure sales on multiple units in the building while the association struggles with a $115,000 budgetary shortfall because of unpaid dues.[107] In Union City, California, a special assessment for roof repairs in Alvarado Village ended up costing each paying owner $18,494.27.[108] A couple in San Francisco reports that over the past three years, their special assessments have exceeded $100,000.[109]

Pervasive assessment default unfairly impacts the paying neighbors financially and psychologically, and anecdotal evidence underscores the reality behind the troubling statistics of unpaid community dues. Ana Martinez, for example, reported that she no longer felt safe living in her own home—a unit within a South Florida condominium that was deteriorating in the face of the association's inability to pay for

103. *See, e.g.*, Bd. of Dirs v. Wachovia Bank, N.A., 581 S.E.2d 201, 206 (Va. 2003) (Lacy, J., dissenting) ("Part of the value of a condominium unit comes from the ability of the condominium association to maintain the common areas of the development . . . . The ability to maintain these elements is directly related to the association's ability to secure payment of assessments from the individual unit owners.").

104. Rachael Lee Coleman, *Desperate Condos Thrown a Lifeline*, MIAMI HERALD, Mar. 7, 2010, at 1A.

105. Haughney, *supra* note 6, at C8.

106. *Id.*

107. *Id.*

108. James Temple, *Neighborhood Fees Go Through the Roof*, CONTRA COSTA TIMES (May 29, 2006), http://www.calhomelaw.org/doc.asp?id=487. The Alvarado Village association also blamed the large special assessment on the property developer who they claim failed to adequately fund reserves. *Id.*

109. Lloyd, *supra* note 11.

maintenance.[110] Some of Ana's neighbors had literally abandoned their units, leaving behind not only unpaid and underwater mortgage loans, but also months of unpaid condominium assessments.[111] Ana's monthly assessment tripled in response to the condominium's budget shortfall, and her property's value fell and continues to plummet in the face of lower occupancy, higher crime, and substandard common area maintenance.[112]

In a modest, low-income area of Providence, Rhode Island, Debra McGarry was forced to take out a $4800 personal credit card loan to keep water, gas, and electricity from being cut off in the eight-unit condominium building in which she lives.[113] Two of the owners in the building stopped paying dues and abandoned their homes, nearly bankrupting the small condominium.[114] Even doubling the condominium fees that the remaining six paying owners were assessed failed to generate enough capital to keep the building afloat.[115] The "affordable" unit Debra and her husband Bernard, a disabled veteran, bought in 2006 ended up being their financial "nightmare" since Debra and her solvent neighbors were left to personally pick up the tab left by lenders who failed to foreclose on strategically defaulted mortgages.[116]

The problem of assessment delinquencies is not confined to lower income owners. Many owners of ritzy Manhattan condominiums that come with top-flight amenities (gym membership, butler and maid service, billiards room, and library) can no longer afford the cost of such services because of a rash of unit owner assessment defaults.[117] In the past year, foreclosure filings for Manhattan condominiums doubled, and now, one in every thirteen units are in some stage of foreclosure.[118] Foreclosures in New York take longer than in any other state, and at the current pace, it would take lenders sixty-two years to complete foreclosure on the 213,000 homes now in severe default.[119] During the

110. Sutta, *supra* note 6.
111. *Id.*
112. *Id.*
113. Dunn, *supra* note 6, at G1.
114. *Id.*
115. *Id.*
116. *Id.*
117. Ryley, *supra* note 6.
118. *Id.*
119. David Streitfeld, *Backlog of Cases Gives a Reprieve on Foreclosures*, N.Y. TIMES, June 19, 2011, at A1 (citing calculations by LPS Applied Analytics, a real estate data firm). Even before the housing crisis, it took up to two years for property to be sold at a foreclosure sale under New York law. In the first half of 2011, the average time to complete a foreclosure in New York was 966 days, and the average time to foreclose in Florida was 676 days. While the number of foreclosure sales dropped dramatically in the first half of 2011, this does not indicate a market

several years foreclosure is pending in the current market, the non-defaulting owners in these glamorous buildings will see their own assessments increase to close the association's budgetary gap while the building services and amenities simultaneously disappear. In one Manhattan condominium, the nonpayment of just one investor—who held title to a dozen units in the building—caused the remaining members' monthly charges to jump by 15%.[120]

3. Barriers to Market Recovery

The housing market continues to implode in many localities. Sustainable home pricing and the expeditious placement of owners willing and able to meet a property's upkeep obligations are the only way out.[121] But predictable credit costs and upkeep charges are a prerequisite to stable home pricing and residential real estate investment.[122] Volatile CIC assessments stymie economic recovery. Would-be buyers, faced with uncertain future assessment increases due to financial entanglement in a CIC, are unwilling and unable to manage certain risks. Loan modifications for overburdened borrowers do not

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recovery, but is rather further testament to rampant processing delays and lender strategic delays. Les Christie, *Foreclosures Plunge in First Half of 2011*, CNN MONEY (July 14, 2011), http://money.cnn.com/2011/07/14/real_estate/housing_market_foreclosures/index.htm.

120. Ryley, *supra* note 6. The situation is different for cooperative buildings because assessment payments are characterized as rent. Thus, the cooperative can evict a defaulting owner and need not wait for the owner's lender to foreclose. In condominiums, however, the association lien is subordinate to the first mortgage lien, and typically, the association's assessment will not be paid upon foreclosure.

121. *See* BEN BERNANKE, CHAIRMAN, U.S. FED. RESERVE, SEMIANNUAL MONETARY POLICY REPORT TO THE CONGRESS 2 (July 13, 2011), *available at* http://www.federalreserve.gov/newsevents/testimony/bernanke20110713a1.pdf (opining that one key roadblock to economic recovery is "the continuing depressed condition of the housing sector"); Steven Pearlstein, *To Sort this Mess, Both Banks and Borrowers Must Own Their Mistakes*, WASH. POST, Oct. 10, 2010, at A09 (explaining that "the longer the foreclosure process goes on, the longer it will take for the excess supply of houses to be absorbed, for prices to stabilize and for the real estate market to return to something closer to a normal equilibrium"); Alexander Eichler, *Foreclosure Processing Time Has Doubled Since 2007, Backlogging Housing Market*, HUFFINGTON POST (July 1, 2011), http://www.huffingtonpost.com/2011/07/01/home-foreclosure-backlog_n_888655.html (citing *The Atlantic*'s Daniel Indiviglio's opinion that "the more foreclosures pile up, the longer it will take for the housing market to hit bottom and begin recovering").

122. While the costs of real estate investment are usually cited as high transaction costs and illiquidity, predictability of future costs and returns is often cited as one of the benefits of real estate investment. It therefore stands to reason that eroding this benefit will decrease the attractiveness of investment in the real property sector. *See* Christian Rehring, *Real Estate in a Mixed-Asset Portfolio: The Role of the Investment Horizon*, REAL ESTATE ECON., June 30, 2011, at 22 (finding that return predictability is very important to attracting real estate investors); *cf.* JOINT CTR. FOR HOUS. STUDIES HARV. U., THE STATE OF THE NATION'S HOUSING 4–5 (2011) (chronicling the declining confidence and investment in the housing sector of the economy as prices remain uncertain).

work when assessments rise so quickly that borrowers still cannot meet their reduced mortgage debt obligations while also paying association assessments. Lenders resist financing and refinancing in communities where assessment levels and the fiscal health of the association are both uncertain.[123] The possibility (or reality) of steeply rising assessments makes investors hesitant to purchase a unit when rents may not cover additional increases. As one example: the common charge for a 601 square foot studio in one Manhattan CIC is now $1095 per month, and this substantial cost has discouraged investor purchasers and financiers, even when the purchase price for the unit is set at a tremendous discount.[124] When rents will not cover assessments, ownership of a unit generates a monthly financial loss.

Lenders are as wary of the uncertain financial future of CIC properties as are would-be buyers. Mortgage financing or refinancing of a unit in a condominium or a house in a privately governed community has become vastly more difficult as banks seek information not only about the creditworthiness of their borrower, but the credit of the other members of the financially linked community.[125] Lenders have started to scrutinize a community's reserve amounts and assessment delinquency levels in an attempt to quantify the risk of assessments materially increasing.[126] A buyer of a new condominium unit in New York reported that Bank of America denied her application to refinance because the condominium association's reserve account was depleted, and 17% of the owners in her building were delinquent in paying their assessments.[127] Most lenders require that reserves be sufficiently funded and that no more than 15% of homeowners be more than thirty days delinquent on homeowner assessments before they will agree to lend on any property located in the community.[128]

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123. *See* Dina ElBoghdady, *New Condo Loan Rules Put More Scrutiny on Neighbors*, WASH. POST, Apr. 25, 2009, at A01 (noting that financing availability depends on the credit of neighboring owners in a condominium); *infra* Part II.A.1.b (discussing lending policies and risk assessment).

124. Ryley, *supra* note 6. Ryley also gives the example of a Manhattan studio that rents for $3000 a month costing $5750 a month in mortgage payments, taxes, and common charges.

125. *See, e.g.*, Lorraine Ash, *People Facing Foreclosure Should Seek Help Early*, DAILY RECORD (Mar. 19, 2011, 6:35 PM), http://www.dailyrecord.com/article/CN/20110319/NJNEWS/103190343/People-facing-foreclosure-should-seek-help-early (noting that banks look at the association finances); Matt Tomsic, *Homeowners Associations Stepping Up Legal Pressures with Foreclosures*, STARNEWS (Mar. 5, 2011, 5:01 PM), http://www.starnewsonline.com/article/20110305/ARTICLES/110309754 (noting that lenders look at the financial help of associations).

126. Ryley, *supra* note 6.

127. *Id.*

128. *HOA Delinquinces in Condos*, FREE ADVICE (Apr. 14, 2010), http://forum.freeadvice.com/buying-selling-home-40/hoa-delinquencies-condos-512763.html. *See also infra* notes 129–32 and accompanying text.

The two giants of the secondary residential mortgage market—the government-sponsored enterprises ("GSEs") Fannie Mae and Freddie Mac—likewise demand certain thresholds of reserves and non-delinquencies for CICs in which their prospective mortgage loan purchases are located.[129] For example, Freddie Mac's Condominium Unit Mortgages Project Analysis requires a budget and certification of a working capital fund, appropriate assessments levied with a minimum of 10% of the budget designated for replacement reserves and deferred maintenance, a working capital fund in an amount consistent with the remaining life of the common elements, and no more than 15% of assessments delinquent more than thirty days.[130] Freddie Mac also mandates that common elements be consistent with the nature of the project and competitive with the local market, and it requires the community to be in good financial and physical condition.[131]

The lack of financing alternatives and the threat of instability that would result if assessment delinquencies reach 15% have chilled investment in condominium properties.[132] Some investors report that they will pay only cents on the dollar because of the possibility that neighboring owners will default in paying their pro rata share of maintenance costs, rendering all units in the CIC unfinanceable.[133] Before he would agree to buy, one investor from Italy reportedly demanded a "written guarantee" from the association that he would not

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129. Fannie Mae (formerly the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation) were chartered by Congress and regulated by federal agencies. Although technically still owned by private shareholders, in September 2008, the Treasury Department placed Fannie Mae and Freddie Mac into conservatorship, reorganizing the enterprises and infusing them with new capital. At the time, this was the largest state rescue in history, to the tune of $100 billion. *See* Herbert M. Allison, Jr., President and CEO, Fannie Mae, Oversight Hearing to Examine Recent Treasury and FHFA Actions Regarding the GSEs (Sept. 25, 2008) (addressing how Freddie Mac pursued its mission to support the mortgage market, provide liquidity, and prevent foreclosures since the conservatorship began); James Lockhardt, Acting Dir., Office of Fed. Hous. Enter. Oversight (OFHEO), Testimony Before the Financial Crisis Inquiry Commission (Apr. 9, 2010), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0409-Lockhart.pdf (explaining the Freddie Mac remediation process). *See generally* Press Release, Fed. Hous. Fin. Agency, Questions and Answers on Conservatorship, http://www.fhfa.gov/webfiles/35/FHFACONSERVQA.pdf (explaining conservatorship and how it will affect the Federal Housing Finance Agency).

130. FREDDIE MAC, FREDDIE MAC CONDOMINIUM UNIT MORTGAGES 1, 3 (Apr. 2011), *available at* http://www.freddiemac.com/learn/pdfs/uw/condo.pdf.

131. *Id.*

132. Some areas of the country—New England and Manhattan in particular—faced a breakdown in the early 1990s. There is anecdotal evidence of New Yorkers during that crisis "handing over their Fifth Avenue apartments for $1 because they could not afford the maintenance fees." Haughney, *supra* note 6, at C1.

133. *Id.*

have to pay larger fees in the future (although such a guarantee is likely not enforceable against the association).[134] The fact that no one—neither banks nor buyers—willingly takes on this uncontrollable risk is more evidence that the current system is broken.[135]

Some associations have responded to their community's budgetary crisis by in-sourcing all possible costs.[136] For example, homeowners may be required to take turns mowing common area lawns, caring for common area maintenance, or even staying up all night to serve as a doorman or security guard. While these efforts may reduce the dollar contributions associations need to functiou, in-sourced upkeep actually replicates the very same collective action and free-rider problems that community governance was designed to eliminate: some people will contribute more than others, and others will be unjustly enriched by their efforts. In-sourcing just replaces the problem of increased assessments of money with the problem of increased "assessments" made in kind, and it is equally inequitable. Either way, the non-defaulting homeowners pick up the costs of the defaulting owners mortgage lenders' free ride.[137]

As an alternative to increasing assessments, associations may reduce the level of services offered to members of the community by decreasing maintenance, closing amenities, or starting to charge amenity user fees. In 2008, the Community Associations Institute conducted an informal poll and found that nearly 40% of the associations nationwide had delayed capital expenditures, and nearly 35% had raised assessments—in each case because of an increase in delinquent assessments.[138] Three years later, these numbers are likely even higher. The end result of the efforts to cut services and impose

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134. *Id.* Associations cannot guarantee limitations on future assessments unless the documents so permit because any limitation to one unit owner's obligations necessarily burdens other owners with greater costs should the association's revenue requirements increase.

135. Condominiums as a real estate product type have incurred the biggest losses in terms of market value and transactional volume. CLIFFORD TREESE, METRICS FOR THE DEPRESSED (May 2011), *available at* https://spreadsheets.google.com/spreadsheet/pub?hl=en_US&hl=en_US&key=0Apv0sov_B8cSdGpwVTd4TEwybGJFd2J3QUQ2ZnRFbXc&output=html. According to statistics compiled by LM Funding from the Hillsborough Property Appraiser's Office and Zillow.com, average values for condominiums have dropped 34% from the peak in 2005 to 2009. *Id.*

136. *Housing Associations*, DUE NORTH, http://www.due-north.com/Industries/housing-associations.aspx (last visited Mar. 21, 2011); Michelle Rindels, *Nevada Legislators Considering Reform for HOAs*, ASSOCIATED PRESS, Feb. 25, 2011, *available at* http://www.kolotv.com/home/headlines/Nevada_Legislators_Considering_Reform_for_HOAs_116980213.html; Vitali, *supra* note 46.

137. *See* Lemley, *supra* note 69, at 1057 (discussing the consequences of free riding); *infra* Part II.B.1 (discussing how lenders benefit from upkeep pre-foreclosure).

138. Bayles, *supra* note 11.

more costs on owners is the same: significant decline in a community's property values and a community government that ceases to function effectively.[139]

4. Association Bankruptcy

Community associations cannot seek relief from their financial obligations in bankruptcy, even if their obligations outpace their revenues. Condominium associations typically have no assets of their own,[140] and homeowner associations are prohibited by their governing documents from selling their assets or otherwise seeking to raise revenues in ways not foreseen and explicitly authorized in their covenants.[141] These entities perform primarily (or exclusively) governance and maintenance roles. Although it is nearly impossible to file bankruptcy as a pass-through entity, it is also practically impossible for an association to function if a significant amount of the units are in arrears. Once more than 15% of unit owners are delinquent in their assessment payments, FHA insurance and Fannie Mae loan qualification becomes unavailable for purchaser mortgages on units in that community.[142] At that level of delinquency, neither associations nor their member owners can obtain financing.

Bankruptcy law currently offers no good solution.[143] Courts generally disallow bankruptcy filings by community associations

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139. *See* HYATT, *supra* note 14, at 121 (stating that cutting services and charging user fees for amenities may cause disrepair of the common and recreational facilities, resulting in a decline in property values within the community). A similar fate befell Alaskan condominiums when workers abandoned their units and moved away after the completion of the Alaska pipeline. *See* MIN DIXON, WHAT HAPPENED TO FAIRBANKS? THE EFFECTS OF THE TRANS-ALASKA OIL PIPELINE ON THE COMMUNITY OF FAIRBANKS, ALASKA 295–96 (1980) (explaining that a housing shortage resulted from a lack of certainty regarding the housing that an industry was to supply its employees and the disposition of that housing after the construction period had terminated).

140. In condominium ownership, the unit owners hold title to all common areas as tenants-in-common, and the association's role is purely one of governance.

141. HYATT, *supra* note 14, at 109–12.

142. U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-19, CONDOMINIUM APPROVAL PROCESSS—SINGLE FAMILY HOUSING (June 12, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-19ml.doc; U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-46 A, TEMPORARY GUIDANCE FOR CONDOMINIUM POLICY (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46aml.pdf; U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-46 B, CONDOMINIUM APPROVAL PROCESS FOR SINGLE FAMILY HOUSING (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46bml.pdf.

143. Professor Evan McKenzie calls association bankruptcy attempts "disaster[s]" that accomplish nothing. Joseph Dobrian, *Condominium Associations Hard Hit by Foreclosures Consider Bankruptcy*, J. PROP. MGMT., May/June 2010, at 32 (quoting McKenzie). Recently, scholars have called for reformation of the Bankruptcy Code to offer some relief to beleaguered condominium associations. Pinkerton, *supra* note 13, at 142–46 (citing the inescapable "death

because the associations have assessment powers, and courts can force associations to levy assessments on unit owners to pay for association debt.[144] Because an association can theoretically make special assessments to make up any budgetary shortfall, an association's inability to pay its obligations is seen as a revenue problem rather than as a debt or asset problem. Only if all the members of the association are themselves insolvent does the actual ability of an association to meet its debts become imperiled.[145]

There have been very few exceptions to this general rule, and each has presented an atypical case. For example, in the recent bankruptcy case filed in Florida by Maison Grande Condominium, the association entered into a long-term recreation lease with an escalation clause and faced inability to meet this obligation when 25% of its units became delinquent while lease fees rose astronomically.[146] The association filed a petition for Chapter 11 bankruptcy seeking to reject the lease, and the bankruptcy judge in that case permitted the lease rejection.[147] The court noted that the board of directors had concluded that further increases of assessments would be unavailing because unit owners had advised the board that they lacked the ability or willingness to pay.[148]

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spiral" of association unpaid dues and debt).

144. *See* White v. Cox, 95 Cal. Rptr. 259, 263 n.3 (Cal. Ct. App. 1971) (stating that a condomium owner may satisfy his portion of any liability arising from the association by the payment of his proportionate share of the liability); HYATT & FRENCH, *supra* note 14, at 591; NATELSON, *supra* note 61, at 328–31; Donald L. Schreifer, *Judicial Action and Condominium Unit Owner Liability: Public Interest Considerations*, 1986 U. ILL. L. REV. 255, 262–65 (1986) (explaining that at least a share of the debt may be collected from any member who has been named and served in the absence of a statute to the contrary); Jessica Meyers, *HOA Bills Start to Get Spotlight*, DALL. NEWS (Mar. 7, 2011, 10:05 AM), http://trailblazersblog.dallasnews.com/archives/2011/03/hoa-bills-start-to-get-spotlig.html; *cf. In re* Rivera, 256 B.R. 828, 830–36 (Bankr. M.D. Fla. 2000) (denying as moot and unnecessary a homeowner association's "Motion for Reconsideration of Order denying Motion to Compel Debtor to Reaffirm, to Redeem, or to Surrender, and to Withhold Entry of the Discharge Pending Consideration of this Motion or Alternately to Dismiss," because post-petition homeowner association assessments survived a Chapter 7 discharge as a condition of continued ownership of a lot subject to such assessment), *superseded by statute*, 11 U.S.C. § 523(a)(16) (2006).

145. *See* Pinkerton, *supra* note 13, at 147–64 (discussing the insolvency and condominium association debtors).

146. *In re* Maison Grande Condo. Ass'n, 425 B.R. 684, 687–88 (Bankr. S.D. Fla. 2010).

147. *Id.* at 689, 707.

148. *Id.* at 688 ("Some owners advised members of the Board that they lacked the financial resources to pay additional assessments. Others advised the Board that they would refuse to pay additional assessments that were only necessitated by other owners not paying their fair share. The Board also took into consideration the demographics of the unit owners, including the fact that many [were] elderly and on fixed incomes." (citation omitted)). Chapter 11 Bankruptcy offers an association the only hope of bankruptcy relief, but even that avenue is uncertain and perilous. *See* Pinkerton, *supra* note 12, at 155–65 (asserting that Chapter 7 is "not a good option for condominium associations" and that while Chapter 11 "might work," the association faces many problems with that route as well); *see also* Kristen L. Davidson, *Bankruptcy Protection for*

This case, however, is an anomaly and upon closer reading, seems to be predicated on a finding that the subject lease's escalation clause was unenforceable in Florida as against public policy.[149]

More typical is the approach of another Florida bankruptcy case, in which the court adamantly rejected the association's proposed Chapter 7 bankruptcy.[150] In this case, the association sought to dissolve and reform to avoid payment obligations to a roofing vender that it could not meet without significant increases to assessments.[151] The court rejected this plan, calling the association's attempt to avail itself of bankruptcy protection bad faith.[152] Carla Barrow, counsel to the roofing company, noted that at least eight other condominiums had also filed for some sort of bankruptcy protection in South Florida, attempting to avoid paying for roof repairs,[153] but such attempts are unlikely to be successful. In 2010, Florida passed the Distressed Condominium Relief Act, which, among other things, specifically empowers associations to take stronger measures to recover revenues from non-paying owners and permits "bulk assignees" and "bulk buyers" to take over unsold developer condominium inventory, assuming assessment obligations but not other liabilities of the original developer.[154]

Without bankruptcy as a potential escape from financial obligations in excess of collected funds, associations with assessment delinquencies are left with only one alternative: increase assessment amounts and hope the paying members will make up the shortfall. Charging paying members more to make up for neighbor defaults is not only unfair,[155] but it is unlikely to actually save the community from de facto insolvency. As the court in *Maison Grande* noted, increased assessments will likely increase delinquencies.[156] Increased delinquencies lead to increased assessments that can further increase delinquencies, requiring still greater increases of assessments (*ad infinitum*). Barring some ability to actually recover from non-paying

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Community Associations as Debtors, 20 EMORY BANKR. DEV. J. 583, 616–25 (2004) (discussing the difficulty that courts have in applying bankruptcy laws to community associations).

149. *In re Maison Grande*, 425 B.R. at 702.

150. *In re* Boca Village Ass'n, 422 B.R. 318, 327 (Bankr. S.D. Fla. 2009).

151. *Id.* at 325.

152. *Id.* at 321–25.

153. Dobrian, *supra* note 143, at 33.

154. S.B. 1196, 2010 Sess. (Fla. 2010) (adding new Sections 718.701–708 to the Florida Statutes through the "Distressed Condominium Relief Act").

155. *See* Hart, *supra* note 5, at 185 ("[W]hen a number of persons conduct any joint enterprise according to rules and thus restrict their liberty, those who have submitted to these restrictions when required have a right to a similar submission from those who have benefited by their submission.").

156. *In re* Maison Grande Condo. Ass'n, 425 B.R. 684, 688 (Bankr. S.D. Fla. 2010).

owners or properties, the only remaining solution is to have a public (state, local, federal) government step in and bail out communities that are unable to collect sufficient revenues from their members.[157] Private government failure mirrors local government failure (when tax revenues are insufficient to maintain the community), but unlike community associations, municipalities can, in fact, declare bankruptcy.[158]

C. Payment Collection and Lien Priority

1. Association Collection Efforts

Because of the difficulty of enforcing payment obligations in privately governed communities, conventional wisdom holds that an association board should act quickly in response to nonpayment of assessments. An association with delinquent members has the ability to enforce its payment obligation in several ways. Associations may be able to use self-help by denying a delinquent owner the right to use common elements or by suspending the owner's voting rights.[159] For example, a nonpaying unit owner may be barred from using a community amenity such as a swimming pool or health club. The

157. *See* Dobrian, *supra* note 143, at 34 ("The main burden of dealing with troubled condo associations will fall on local governments, which are seldom experienced in such matters.") (quoting Professor Evan McKenzie).

158. 11 U.S.C. § 109(c)(1) (2006). Chapter 9 of the Bankruptcy Code provides for reorganization of municipalities, which includes cities, towns, villages, counties, taxing districts, municipal utilities, and school districts. *E.g.*, *Municipality Bankruptcy*, U.S. COURTS, http://www.uscourts.gov/federalcourts/bankruptcy/bankruptcybasics/chapter9.aspx (last visited Aug. 16, 2011). It does not, however, cover common interest communities. Municipal bankruptcy legislation has a history of constitutional fragility. *See, e.g.*, Ashton v. Cameron Cnty. Water Improvement Dist. No. 1, 298 U.S. 513, 530–32 (1936) (striking down as incompatible with the Tenth Amendment the initial attempt by Congress to craft bankruptcy protection for local governments). According to the federal government, in the more than sixty years since Congress established a constitutionally viable municipal bankruptcy procedure, there have been less than 500 governmental bankruptcy petitions filed. *Municipality Bankruptcy*, *supra*. Those filings that do occur, however, are typically extreme cases in large municipalities (e.g., Orange County, CA) and can involve many millions of dollars in municipal debt. MARK BALDASSARE, WHEN GOVERNMENT FAILS: THE ORANGE COUNTY BANKRUPTCY 7 (1998).

159. HYATT, *supra* note 14, at 121–22; *see also* How v. Mars, 513 N.W.2d 511, 516 (Neb. 1994) (holding that both the association bylaws and Nebraska's nonprofit corporations code permitted the association to deny delinquent owners the right to vote in the community). *But see* Mountain Home Props. v. Pine Mountain Lake Ass'n, 185 Cal. Rptr. 623, 630 (Cal. Ct. App. 1982) (holding that California law bars a community association from denying membership privileges to a new member because of the unpaid association debts of the new member's predecessors in interest). In most cases, private governments are able to suspend voting rights of members due to non-payment of assessments even though public governments may not suspend the right to vote based on non-payment of taxes. For example, a Florida law passed in July 2010 clarifies the availability of this type of self-help in that state. S.B. 1196, 2010 Sess. (Fla. 2010). For further discussion of how assessments in communities are similar to and yet distinct from taxes, see *infra* Part II.A.3.

extent to which services may be denied, however, depends on state law. For example, a Texas court permitted an association to turn off the utilities of a delinquent owner,[160] but few states permit the discontinuance of essential services, such as heat, water or electricity.[161]

If such efforts fail, an association can commence an action to collect a debt against the non-paying owner. Federal case law is split on the issue of whether association assessments are debts for the purposes of the 1966 Fair Debt Collection Practices Act, 15 U.S.C. § 1692 (2006), which would require certain explicit warnings and notices to be served prior to collection efforts.[162] To the extent an association complies with any such applicable laws, it can thereafter bring lawsuits against delinquent owners personally, claiming breach of contract and seeking damages equal to the unpaid assessment amounts.[163] Collection based on a judgment against the owner can proceed like any other debt collection (garnishing wages, seizing assets, enforcing a judgment lien, etc.).[164] Bringing a lawsuit, however, can be costly to the association in terms of time and attorney fees, and the paying owners—those who are already bearing the costs of their neighbors' delinquencies—will have to foot that bill unless the delinquent owner or responsible party can

160. San Antonio Villa Del Sol Homeowners Ass'n v. Miller, 761 S.W.2d 460, 465 (Tex. App. 1988) ("Clearly, a condominium dweller who does not pay his share of the maintenance fee, admits that the other owners are in essence paying his way, and fails to respond to notice of disconnection is in violation of the meaning and intent of the [by-laws]. The Association took appropriate action to abate this condition.").

161. *See, e.g.*, N.Y. GEN. BUS. LAW § 352-eee(4) (McKinney 2011) (prohibiting a property owner who wishes to convert a building to cooperative or condominium ownership from the "interruption or discontinuance of essential services, which substantially interferes with or disturbs the comfort, repose, peace or quiet of any tenant in his use or occupancy of his dwelling unit or the facilities related thereto."). Among property managers, the belief is that the most efficient way to collect unpaid assessments is to turn off community-provided cable or satellite television services where law permits. *See* Polyana da Costa, *Associations Get Creative in Punishing Delinquencies*, MIAMI DAILY BUS. REV., Nov. 23, 2010, at A1 (discussing legal and prohibited methods of encouraging assessment compliance); *see also* Mark Leen, *Condo Utilities May Be At Mercy of Assessments*, KING CNTY. BAR ASS'N BAR BULLETIN, 2009, *available at* http://www.kcba.org/newsevents/barbulletin/archive/2009/09-07/article18.aspx (discussing why cutting services off to a unit is "particularly effective").

162. *Compare, e.g.*, Bryan v. Clayton, 698 So. 2d 1236, 1237 (Fla. Dist. Ct. App. 1997) (assessments are not covered by the Act) *with* Newman v. Boehm, Pearlstein & Bright, Ltd., 119 F.3d 477, 479 (7th Cir. 1997) (finding that a past due assessment is a "debt" under the Act).

163. *See* HYATT, *supra* note 14, at 119 (discussing a typical collection process for an association against a delinquent owner, including filing a lawsuit against the delinquent owner personally, in addition to filing a lien on the delinquent owner's unit).

164. *See infra* Part I.C.1 (discussing association collection efforts). The priority of any such judgment lien, however, will be subordinate to any mortgages or other obligations currently secured by the property, and thus, perfecting the association's assessment lien likely offers a better chance for ultimate recovery.

obtain the costs of collection.[165] Nevertheless, these sorts of collection actions are how the bulk of unpaid assessments are eventually collected.[166]

The lien on the defaulting owner's property that association covenants create for delinquent assessments is another tool for delinquency recovery.[167] The lien guarantees that the association will be paid out the proceeds of any resale, after all senior interests are satisfied. Furthermore, a lien for unpaid assessments clouds the owner's title and can be used as leverage to convince an owner who is seeking clear title (for sale or financing) to pay up. A last resort for associations is to foreclose on the property lien securing the assessment obligation.[168]

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165. *See* HYATT, *supra* note 14, at 121 (discussing the substantial amount of time it takes to foreclose on a lien and collect a judgment, the low price a sheriff's sale may generate, and that the availability of wage garnishment is dependent on the delinquent owner having an income).

166. *See, e.g.*, KATZMAN GARFINKEL & BERGER, COMMUNITY ASSOCIATION ASSESSMENT COLLECTION AND FORECLOSURE 14–15 (2011), *available at* http://www.canfl.com/pdfs/KGBcollFAQs_sm.pdf (explaining the benefits of collection actions).

167. *See* Pinkerton, *supra* note 13, at 143 ("Functionally, condominium associations only possess one remedy to recover their expenses from delinquent unit owners. They can obtain a lien on the unit for the amount owed to the association by that unit owner. The association can then foreclose on its lien if the debt remains unpaid. However, this remedy is not very useful in the face of many states' laws concerning the relative priority of mortgages."). The association lien has always been used as a practical means to induce voluntary compliance with assessment obligations rather than as a means to collect from the asset's value directly via foreclosure (although the viable threat of foreclosure can motivate payment). The problem arises in situations where a homeowner is already facing foreclosure (under the mortgage) and the owner's equity is gone. The association in such cases loses its power to motivate compliance. At this point, the only other interest holder of the property who still has a stake in its value is the first mortgagee, which is why eroding that priority position may incentivize a lender to pay, or cause a borrower to pay, assessments. A lender would be motivated to pay to preserve its own collateral value if its claim on the property would diminish should assessments remain delinquent.

168. *See, e.g.*, UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (amended 2008) (outlining enforcement of lien for sums due the association, including foreclosure); Societe Generale v. Charles & Co. Acquisition, Inc., 597 N.Y.S.2d 1004, 1009 (N.Y. Sup. Ct. 1993) ("[A] condominium's lien for unpaid common charges may be foreclosed in the same manner as a mortgage on real property . . . ."). Some state laws limit recovery for debt repayment from foreclosure of a homestead. Homestead exemptions protect a certain amount of equity from sale to satisfy a debt. In Missouri, for example, the first $15,000 of debt is exempted as the owner's homestead. MO. REV. STAT. § 513.475 (2002). Florida, Texas, Oklahoma and Colorado have virtually unlimited homestead exemptions. *See, e.g.*, TEX. PROP. CODE ANN. § 41.001 (West 2010) (providing that a homestead is "exempt from seizure for the claims of creditors except for encumbrances properly fixed on homestead property," which include: (1) purchase money; (2) taxes on the property; (3) work and material used in constructing improvements on the property; (4) an owelty of partition; (5) the refinance of a lien against the homestead; (6) an extension of credit subject to certain conditions including security by a voluntary lien; and (7) a reverse mortgage which meets certain requirements); *Id.* § 52.001 (attaching judgment liens to real property except that property exempt from seizure or forced sale under Chapter 41, the Texas Constitution, or any other law). Mortgage lenders typically require an explicit waiver of this statutory protection of borrower equity.

How useful association foreclosure is as an enforcement tool depends greatly on the perfection and priority regime of the applicable state.[169] A first mortgage loan on a particular unit in a CIC enjoys senior priority to the association's assessment lien in all states, although the first mortgage priority is subject to a capped payment priority association lien in several states.[170] In those states lacking a six-month super-priority for assessment liens, the association will only be able to recover from the sale if foreclosure proceeds exceed the senior loan amount.[171]

Depending on the jurisdiction, lien foreclosures are effected either by a sale in a court action in equity or by private power of sale granted in the security instrument.[172] Judicial foreclosure is the exclusive method of foreclosure in over one-third of the states,[173] and it is available in

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Similarly, association declarations may purport to waive application of the homestead exemption for foreclosure of the association lien. Many states have passed statutes explicitly carving out CIC associations from the applicability of such limitations. The Colorado statute expressly authorizes an association to ignore the homestead exemption otherwise applicable in that state. BA Mortg., LLC v. Quail Creek Condo. Ass'n, 192 P.3d 447, 451 (Colo. App. 2008). Texas, a state with a very broad homestead exemption, allows association foreclosure to circumvent this limitation. Inwood N. Homeowners' Ass'n v. Harris, 736 S.W.2d 632, 637 (Tex. 1987). In other states, the applicability of the homestead exemption to association lien foreclosure proceedings is less clear. *See, e.g.*, Andres v. Indian Creek Phase III-B Homeowner's Ass'n, 901 So.2d 182, 182–83 (Fla. Dist. Ct. App. 2005) (expressing, in dicta, doubt that covenants purporting to waive the state's homestead exception would he effective); Knolls Condo. Ass'n v. Harms, 781 N.E.2d 261, 267–69 (Ill. 2002) (holding that the homestead exemption did not preclude the association suing for possession of a defaulting unit hut not reaching the question of whether it would preclude foreclosure of the association's lien).

169. *See* HYATT, *supra* note 14, at 120–21 (discussing the practical value of an association's lien rights as dependent upon the state law authority for the lien, procedures for perfection and enforcement, and lien priority). In some states, perfection of the lien is automatic. In other states, a filing is required to perfect the lien. State law may require re-filing to maintain perfection. For example, in New Hampshire, a notice of an association's lien must be re-filed every six months to retain perfection. N.H. REV. STAT. ANN. § 356-B:46, III (LexisNexis 2010). States specifically prescribe the method of foreclosure and the process required in order to legally foreclose on real property. In addition, certain states have attempted to limit the power of associations to foreclose based on unpaid assessment liens. For example, in 2004, a bill in California that would have set a threshold of $2500 of unpaid assessments before an association could pursue foreclosure was vetoed by Governor Arnold Schwarzenegger. *See* Jim Wasserman, *Schwarzenegger Rejects Ban on Foreclosures*, ASSOCIATED PRESS, Oct. 1, 2004, *available at* http://www.calhomelaw.org/doc.asp?id=462 (discussing Governor Schwarzenegger's veto of a bill that would have required associations to use small claims courts, instead of nonjudicial foreclosure, to collect unpaid debts under $2500).

170. *See infra* Part I.C.2 (discussing assessment lien priority).

171. *See, e.g.*, Bd. of Dirs. of Olde Salem Homeowners Ass'n v. Sec'y of Veterans Affairs, 589 N.E.2d 761, 764 (Ill. App. Ct. 1992) (finding that a buyer at a mortgage foreclosure took the property free of assessments accruing prior to recording of the deed, which were extinguished by the foreclosure action); Long Island Sav. Bank, F.S.B. v. Gomez, 568 N.Y.S.2d 536, 537 (N.Y. Sup. Ct. 1991) (finding that an association's junior lien was extinguished by foreclosure of the senior priority mortgage).

172. NELSON & WHITMAN, *supra* note 58, at 600–01, 633.

173. *Id.* at 601 n.1. Judicial foreclosure is the exclusive or generally used method in

every jurisdiction.[174] Judicial foreclosures are complicated, costly, and time-consuming compared with non-judicial foreclosures pursuant to a power of sale.[175] Some states that permit a mortgage containing an explicit power of sale to be non-judicially foreclosed will likewise permit non-judicial foreclosure of association liens. Such states have a separate foreclosure statutory provision dealing solely with association liens.[176]

Most associations, as well as owners and legislatures, view the foreclosure of an assessment lien as "a last resort" for two reasons.[177] First, foreclosure proceedings—even in states permitting non-judicial foreclosure of association liens—involve significant upfront costs such as advertising, auction, and legal fees. These costs would have to be borne by the neighborhood as a whole, unless they can be recovered from the delinquent owner. Second, a buyer who purchases at an association foreclosure would take the property subject to a first priority mortgage lien unless that loan amount is paid off.[178] This vastly

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Arkansas, Delaware, Florida, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Montana, Nebraska, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, South Carolina, and Wisconsin. In two other states, Connecticut and Vermont, foreclosure is judicial but is not a public sale; rather, it is a transfer of ownership to the lienor (called strict foreclosure).

174. In some states, an explicit statutory right to foreclose through the court exists. In others, judicial foreclosure is available as an incident to the jurisdiction of courts of equity. *See* Lansing v. Goelet, 9 Cow. 346, 366, 403 (N.Y. 1827) (holding that the decree for the sale of mortgaged premises was within the inherent powers of a court of equity, in addition to a statutory right to foreclose through the court).

175. STEVEN W. BENDER ET AL., MODERN REAL ESTATE FINANCE AND LAND TRANSFER 419–21 (4th ed. 2008); NELSON & WHITMAN, *supra* note 58, at 601–02.

176. *E.g.*, Property Owners' Association Act, VA. CODE. ANN. tit. 55 § 516 (2007) (titled "Lien for Assessments"); Maryland Condominium Act, MD. CODE ANN., REAL PROP. § 11-110 (West 2003), *amended by* Act of May 10, 2011, ch. 387, H.B. 1246 (effective Oct. 1, 2011).

177. Benny L. Kass, *Condo Board Can Foreclose for Delinquent Fees*, WASH. POST, Feb. 14, 2009, at F4; *see also* Baker v. Monga, 590 N.E.2d 1162, 1164–65 (Mass. App. Ct. 1992) (holding that a unit valued at $350,000 could be foreclosed for the owner's nonpayment of assessments totaling less than $3000). A recent unsuccessful bill in California attempted to place a significant cost threshold on when an association could pursue foreclosure to enforce its lien for unpaid assessments. S.B. 1682, 2003–2004 Reg. Sess. (Cal. 2004).

178. Junior priority liens are wiped out by foreclosure and, after paying amounts owed to the association, are distributed to such lienors in order of priority, but buyers at the foreclosure of a junior lien take subject to senior liens. Most courts have held, and scholars have opined, that this "subject to" means that a junior lien foreclosure transfers the property with the senior liens intact but unpaid. NELSON & WHITMAN, *supra* note 58, at 611–14; *see also, e.g.*, Shaikh v. Burwell, 412 S.E.2d 924, 926 (N.C. Ct. App. 1992) ("If the trustee is only foreclosing on the junior deed of trust, the senior lien continues with the property and the trustee must sell subject to the senior lien."). In a puzzling recent Virginia decision, however, foreclosure of an association's junior lien was misinterpreted to mandate payment of the first mortgage, rather than as a sale of property subject to a first mortgage lien. Bd. of Dirs. of the Colchester Towne Condo. Council of Co-Owners v. Wachovia Bank, N.A., 581 S.E.2d 201, 206 (Va. 2003). The Supreme Court of Virginia, over a vigorous dissent, interpreted the statutory authority to foreclose the unit "subject to prior liens" to mean that proceeds of the association's foreclosure sale must be used first to

decreases the ability of the association to find a third-party buyer at such a sale. In fact, in today's environment of underwater properties, finding an interested third-party buyer at a junior lien foreclosure would be unlikely at best.

In the absence of a third-party buyer, the association in an assessment foreclosure would be forced to take title to the unit itself. While this strategy might allow an association to rent out a unit and pay rental proceeds toward association costs, this approach is risky.[179] Once an association takes title to a unit, it becomes responsible for the assessments on that unit, which means that the unit's assessment obligations will continue to be spread among the paying owners in the community—precisely the unsatisfactory result that collection efforts against the prior owner were trying to avoid in the first place. As the owner, the association also becomes liable for property taxes, meaning that yet another cost is passed on to the community. Although the association could theoretically mitigate these costs by renting out the unit, this would entail the association becoming a landlord, exposing the community to the various risks and liabilities of assuming that role.[180] Even if an association is willing to serve as a landlord, rental properties

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satisfy the lien of the first deed of trust before any delinquent assessments are reimbursed. *Id.* at 203–04. The doctrinal basis of this holding seems misconstrued. The majority cites principles of interpretation—that a statute should be read to be internally consistent—to support its conclusion. *Id.* at 203. But the asserted inconsistency seems to arise from the court's complete misunderstanding of secured transactions law. The court states that by granting first mortgage liens super priority in Virginia Code section 55-79.84(A), the Virginia Legislature implicitly required the judicial reformation of the statutory repayment waterfall in an association foreclosure, as contained in Virginia Code section 55-79.84(I)(5)(c). *Id.* at 203–04. As the dissent noted, this interpretation "is inconsistent with that phrase's well-understood and long accepted meaning." *Id.* at 205 (Lacy, J., dissenting). Justice Lacy also notes that there is nothing ambiguous or inconsistent in the statute that requires judicial re-writing of the language to reach the majority's result, chiding that "we generally do not engage in adding words to a statute." *Id.* While this decision runs contrary to nearly every other interpretation of the term "subject to," the Virginia General Assembly has thus far been unable to pass legislation correcting this judicial precedent. *See* S.B. 411, 2010 Sess. (Va. 2010) (stricken Jan. 27, 2010) (attempting to clarify the statute by adding language that states that the term "subject to" means that liens to which an association's lien is subordinate "shall survive the sale and be binding upon the purchaser at such sale").

179. *See, e.g.*, Daniel Vasquez, *Should Condo Associations Rent Units in Foreclosure?*, SUN SENTINEL (Mar. 18, 2009), http://articles.sun-sentinel.com/2009-03-18/news/0903170451_1_rent-units-condo-associations-foreclosure-action (explaining the various costs and liabilities that an association incurs when it becomes a landlord of units it acquires in assessment foreclosure proceedings).

180. *See, e.g.*, Matt Humphrey, *HOA Foreclosing to Rent Units? First Know the Risks*, HOALEADER.COM (Mar. 25, 2011), http://www.hoaleader.com/public/554.cfm (warning that an association becoming a landlord of a unit acquired in foreclosure is "very dangerous" because it "opens the association up to economic liability"). *But see* Gehrke-White, *supra* note 13 (explaining that in the context of long bank foreclosure delays, condominium association foreclosure and renting of units is the only way to obtain assessment funds from defaulting units).

that are subject to pending mortgage foreclosure—and therefore potentially terminable with little advance notice—would likely fetch rentals that are far below market. The depressed rental revenue may not be enough to pay property taxes and assessment charges on the unit.[181]

Generally, senior lienholders cannot be joined in a foreclosure action involuntarily.[182] Some dated case law supports the contention that a junior lienor may join a senior lienor in a combined foreclosure proceeding when the senior loan is also in default and is due and payable.[183] In the unlikely event that this doctrine would gain new traction, it could permit foreclosing associations to join a lender and potentially safeguard its lien in a sufficient sale or, at least, speed the process of senior lien foreclosure, giving associations the legal ability to self-protect in an environment of lender foreclosure delays. Most courts today, however, agree that a lienor has the right to choose the timing of foreclosure of its lien.[184]

2. Priority Baseline

As a general rule, liens on real property enjoy a priority based on the order in which they were perfected.[185] This first-in-time basic presumption is usually subject to a handful of exceptions under state law, including municipal real property taxes, which always enjoy the highest lien priority.[186] In addition, most states set the priority of a mechanic's lien supporting payment obligations for work done to the

181. *See* Bruce Rogers, *Collecting Delinquent Assessments: Why the Old Ways Won't Work and How to Play the Association's Cards in the Great Recession*, LM FUNDING LLC, 1, http://www.lmfunding.com/assets/Collecting-Delinquent-Assessments-in-Todays-Market.pdf (last visited Oct. 30, 2011) (explaining that current economic reality is why only 4% of associations with delinquent assessments foreclose on their liens).

182. NELSON & WHITMAN, *supra* note 58, at 611; *see also, e.g.*, Osage Oil & Ref. Co. v. Mulber Oil Co., 43 F.2d 306, 308 (10th Cir. 1930) (holding that the junior lienor cannot enforce a sale for more than its own equity of redemption without consent of the senior lienor).

183. *See, e.g.*, Hefner v. Nw. Mut. Life Ins. Co., 123 U.S. 747, 754 (1887) (holding that when a first mortgagee's debt is due and payable, the first mortgagee may be made a party); Hagan v. Walker, 55 U.S. 29, 37 (1852) (holding that a senior lienor may be a "necessary party" to a foreclosure, when the senior lienor is also in default, so that "a sale may be made of the whole title"); Masters v. Templeton, 92 Ind. 447, 451–52 (1883) (allowing a junior mortgagee to join a senior mortgagee so that the "ultimate rights of the parties" may be determined in one action); Peabody v. Roberts, 47 Barb. 91, 102 (N.Y. 1866) (allowing a junior mortgagee to proceed with a foreclosure action despite a prior foreclosure and sale under the senior mortgage). Even as late as 1992, the court in *Shaikh v. Burwell* cited six possible "special circumstances" that would enable a junior lienor to join a senior lienor in a foreclosure action. *Shaikh*, 412 S.E.2d at 927–28.

184. NELSON & WHITMAN, *supra* note 58, at 612. This creative approach is similar to the "mortgage terminator" approach that has recently been used on occasion in Florida. *See infra* Part II.A.2 (discussing creative strategies used by attorneys in seeking recovery for their clients).

185. BENDER ET AL., *supra* note 175, at 123.

186. *Id.* at 271–73.

real property itself as relating back to the date on which such work was commenced.[187] In the absence of a statutory directive to the contrary, assessment liens follow the general first-in-time priority rule, and because mortgage loans are typically funded prior to assessment delinquencies, such first mortgage liens are senior to assessment liens.[188] The California Condominium Act, for example, explicitly follows the first-in-time rule, setting lien priority according to the time a separate "notice of delinquent assessment" is filed in the land records.[189]

In some states, assessment liens are considered automatically perfected with the date of perfection relating back to the date on which the association was formed (when the declaration was filed in the land records).[190] However, statutes defining priority in such states specifically make an exception for first mortgage liens on individual units within the community, permitting the first mortgage to always enjoy a priority senior to the association lien, even though the first-in-time rule would otherwise deem the related-back perfected association lien to be first.[191] For example, the Virginia Condominium Act provides that the assessment lien is subordinate to "sums unpaid on any first mortgages or first deeds of trust recorded prior to the perfection of said lien for assessments and securing institutional lenders."[192]

187. *See, e.g.*, CAL. CIV. CODE §§ 3134, 3137 (West 1993) (providing that liens for site improvements have priority based on the commencement of site improvements); 770 ILL. COMP. STAT. ANN. 60/16 (West 1989) (providing that no encumbrances placed upon land shall operate before a lien in favor of work done or materials furnished has been satisfied).

188. An increasing number of states have statutorily created a limited priority for such liens. *See infra* Part II.A (discussing some attempted and proposed solutions to the problem of assessment nonpayment and foreclosure delay). Some states define the time of perfection for association liens as relating back to the date on which the assessment was due. *See infra* note 190 and accompanying text.

189. CAL. CIV. CODE § 1367.1(b), (d) (West 2011).

190. The UCIOA takes this approach. *See* UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (1994), *available at* http://www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/ucioa94.htm (stating that recording of the declaration constitutes record notice and perfection of the lien); *see also* FLA. STAT. ANN. § 718.116(15)(a) (West 2011) (providing that the lien is effective dating back to the recording of the original declaration); TEX. PROP. CODE ANN. § 82.113 (West 1997) (providing that the association's lien for assessments is created by recordation of the declaration, which constitutes perfection); *see also, e.g.*, American Holidays, Inc. v. Foxtail Owners Ass'n, 821 P.2d 577, 580 (Wyo. 1991) (deeming the date the declaration was recorded as the date of perfection for assessment lien).

191. *See, e.g.*, COLO. REV. STAT. ANN. § 38-33.3-316 (LexisNexis 2010) (providing that any security interest created before the assessment becomes delinquent has priority over the assessment lien). This way of conceptualizing the priority of association liens likely originated with the FHA Model Condominium Act of 1961. In some cases, the priority granted to first mortgage liens is subject to a capped super-priority. *See infra* Part II.A (discussing capped "super priority" liens).

192. VA. CODE ANN. § 55-79.84A (LexisNexis 2007).

Arizona's Condominium Act protects first mortgage priority even further, providing that such liens are always superior to assessment liens regardless of when they arose.[193] Maryland and North Carolina also deem an association lien completely subordinate to first mortgage liens on units within the community.[194] In states where the statute is arguably vague as to the priority position of the first mortgage, courts have clarified that even an assertion of super-priority in the declaration establishing the community will not create a priority superior to a first mortgage lien.[195] Thus, regardless of jurisdiction, first mortgages on units within a community are senior in priority to association liens for unpaid assessments. Legislatures and courts cite a policy of promoting financing availability as the motivation for this priority scheme.[196]

Holders of junior claims on the property (both liens and holders of equity) must be joined in a foreclosure proceeding to terminate their rights.[197] Because the association is a junior lienor, a foreclosing first mortgage loan is required to name the association as a necessary party to the foreclosure proceeding, and any excess sale proceeds beyond the amount owed on the first mortgage will be applied to the association's claim. However, where mortgages are under-collateralized, foreclosure sales typically do not obtain sufficient proceeds to pay off the first mortgage, let alone junior liens. Whether paid off or not, junior liens are wiped out in foreclosure of the senior lien.

Courts and legislatures in some states have attempted to limit the extent of association losses and protect community members against non-payment of assessments, even those lacking any priority protection with respect to first mortgages.[198] In New York, for example, the

193. ARIZ. REV. STAT. ANN. § 33-1256B (West 2007) (effective through Jan. 1, 2012).

194. MD. CODE ANN., REAL PROP. § 11-110 (LexisNexis 2010); N.C. GEN STAT. ANN. § 47C-3-116 (LexisNexis 2009). Maryland recently enacted a three-month capped priority for unpaid assessments. *See infra* notes 290–92 and accompanying text.

195. *See* Holly Lake Ass'n v. Fed. Nat. Mortg. Ass'n, 660 So. 2d 266, 269 (Fla. 1995) (holding that an assessment lien relating back to the date of declaration would expose lenders to unknown risks and therefore cannot have priority); Tally Arms Condo. Ass'n, Inc. v. Breland, 854 So. 2d 28, 30 (Miss. Ct. App. 2003) (holding that a subsequent assessment lien cannot have priority over a mortgage lien); First Fed. Sav. & Loan Ass'n of Charleston v. Bailey, 450 S.E.2d 77, 81 (S.C. Ct. App. 1995) (holding that assessments fixed or determined subsequent to a mortgage lien are subordinate to the assessment lien).

196. *See, e.g*, Bd. of Dirs. of Colchester Towne Condo. Council of Co-Owners v. Wachovia Bank, N.A., et al., 581 S.E.2d 201, 202 (Va. 2003) (explaining that "the realities of the marketplace require that such lenders be encouraged to provide the desired financing for individual condominium units by granting priority to the lien of their first mortgages or first deeds of trust").

197. NELSON & WHITMAN, *supra* note 58, at 570–73, 602–08.

198. A limited priority lien for assessment liens has been proposed multiple times to the New York legislature, but lenders have lobbied against the adoption of the measure. The first year it

statutory lien securing all unpaid condominium assessments is junior in priority to first mortgage liens,[199] and New York case law has confirmed that all sums related to a first mortgage lien (including collection costs, fees, etc.) on a unit within a community take priority over an association lien.[200] If a unit is delinquent on assessments in New York, however, legislation provides that the association may obtain a court-appointed receiver to pay regular assessments to the association *prior to* making any mortgage payments, and collect rents directly from a tenant.[201] Case law clarified that this provision does not apply to special assessments that are payable by a receiver only after mortgage loan payments are made.[202]

Even without appointing a receiver or foreclosing its lien, associations in Florida, like New York, can collect rents directly from any tenants living in units owned by defaulting members.[203] The 2010 amendment to the Florida Common Interest Community Act provides that associations can collect rent payments directly from tenants when the owner of a unit is delinquent and further provides that if tenants do not pay rent to the association, the board can evict them.[204] The revised law also explicitly permits associations to suspend voting privileges for owners who are ninety days delinquent in their assessments and clarifies

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was proposed, the measure was allowed to die in committee. The next year, it was defeated on the floor. *See* Ronald A. Sher, Esq., *Habitat Board Leadership Conference Seminar: Condo Collections*, HIMMELFARB & SHER LLP, http://www.himmelfarb-sher.com/options/condo_collections.htm (last visited Aug. 16, 2011) (discussing a proposed law that would give assessment liens a limited priority for six months).

199. N.Y. REAL PROP. LAW § 339-z (McKinney 2006).

200. Bankers Trust Co. v. Bd. of Managers of Park 900 Condo., 616 N.E.2d 848, 849 (N.Y. 1993).

201. N.Y. REAL PROP. ACTS § 1325(2) (McKinney 2006).

202. *See* First N.Y. Bank for Bus. v. 155 E. 34 Realty Co., 158 Misc. 2d 658, 661 (N.Y. Sup. Ct. 1993) (holding that special assessments are generally for capital improvements well beyond the period of receivership, and thus, obligation for the special assessments cannot be placed on the receiver).

203. *See* S.B. 1196, 2010 Sess. (Fla. 2010) (effective July 1, 2010).

204. S.B. 1196, 2010 Sess. (Fla. 2010) (codified at Fla. Stat. § 718.116 (2011)). The newly amended Florida provision attempts to permit associations to walk the fine line between incurring landlord liability and having the authority to collect rents and evict tenants. Tenants in Florida and New York, however, raise a valid complaint that they have no contractual or property relationship with the association (except indirectly through their landlord) and that even though the statute in question purports to immunize tenants who pay rents to the association against eviction by the landlord, landlords can do much to lower a tenant's quality of life while still acting within the strict "letter of the law" of a lease. *See* Kenric Ward, *Condo Associations Put 'Hammer' Down on Renters*, SUNSHINE STATE NEWS (June 2, 2010), http://www.sunshinestatenews.com/story/condo-associations-put-hammer-down-renters (highlighting the potential pitfalls of the new law for tenants).

that associations can restrict delinquent owners' use of common areas.[205]

Bankruptcy of a delinquent owner may impact an association's ability to collect delinquent assessments, particularly under Chapter 12, which permits junior liens to be "stripped" of their collateral claims when the collateral's value is less than the amount owed on a senior debt.[206] In a November 2010 decision, the U.S. Bankruptcy Court for the Eastern District of Virginia ordered that a community association be stripped of its unpaid assessment lien in the amount of nearly $7000 because the property was subject to a first mortgage debt that exceeded its current county-assessed value, which, the court opined, left no excess security to which the association's lien could attach.[207] Although the association argued that the cited real estate value for the property was "artificially low" because of a depressed housing market,[208] the court refused to preserve the lien "based solely on anticipated future increase in the value of a secured creditor's collateral."[209] The court held that while under-secured creditors' liens are generally valid, in the case of a party whose secured claim has "inconsequential value," a bankruptcy filing should cause the lien to disappear.[210] The operation of the Bankruptcy Code in this case further bolsters the argument that a junior priority for association liens is inequitable, particularly in cases of homes securing under-collateralized mortgages.

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205. S.B. 1196, 2010 Sess. (Fla. 2010).

206. *See In re* Cook, No. 10-10113-SSM, 2010 WL 4687953 at *1–2 (Bankr. E.D. Va. Nov. 10, 2010) (holding that Section 506(d) of the Bankruptcy Code makes any junior lien void upon a prior lien exhausting a creditor's collateral); *see also* 11 U.S.C. § 523(a)(16) (2006). Although Congress has specified that post-petition assessments are non-dischargeable in Chapter 7 bankruptcies, this carve-out specifically does not apply to pre-petition debts including assessments. *Id.*

207. *In re Cook*, 2010 WL 4687953, at *2. Interestingly, county tax assessed value is not how a property's value is typically determined. Market players typically price according to comparable sales or stream-of-income value for a property, and even judicial review of foreclosure sale prices admits that there is no precise benchmark for real property valuation. *See* B.F.P. v. Resolution Trust Corp., 511 U.S. 531, 545 (1994) (mentioning that there are several ways to determine a property's fair market value).

208. The association cites the "economic crisis that was triggered by the sub-prime mortgage loan meltdown" as having caused the drop in property valuation. *In re Cook*, 2010 WL 4687953, at *2.

209. *Id.*

210. The court also noted that "[a]lthough there may well be policy arguments favoring preservation of liens for pre-petition assessments when debtors in reorganization cases propose to retain the property, such arguments are properly addressed to Congress." *Id.*

II. ALTERNATIVES TO FAILED PRIVATE GOVERNANCE

Under current laws, owners in a CIC face financial uncertainty stemming from the ownership structure and assessment model of their community. Linked fiscal fortunes means that owners face the threat of ever-increasing assessments due to their neighbors' delinquencies, and these unpaid assessments may never be recovered because of such neighbors' mortgage defaults. The status quo in most states is not only destabilizing, it is also inequitable. Association maintenance preserves the value of a lender's collateral, and passing the pro rata share of upkeep costs onto non-defaulting owners results in unjust enrichment of the lenders.[211] Courts and legislatures have struggled to resolve such unfairness, particularly now that the current crisis has highlighted this deficiency in the CIC assessment system.

A. Other Attempted and Proposed Solutions

1. Limited Priority Liens

a. UCIOA and Six-Month Limited Priority Lien

The drafters of the Uniform Common Interest Ownership Act ("UCIOA"),[212] recognizing that assessment liens would ordinarily be junior in priority to individual first mortgage liens, crafted an "innovative" solution to the problem of assessment nonpayment during mortgage default: the six-month "limited priority lien."[213] The UCIOA model, which has been adopted by eight states to date,[214] provides that

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211. *See generally* RAWLS, *supra* note 5, at 96 (advocating that beneficiaries of a cooperative venture should bear the costs of such a venture on a *pro rata* basis); Hart, *supra* note 5, at 185–86 (arguing that enjoyment of benefits by parties not bearing associated costs is inequitable).

212. *See generally* UNIF. COMMON INTEREST OWNERSHIP ACT (1994) [hereinafter UCIOA]. In 1977, the National Conference of Commissioners on Uniform State Laws began drafting the Uniform Condominium Act based on the 1974 Virginia model. Subsequently, the Conference prepared three uniform laws governing condominiums, cooperatives, and homeowners associations—the three forms of privately governed communities with different ownership structures. These were the Uniform Condominium Act, the Uniform Planned Community Act, and the Model Real Estate Cooperative Act. The Conference then combined the three acts, resulting in the UCIOA. This Act contains provisions governing condominiums, planned unit development/homeowner associations, as well as cooperatives.

213. Carl Lisman, Chair of UCIOA's Drafting Comm., Presentation to the Maryland Task Force on Common Ownership Communities—Maryland Dep't of Hous. and Cmty. Dev. at the American Homeowners Resource Center: The Uniform Common Interest Ownership Act (June 9, 2006) (transcript available at http://www.epohoa.org/index.php?option=com_content&view=article&id=104:formation-1975-a-birth-of-ucioa&catid=93:news&Itemid=111). Lisman seems to believe that the UCIOA limited priority lien solves the problem of non-payment of assessments, noting that "we are now convinced that we are more brilliant than we thought we were." *Id.*

214. *See infra* notes 221–28 (explaining that these eight states include Nevada, Alaska,

an assessment lien, which is normally subordinate in priority to first mortgages on units, is given limited priority upon foreclosure of the first priority mortgage lien "to the extent the common expense assessments based on the periodic budget adopted by the association . . . would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien."[215] Thus, an association under UCIOA would have a priority position arising at a mortgage foreclosure sale for unpaid assessments up to an amount equal to six months of regular-assessment assessments.[216]

The six-month capped "super priority" portion of the association lien does not have a true priority status under UCIOA since this six-month assessment lien cannot be foreclosed as senior to a mortgage lien. Rather, it either creates a *payment* priority for some portion of unpaid assessments,[217] which would take the first position in the foreclosure repayment "waterfall," or grants *durability* to some portion of unpaid assessments,[218] allowing the security for such debt to survive foreclosure.[219]

The UCIOA priority portion does not include costs incurred by the association to collect delinquent assessments, such as attorney fees. Some states, however, have enacted statutory variations that include such costs.[220] According to Washington, D.C. lawyer Catherine Park,

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Colorado, West Virginia, Connecticut, Vermont, Minnesota, and Delaware). Legislative proposals to adopt UCIOA are pending in six more states: Utah, Indiana, New Jersey, South Carolina, Kentucky, and Ohio.

215. UCIOA § 3-116.

216. *Id.* Under such a capped priority arrangement, the priority position of the association lien is split: a super-priority position is given to up to six months of unpaid assessment amounts, and the remainder of unpaid amounts is accorded the typical priority position of the association lien, namely subordinate to the first mortgage lien. *Id.*

217. *See, e.g.*, MINN. STAT. ANN. § 515A.3-115 (West 2002 & Supp. 2010), *amended by* H.F. 1023, ch. 116, 2011 MINN. SESS. LAW SERV. (West) (providing that the lien does not have priority over a senior mortgage lien, but allows for recovery of assessments for a period of six months). Under this interpretation, six months of unpaid assessments are paid out of foreclosure proceeds prior to repayment of the first mortgage.

218. Under this interpretation, a lien securing six months of unpaid assessments would survive the first mortgage foreclosure. One problem with this second interpretation of the super-priority provision is that post-foreclosure, an association often still has to bring a lawsuit against the buyer or lender to recover the six months of allowable unpaid assessments. This can be onerous for the association. For example, in Georgia, an association cannot recover the costs of bringing an action to recover the six months' worth of assessments against the lender. First Fed. Sav. Bank of Ga. v. Eaglewood Court Condo. Ass'n, Inc., 367 S.E.2d 876, 878 (Ga. Ct. App. 1988) (finding that the statutory language limited recovery from the lender at six months of assessments, not including the costs of collecting such assessments).

219. The effect depends on a state's interpretation of the provision.

220. *See, e.g.*, MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 1996 & Supp. 2002); CONN. GEN. STAT. ANN. § 47-258 (West 2009 & Supp. 2011) (allowing for recovery of attorney's fees within the priority portion).

who specializes in condominium law and litigation, the failure of strict UCIOA states to include attorney costs can be exploited by mortgage lenders, which gamble that an association will not hire an attorney to recover "a mere six months" of unpaid assessments.[221]

The lien priority concept contained in UCIOA has gained traction even in states that have not otherwise enacted these uniform acts. Today, in the eight UCIOA states (Alaska,[222] Colorado,[223] Connecticut,[224] Delaware,[225] Minnesota,[226] Nevada,[227] Vermont,[228] and West Virginia[229]), in ten more states (Alabama,[230] Florida,[231] Illinois,[232] Maryland,[233] Massachusetts,[234] New Jersey,[235] Pennsylvania,[236] Rhode Island,[237] and Washington[238]), and in the

221. Catherine Park, *"Super Lien" Legislation: How Super is it Really? And Why Isn't the Mortgage Industry Complying with the Legislation?*, LAW OFFICE OF CATHERINE PARK (July 10, 2010), http://cparklaw.com/condolaw/2010/07/10/super-lien-legislation-how-super-is-it-really-and-why-isnt-the-mortgage-industry-complying-with-the-legislation. According to Park, the only way for would-be homeowners to protect themselves in such jurisdictions is to "avoid buying in a small community" and thereby hope to minimize the budgetary impact of assessment defaults. *Id.*

222. ALASKA STAT. § 34.08.470 (2010).

223. Colorado Common Interest Ownership Act, COLO. REV. STAT. § 38-33.3-316 (LexisNexis 2010); *see infra* notes 241–46 and accompanying text.

224. CONN. GEN. STAT. ANN. § 47-258.

225. DEL. CODE ANN. tit. 25, § 81-316 (2009).

226. MINN STAT. ANN. § 515B.3-115(a), (e)(1)–(3), (f), (i) (West 2002 & Supp. 2010), *amended by* State Agencies–Courts And Common Interest Ownership Act, ch. 116, sec. 16, § 515B.3-115, 2011 MINN. SESS. LAW SERV. (West).

227. NEV. REV. STAT. ANN. § 116.3116(2)(c) (LexisNexis 2010), *amended by* Uniform Laws–Amendments–Common Interest Communities Act, ch. 389, sec. 49, § 116.3116, 2011 Nev. Legis. Serv. (West); *see infra* notes 273–74 and accompanying text.

228. VT. STAT. ANN. tit. 27, § 1323 (2006).

229. W. VA. CODE ANN. § 36B-3-116 (LexisNexis 2005).

230. ALA. CODE § 35-8A-316 (LexisNexis 1991).

231. FLA. STAT. ANN. (West 2011); *see infra* notes 280–86 and accompanying text.

232. 765 ILL. COMP. STAT. ANN. 605/9 (West 2009). Section 9(g) of the Illinois Condominium Property Act requires the association board to have "taken action" to trigger the requirement that subsequent purchasers of a foreclosed unit pay six months of unpaid assessments. *Id.*

233. MD. CODE ANN., REAL PROP. § 11-110 (LexisNexis 2010), *amended by* Condominiums and Homeowners Associations—Priority of Liens Act, ch. 387, sec. 2, § 11-110, 2011 Md. Legis. Serv. (West) (granting a mere four-month, $1200-capped priority to association assessment liens at mortgage lender foreclosure).

234. MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 1996 & Supp. 2002). The Massachusetts statute includes a provision for attorneys' fees together with a dollar-amount cap. *Id.*

235. N.J. STAT. ANN. § 46:8B-21 (West 2003 & Supp. 2010).

236. 68 PA. CONS. STAT. ANN. § 3314 (West 2004).

237. R.I. GEN. LAWS § 34-36.1-3.16 (1956 & Supp. 2010).

238. WASH. REV. CODE ANN. § 64.34.364 (West 2005).

District of Columbia,[239] community association liens enjoy a limited priority, typically capped at six months or less. Legislatures in five states (Indiana, Kentucky, Ohio, South Carolina, and Utah) have been considering adopting a UCIOA-based statute that would include a six-month lien priority for unpaid assessments.[240] Even with these progressive statutory developments in many states, more than thirty states lack any lien priority for association assessments.

To illustrate the typical UCIOA lien priority approach, consider the Colorado Common Interest Ownership Act ("CCIOA").[241] Under the Act, association liens, which include assessments and all collection costs, are considered automatically perfected as of the date the association was created.[242] This type of lien is subordinate to property tax liens and to a first deed of trust on the property, but it is superior to all other encumbrances of record, regardless of when such other lien is filed.[243] At foreclosure of a first deed of trust on a property,[244] the association lien will be paid according to a limited priority position to the extent of six months of budgeted assessment amounts.[245] Colorado courts have held that the lien may be more than assessments alone, as it also includes "attorney fees, interest & other allowable items."[246] In

239. D.C. CODE § 42-1903.13 (2001).

240. *See* MALLACH, *supra* note 29, at 12 (advising state policymakers to consider allowing borrowers of mortgages in foreclosure a six month forbearance period).

241. COLO. REV. STAT. § 38-33.3-316 (2011). The 1992 version of the Colorado Common Interest Ownership Act ("CCIOA") automatically applies to associations created after 1992, but any pre-1992 association can elect to avail itself of the protections and provisions of the Act. By electing to come under the 1992 CCIOA, an association can effectively change the provisions in its own governing documents, without filing an amendment, since application of the law is deemed to change inconsistent declaration language in order to conform to the Act.

242. *Id.* The automatically perfected lien applies to "any assessment levied against that unit or fines imposed against its unit owner," which includes fees, late charges, attorneys' fees, and interest. *Id.* § 38-33.3-316 (1). There are no limits on late fees and interest, but it is arguably unclear whether the statutory language includes attorney fees.

243. *Id.* § 38-33.3-316 (3). This is because the priority timing for the association lien relates back to the recordation of the declaration. This applies only to liens for deeds of trust recorded after 1992 when CCIOA was created. For all such provisions, the super-priority six-month lien applies, regardless of language in the community documents or the deed of trust to the contrary. *Id.*

244. A deed of trust is essentially a mortgage. The common foreclosure method for mortgage liens in Colorado is non-judicial foreclosure through power of sale in a deed of trust. The only way to foreclose an association lien, however, is through a judicial proceeding. *See, e.g.*, ORTEN CAVANAGH RICHMOND & HOLMES, LLC, COLO. FORECLOSURE LAWS 1–2, 8 (Mar. 2008), *available at* http://www.ocrhlaw.com/library/Colorado_Foreclosure_Laws.pdf (explaining the non-judicial foreclosure procedure in Colorado and contrasting the non-judicial procedure to the mandated judicial foreclosure procedure for association liens).

245. *Id.* at 8.

246. First Atl. Mortg., LLC v. Sunstone N. Homeowners Ass'n, 121 P.3d 254, 255 (Colo. App. 2005) (citing COLO. REV. STAT. § 38-33.3-316 (2)(b) (2010)).

Colorado, the lien is not payable out of foreclosure proceeds, but rather survives the foreclosure of the first deed of trust (a durability interpretation of the UCIOA lien priority provision).[247]

Within non-UCIOA states, some lien priority statutory provisions originated in response to past housing crises imperiling community associations in that jurisdiction. For example, Massachusetts' lien priority law grew out of the state's real estate boom and bust of the late 1980s and early 1990s.[248] Two decades ago, associations in Massachusetts struggled with massive budget shortfalls when homeowners abandoned units they could no longer afford, forcing the communities to increase assessments on the remaining owners to keep the association afloat. The remaining owners often could not afford to make up extra payments to bridge the budgetary gap, which led to a domino effect of assessment and mortgage delinquencies.[249] Today, CIC liens in Massachusetts have a capped super-priority because of judicial and legislative efforts to protect communities during the 1990s.[250]

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247. This follows logically from the limitation on non-judicial foreclosure of association liens. *See supra* notes 201–02 (explaining that New York case law provides that all sums related to a first mortgage lien on a unit within a community, including collection fees and costs, take priority over an association lien). However, New York legislation provides that if a unit is delinquent on assessments, the association is able to obtain a court-approved receiver to pay regular assessments to the association before making any mortgage payments. N.Y. REAL PROP. ACTS. § 1325(2) (McKinney 2006). The association may also collect rents directly from a tenant. *Id.*

248. MICHAEL GOODMAN & JAMES PALMA, OFFICE OF THE PRESIDENT, UMASS DONAHUE INST., WINNERS AND LOSERS IN THE MASSACHUSETTS HOUSING MARKET: A STUDY FOR CITIZENS' HOUSING AND PLANNING ASSOCIATION AND THE MASSACHUSETTS HOUSING PARTNERSHIP 2 (2004), *available at* http://www.massbenchmarks.org/publications/studies/pdf/housingmarket04.pdf.

249. *See* Grahame K. Wells, *The Use of Super-Liens to Promote Cooperation Between Condominium Associations and Lenders*, 13 ANN. REV. BANKING L. 477, 477–78 (1994) (citing Henry L. Judy & Robert A. Wittie, *Uniform Condominium Act: Selected Key Issues*, 13 REAL PROP., PROB., & TR. J. 437, 475 (1978)). The troublesome state of the economy during the late 1980s and early 1990s left many condominium owners with severe financial problems, which in turn, led those owners to stop paying condo fees. Subsequently, the condos could no longer afford to perform proper maintenance or pay utility bills, the utilities were shut off by their providers, and local governments condemned the buildings. *Id.*; *see also* James Winokur, *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 353, 355 (1992) (discussing the real estate economy of the 1990s as a catalyst for creating limited lien priorities in several states).

250. Baker v. Monga, 590 N.E.2d 1162, 1164 (Mass. App. Ct. 1992) (holding that owners had an absolute obligation to pay assessments and that owners lack the right to withhold payments); *see also* Trs. of Prince Condo. Trust v. Prosser, 592 N.E.2d 1301, 1302 (Mass. 1992) (reiterating the *Monga* court's holding, stating that "[f]or the same reason that tax payers 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"). The Massachusetts legislature attempted to further mitigate the harm felt by associations losing their

Rhode Island's lien priority law is one of the newest in the nation, and it passed unanimously in the state's House and Senate in June 2008.[251] This legislation increased the capped foreclosure and collections cost amount to $5000 and $7500, respectively (inclusive of legal fees), and provided for a six-month lien priority for assessment liens upon foreclosure of the first mortgage.[252] Before the measure came to a vote, and when seeking the governor's veto thereafter, the Rhode Island Mortgage Bankers Association strenuously objected to the new law's lien priority provisions, claiming that they would spell the end of residential mortgage finance for community association housing in Rhode Island.[253] Legislative counsel to the Bankers Association bemoaned the measure, claiming that "it's basically picking the lenders' pockets, at the end of the day."[254] Rhode Island disagreed and passed the measure.

By crafting legislation that creates a six-month limited lien priority for assessments, state legislatures hope to motivate first mortgage lenders to help pressure non-paying owners to pay their delinquent obligations. If their borrowers make all their association payments, lenders can avoid paying six months' worth of assessments out of their foreclosure proceeds. If, however, the property is under-collateralized and mortgage foreclosure takes vastly longer than six months, the six-month priority cap actually may (perversely) induce a lender to further delay foreclosure until there is a ready third-party purchaser on hand. This is because a lender purchasing at foreclosure will be liable for all subsequent assessments, and the foreclosure will also trigger the six-month payment obligation, increasing the prospective lender costs of foreclosing. Also, a lender is still likely to recover more in an upside-down loan if a borrower makes payments on the mortgage rather than association deficiencies because the lender will only have to reimburse a six-month capped amount of association deficiencies at some future time.

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entire assessment lien by passing legislation that provides for a six-month lien priority arising at closing. MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 2011).

251. R.I. GEN. LAWS § 34-36.1-3.16 (2010). The previous law not only failed to provide any lien priority for assessment liens, but capped an association's reimbursement for foreclosure costs at $2500, with any additional costs having to be paid by the community as a whole. Patricia Antonelli, *Changes to Rhode Island Law Affect Foreclosures, Priority of Condominium Liens for Assessments, Mortgage Escrow Accounts and Reverse Mortgages*, PARTRIDGE SNOW & HAHN LLP (July 2008), http://www.psh.com/content345.

252. R.I. GEN. LAWS § 34-36.1-3.16 (2010).

253. Dunn, *supra* note 6, at G1 (quoting Terrance Martiesian, a lawyer for the Rhode Island Mortgage Bankers Association, who remarked that "[a] bank is not going to take second place . . . in the chain of liens against the property. . . . They want to be first.").

254. *Id.* (quoting James Hahn).

b. Federal Housing Impacts on Association Fiscal Recovery

Federal agencies and GSEs, such as Fannie Mae and Freddie Mac, insure or guarantee more than nine out of every ten mortgages that have been originated since the meltdown in credit markets in 2008.[255] The FHA now insures nearly 50% of all residential mortgages, up from 1.7% of the market in 2006.[256] As the buyer or insurer of nearly every currently originated mortgage loan, these federal policies regarding lending risk have an enormous impact in terms of capital availability. The policies of the FHA and the GSEs impact the resolution of the community assessment issue in two ways: first, by requiring any super-priority of assessment liens to be limited at six months' worth of assessments and, second, by prohibiting loans secured by units located in condominiums with high rates of neighborhood mortgage defaults.[257]

The GSE secondary market purchasers and the FHA insurers specifically define qualifying mortgages as a mortgage subject to no greater than a six-month capped assessment lien priority.[258] This effectively prevents association recovery beyond that threshold.[259]

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255. DEP'T OF TREASURY & U.S. DEP'T OF HOUS. & URBAN DEV., REFORMING AMERICA'S HOUSING FINANCE MARKET: A REPORT TO CONGRESS 12 (2011), *available at* http://www.treasury.gov/initiatives/Documents/Reforming%20America%27s%20Housing%20Finance%20Market.pdf [hereinafter TREASURY/HUD REPORT]; *see also* CTR. FOR AM. PROGRESS, A RESPONSIBLE MARKET FOR HOUSING FINANCE: A PROGRESSIVE PLAN TO REFORM THE U.S. SECONDARY MARKET FOR RESIDENTIAL MORTGAGES 2 (2011), *available at* http://www.americanprogress.org/issues/2011/01/pdf/responsiblemarketforhousingfinance.pdf (explaining that "Fannie Mae and Freddie Mac also now purchase more than 80 percent of all multifamily mortgages, loans to owners, and developers of rental residential properties").

256. CTR. FOR AM. PROGRESS, *supra* note 255, at 44–45; *see also Government Affairs Update: FHA Condo. Recertification Requirements*, NAT'L ASS'N OF REALTORS, http://www.realtor.org/wps/wcm/connect/15f94c8044f67a04b112f35d6aeab3b5/FHA%2BCondo%2BRecertification%2BRequirements%2B12.8.10.pdf?MOD=AJPERES&CACHEID=15f94c8044f67a04b112f35d6aeab3b5 (last visited Aug. 16, 2011); Rick Newman, *Kill Fannie and Freddie? Not Likely*, U.S. NEWS & WORLD REPORT (Feb. 21, 2011, 12:12 PM), http://money.msn.com/investing/kill-fannie-and-freddie-not-likely-usnews.aspx (explaining that most mortgages issued are currently supported by Fannie Mae, Freddie Mac or the FHA). In contrast, private lenders handled twenty percent of mortgages during "normal" times. *Id.*

257. *See infra* notes 258–59 and accompanying text.

258. *See* FANNIE MAE, FORM 1054 (1208): WARRANTY OF CONDOMINIUM PROJECT LEGAL DOCUMENTS, *available at* https://www.efanniemae.com/sf/formsdocs/forms/pdf/projectrevs/1054.pdf (specifying that in order for a loan to be qualifying, "[a]ny first mortgagee who obtains title to a condominium unit pursuant to the remedies in the mortgage or through foreclosure will not be liable for more than six months of the unit's unpaid regularly budgeted dues or charges accrued before acquisition of the title to the unit by the mortgagee"); *see also Condominium Unit Mortgages—Project Analysis*, FREDDIE MAC (Apr. 2011), http://www.freddiemac.com/learn/pdfs/uw/condoprojectanalysis.pdf (requiring that the first mortgagee obtaining title to the unit be liable "for no more than six months of unpaid, regularly budgeted assessments or charges (for late fees and collection costs) accrued before acquisition").

259. Financing for non-qualifying loans is increasingly hard to obtain in the current economic climate. *See* Dunn, *supra* note 23, at G1 (discussing Rhode Island foreclosure).

These definitions of qualifying mortgages make it impossible for a state to increase the priority of a community assessment. Such funding or insuring requirements therefore indirectly, but effectively, limit a community's ability to fully recover delinquent assessments at foreclosure of an underwater unit. These federal guidelines drive the bulk of all mortgage lending and unless the six-month limitation is changed, will prevent state legislatures from acting to solve the community assessment delinquency problem.

In addition to their priority requirements for qualifying mortgages, policies of these entities significantly limit finance capital availability for condominium units. The Department of Housing and Urban Development ("HUD") maintains a list of "Approved Condominium Projects," and FHA, Fannie Mae, and Freddie Mac will not insure or purchase mortgages to units in condominiums that are not on the approved list.[260] The new approval process implemented in the wake of the Housing and Economic Recovery Act of 2008 now disallows "spot loan" approvals—approvals based on applications for individual unit mortgages rather than the condominium as a whole.[261] Condominium projects will not be approved unless, *inter alia*, no more than 15% of the total units are in arrears (more than thirty days past due) of their association assessments.[262] An association with more than 15% delinquent owners can go after those owners personally for the unpaid amounts and would be wise to do so.[263] But if the owners are unable to

260. *See* Mortgagee Letter 2009-19 from Brian D. Montgomery, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees & All FHA Roster Appraisers 1 (June 12, 2009), *available at* http://www.bestfhalender.com/wp-content/uploads/2010/01/09-19ml.pdf [hereinafter Montgomery, Mortgagee Letter 2009-19] (stating that the FHA "will now allow lenders to determine project eligibility, review project documentation, and certify to compliance . . . . HUD will continue to maintain a list of Approved Condominium Projects"); Mortgagee Letter 2009-46A from David H. Stevens, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees 1 (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46aml.pdf ("This Mortgagee Letter (ML) waives five provisions of that guidance and serves as a temporary directive to address current housing market conditions."); Mortgagee Letter 2009-46B from David H. Stevens, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees and All FHA Roster Appraisers 1 (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46bml.pdf [hereinafter Stevens, Mortgagee Letter 2009-46B] (stating that the FHA will allow lenders to determine project eligibility, review project documentation, and certify compliance, but FHA will continue to have a list of approved condominium projects).

261. *See supra* note 260. Previously, individual loans in a community could earn HUD approval even if the community as a whole did not get blanket approval from HUD. Such per-unit approval is no longer an option.

262. Stevens, Mortgagee Letter 2009-46B, *supra* note 260, at 4.

263. *See supra* notes 159–77 and accompanying text (discussing association collection efforts).

pay, the paying members make up the budgetary shortfall, while they are simultaneously denied access to financing because of their neighbors' default. Even if a community earns a coveted spot on HUD's "Approved" list, that approval expires in two years unless all requirements are re-certified to the satisfaction of HUD.[264]

Other requirements for condominium project approval also impact the resolution of the assessment delinquency issue and have contributed to a slowdown in condominium unit sales in an already sluggish market.[265] HUD requires that "[n]o more than 10 percent of the units" be owned by one entity, and states that "[a]t least 50 percent of the units of a project must be owner-occupied."[266] Such limitations may practically limit the ability of a condomininm association to foreclose on liens for unpaid assessments and rent out units in the community in order to attempt to recover some amounts toward the delinquency while also prohibiting troubled owners from generating income from property rental to meet obligations.[267] Furthermore, such restrictions make it more difficult for a unit to be sold, since once a community passes the 15% delinquency tipping point (or the 50% rental tipping point), financing for would-be purchasers is essentially no longer available. And most ironically, if a condominium's documents restrict a unit owner's freedom to rent a unit, which it must do to ensure compliance with HUD's 50% rental limitation, the FHA has deemed the documents

264. *See* Montgomery, Mortgagee Letter 2009-19, *supra* note 260 (explaining that the recertification deadline for previously approved condominiums, previously set for December 7, 2010, was extended to dates from December 31, 2010 to March 31, 2010, staggered according to the original project approval date); *see also Government Affairs Update: FHA Condominium Recertification Requirements*, NAT'L ASS'N OF REALTORS (Dec. 8, 2010), http://www.realtor.org/wps/wcm/connect/15f94c8044f67a04b112f35d6aeab3b5/FHA%2BCondo%2BRecertification%2BRequirements%2B12.8.10.pdf?MOD=AJPERES&CACHEID=15f94c8044f67a04b112f35d6aeab3b5 ("Mortgagee Letter 2009-46B states that FHA approved condominium projects must be recertified every two years").

265. *See, e.g.*, Mandyvilla, Comment to *New FHA Condo Guidelines*, BROKER OUTPOST MORTGAGE FORUMS (Dec. 20, 2009, 7:55 AM), http://forum.brokeroutpost.com/loans/forum/2/283263.htm ("[Realtors should] motivate sellers to slash the price [of condominium units offered for sale] NOW on their listings before the market does it for them. . . . This is going to be the nail in the condo market. Values are going to plummet around here due to the number of projects that are at 51% concentration [of investor owners] and above.").

266. Montgomery, Mortgagee Letter 2009-19, *supra* note 260, at 4.

267. *See* DAVID H. STEVENS, ASSISTANT SEC'Y FOR HOUS./FED. HOUS. COMM'R, U.S. DEP'T OF HOUS. & URBAN DEV'T.: CONDO APPROVAL PROCESS (May 2010), *available at* http://portal.hud.gov/hudportal/documents/huddoc?id=MAY2010.pdf (noting that although David Stevens, Assistant Secretary of HUD, explained in May 2010 that HUD modified this "50% owner occupancy requirement to allow the exclusion of vacant and tenant-occupied REOs from the calculation," such exclusions do not apply to real estate owned by *associations* rather than *lending banks*).

as violating the "free transferability" provisions.[268] The result is that it is impossible for a condominium to be adequately approved for FHA insurance, either because it allows rentals or because it does not. Fannie Mae and Freddie Mac require similar owner-occupancy percentages, and thus, a condominium today cannot simultaneously satisfy the criteria of the GSEs and the FHA.[269]

Because nearly half of all mortgage loans are now insured by the FHA, and almost the entire remainder is sold on the secondary market to either Fannie Mae or Freddie Mac, the policies of the FHA, Fannie Mae, and Freddie Mac hugely impact resolution of the issue of assessment recovery.[270] The current requirements for loans, however, work at cross-purposes: while the delinquency rate is used as a proxy for community fiscal health, the priority limits on association assessments remove from a community a potentially crucial tool for ensuring the association's financial well-being. In recognition of the harm to communities and lenders that can result from a community with excessive delinquencies, it seems that the FHA, Fannie Mae, and Freddie Mac should use their market power and definitions of qualifying mortgages to support community health rather than place roadblocks to recovery.

c. State Efforts to Add or Enhance Lien Priority

Because capped lien priority typically protects only six months' worth of assessments, the longer it takes to get a paying owner to take title to the unit, the less protection the law provides. In early 2010, Lender Processing Services, Inc. estimated that on average, it took fifteen months for a home loan to go from being thirty days late to the property being sold in foreclosure.[271] The lengthy foreclosure timeline is caused in part by the sheer magnitude of the increase in foreclosure

268. 24 C.F.R. § 203.41 (2011).

269. Letter from Loura K. Sanchez, Managing Partner, Hindman Sanchez, to Comm. Ass'ns Inst. (Nov. 23, 2010) (on file with author).

270. *See* TREASURY/HUD REPORT, *supra* note 255, at 12 (explaining that the lack of private capital in the housing market since 2008 has led government agencies to insure or guarantee the vast majority of new mortgages); Jody Shenn & John Gittelsohn, *FHA Home-Loan Volume Is Sign of 'Very Sick System,' Agency's Stevens Says*, BLOOMBERG (May 24, 2010), http://www.bloomberg.com/news/2010-05-24/fha-home-loan-volume-is-sign-of-very-sick-system-agency-s-stevens-says.html (noting that the FHA, Fannie Mae and Freddie Mac have been financing more than 90% of U.S. home lending since the 2008 market collapse); Saskia Scholtes, *Fannie and Freddie Drive Home Loans*, FIN. TIMES (Apr. 2, 2008, 7:23 PM), http://www.ft.com/intl/cms/s/0/65c8ab08-00dd-11dda0c5000077b07658.html#axzz1TWkKeq6Y (discussing how government-sponsored mortgage companies have become the "backbone" of the U.S. mortgage market); *see also infra* Part II.A.1.c.

271. Viega, *supra* note 8.

volume over the past few years—in 2010, there were more foreclosures commenced each month than were typically commenced in an entire year prior to 2005.[272] The recent foreclosure moratoriums and government investigations into bank procedures, introduced in all fifty states in October 2010, significantly lengthened the time needed to complete foreclosure,[273] as lenders have (appropriately) responded to increased procedural scrutiny by slowing the process to ensure validity of the foreclosure.[274]

Some states have responded to the longer foreclosure timeline and the financial dire straits of associations by increasing the capped amount of their lien priority statutes. Nevada increased the six-month period to nine months,[275] and Florida increased its cap to the lesser of twelve months' worth of assessments or 1% of the outstanding mortgage loan amount.[276] Although both of these enhanced lien priority measures increased ultimate recovery by an association, they failed to solve the underlying problem that still plagues the six-month capped priority laws: once the designated period has elapsed (be it six or nine or twelve months), lenders have no further incentive to contribute to property upkeep or to expeditiously foreclose so that someone new can take title.

The housing crash prompted the Nevada Legislature to swiftly pass legislation strengthening lien priority protection for assessment liens, increasing the six-month lien priority to a nine-month priority, effective October 1, 2009.[277] The state legislators were mindful of the FHA and GSE guidelines, however, so the Nevada statute has an automatic carve-out for mortgages purchased by the GSEs, limiting the lien priority to the maximum allowed by such entities' guidelines (namely, six

272. *See supra* notes 18–19 and accompanying text (reporting 2010 foreclosure statistics).

273. Ariana Eunjung Cha & Dina Elboghdady, *50 State Attorneys General Announce Foreclosure Probe*, WASH. POST, Oct. 13, 2010, at A13.

274. Ensuring compliance with foreclosure procedure is crucial to protecting borrower rights and equity. Because the sale price at a foreclosure is not subject to substantive review, strict adherence to procedural safeguards is the only way that the system can ensure the price obtained is fair and that the borrower is given all notice and the right to redeem, which statutory law and equity require. *See, e.g.*, BFP v. Resolution Trust Corp., 511 U.S. 531, 545 (1994) (refusing to review the adequacy of a foreclosure sale price and instead focusing exclusively on the foreclosure process, stating, "[w]e deem, as the law has always deemed, that a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with").

275. NEV. REV. STAT. ANN. § 116.3116(2)(c) (2010).

276. FLA. STAT. ANN. § 718.116 (West 2010 & Supp. 2011), *preempted by In re* Spa at Sunset Isles Condo. Ass'n, Inc., No. 10-33758-PGH, 2011 WL 3290239 (Bankr. S.D. Fla. July 13, 2011).

277. NEV. REV. STAT. ANN. § 116.3116(2)(c) (2010).

months).[278] This carve-out undercuts the statute's effectiveness dramatically, as the vast majority of residential mortgage loans are originated for resale on the secondary market.[279] In addition, increasing the cap to nine months, even when applicable, rapidly became insufficient recovery as the post-default/pre-foreclosure duration of mortgages in the state increased.

Florida was the next state to increase the assessment lien priority cap amount. The Florida Distressed Condominium Relief Act of 2010, effective July 1, 2010, provides that a first mortgagee taking title to property through foreclosure is liable for the twelve months of unpaid common expenses and regular periodic assessments that came due during the immediately preceding year.[280] The total potential exposure of lenders under this statute, however, is capped at 1% of the outstanding mortgage debt.[281] While the previous change in the law implementing a six-month cap inspired widespread adherence among lenders who have not contested its retroactive application, Florida courts have not yet stated definitively that the Florida amendment creating a twelve-month cap can be applied retroactively.[282] In addition, although states like Colorado have specified that their statutory lien priority provisions trump association documents with provisions to the contrary, it is unclear whether this is true in Florida or whether Florida associations must amend their documents to take

278. *Id.*

279. *See* TREASURY/HUD REPORT, *supra* note 255, at 2. Secondary resales today are primarily through Fannie Mae and Freddie Mac. *Id.*

280. Distressed Condominium Relief Act, 2010 Fla. Sess. Law Serv. 36 (codified at Fla. Stat. Ch. 718.701–08). Previous modifications in the law increased the cap to twelve months for single family homes in CICs but left the cap at six months for condominium units. The 2010 amendment equalized recovery in both types of CICs. *Id.*

281. FLA. STAT. ANN. § 718.116(1)(b)2 (2011). According to some Florida lawyers, the new law permits unlimited recovery of unpaid assessments from third-party buyers at mortgage foreclosure (unlimited durability of the association lien) and caps recovery only from lenders. Telephone interview with Ben Solomon, Attorney, Association Law Group, P.L., North Bay Village, Fla. (Sept. 28, 2011) (notes on file with author) [hereinafter Solomon Interview]. Other Florida attorneys dispute this reading of the law, noting that the twelve-month cap applies to all foreclosure sales, regardless of the identity of the buyer, and expressing doubt that the new twelve-month limit will apply to foreclosures of mortgages originated before 2010. Telephone interview with Chuck Edgar, Attorney, Cherry, Edgar & Smith, P.A., Palm Beach Gardens, Fla. (Sept. 27, 2010) (notes on file with author) [hereinafter Edgar Interview]. Edgar agrees that the statutory language is ambiguous on this point but notes that there is nothing in the legislative history to suggest that Florida legislators intended to create a different rule for lender and third-party foreclosure buyers. *Id.*

282. Edgar notes that "Everyone is collecting the six months of assessments, and lenders aren't fighting it." Edgar Interview, *supra* note 281. But Edgar also opines that the twelve-month cap may not apply to mortgages originated prior to July 2010 and believes that the legislature in Florida cannot retroactively impose the cap, and only the federal government, not a state government, could pass a law that effects such an "impairment of contract." *Id.*

advantage of the enhanced lien priority if the documents reference the prior (six-month) capped level.[283] The flaws of Florida's newly amended statute are already apparent, and less than a year later, new legislation has been introduced to "refund and expand upon those amendments and to clarify other condo association issues."[284]

Florida has been coping with perhaps the worst volume and quality of foreclosures in the nation during the past few years, and the large quantity of foreclosures and many lender missteps have so far discouraged lenders at foreclosure from challenging the law or its application.[285] Even if unchallenged, the long delay between commencing and completing foreclosure proceedings in Florida makes the twelve-month capped priority still inadequate in many cases anyway.[286] In Florida, as in other states, the best way to ensure repayment of assessment amounts is to immediately start legal proceedings when a homeowner has not paid his dues to get a personal money judgment against the owner in order to compel collection. Pursuing a money judgment is often the cheaper and easier route for an association to take to recover unpaid assessments.

The Florida law is so new that the state's mortgage market has not yet reacted to the change. Interestingly, Florida's twelve-month limit does not have a GSE limit carve-out like the Nevada provision.[287] It is unclear how this limitation will play out in Florida with respect to availability of mortgage capital, since Fannie Mae and Freddie Mac specifically exclude debts for which a lender could be liable for more than six months of assessment charges from pools of qualifying mortgages.[288] Mortgage originators today almost never originate non-

283. *See id.* (noting that everyone is taking advantage of the six-month cap, despite the fact that it is unclear whether or not Florida associations need to amend their documents to take advantage of the enhanced lien priority); Solomon Interview, *supra* note 281 (stating that Florida law permits unlimited recovery of unpaid assessments from third-party buyers at mortgage foreclosure and caps recovery only from lenders).

284. Joshua Krut, *Board of Contributors: After Sweeping Changes in Florida's Condo Law, Expect New Revisions*, DAILY BUS. REV. (Feb. 23, 2011), http://www.law.com/jsp/article.jsp?id=1202482933797 (calling this pending legislation the "glitch bill" because it is designed to clarify unanswered questions relating to the amendments of the prior year).

285. *See* Edgar Interview, *supra* note 281 (agreeing that the statutory language is ambiguous but that the legislature did not intend to create a different rule).

286. *See, e.g.*, *supra* notes 110–12 and accompanying text (identifying incidents in which enhanced lien priority statutes failed to protect condominium associations).

287. It does, however, have a dollar-based cap of 1% of the mortgage loan amount. FLA. STAT. § 718.116(1)(b)2 (2010).

288. Section B4-2.1-06 of Fannie Mae's lending guidelines explicitly states that Fannie Mae will not purchase debt if the holder of the mortgage could be liable for more than six months of regular common expenses charged by a community association. *See* FANNIE MAE, SELLING GUIDE 575–76 (June 28, 2011).

FHA loans that they cannot sell on the secondary mortgage market, and the only truly active secondary residential mortgage market purchasers are the GSEs.[289] It remains to be seen if the Distressed Condominium Act adversely impacts the availability of mortgage financing in CIC homes in Florida, or if the GSEs will not enforce these guidelines there or will change their mandates.

After facing much resistance from lender lobbyists, the Maryland General Assembly approved a statute to grant CIC assessment liens a capped priority in mortgage lender foreclosure sales.[290] The new law requires that $1200 of assessments (or up to four months of assessments, if less) be paid to an association prior to payment on the mortgage debt at foreclosure.[291] Since foreclosure in Maryland takes a minimum of five months to complete,[292] this capped assessment liability is clearly inadequate to cover all of an association's costs during the pendency of foreclosure.

Bills specifically aimed at creating six-month limited priority for association assessment liens are currently pending in Ohio and Missouri. Each case is strongly supported by individuals who reside in CICs and community association lobbies, and each case is strongly opposed by bank lobbies. In Ohio, efforts to pass a UCIOA-based lien priority for assessments (House Bill 408) failed to achieve legislative action in the legislature's 2010 session.[293] The efforts are still alive, and proponents of the measure hope that 2011 will see passage of a law creating a provision for six months of assessments plus attorney fees, costs, and expenses to enjoy lien priority superior to all liens but those for property taxes. National and state lenders in Ohio have strongly opposed the bill, contending that it will increase lending costs and complexity and will chill mortgage lending in an already semi-frozen housing capital market.[294]

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289. *See* TREASURY/HUD REPORT, *supra* note 255, at 2 (discussing how the new plan developed by the administration will bring private capital into the market and decrease the role of Fannie Mae and Freddie Mac).

290. H.B. 1246, 428th Gen. Assemb. (Md. 2011). The original bill set the priority cap higher—six months plus late fees and collection costs—but this proposal met vigorous opposition by the Maryland Bankers Association. *Community Association Law Letter*, THOMAS SCHILD LAW GROUP LLC, 1 (Spring 2011), http://www.schildlaw.com/Spring%202011%20Newsletter.041811.pdf. The legislature cut down the cap in an effort to appease the mortgage lender lobby. *Id.*

291. Md. H.B. 1246.

292. *See* Mallory Malesky, *How Long Does Foreclosure Take in Maryland*, EHOW (Mar. 23, 2011), http://www.ehow.com/info_8098323_long-foreclosure-maryland.html (explaining Maryland foreclosure procedures).

293. *See* MALLACH, *supra* note 29 (discussing the foreclosure crisis in Ohio).

294. *See* Ann Fisher, *Condo Associations Want Plan to Make Owners Pay*, THE COLUMBUS

Banks are also concerned with potential retroactive application of the priority law with respect to loans that have already been funded.[295] While active debates on limited priority statutes remain in Ohio and Missouri, in many other states, efforts to create a limited lien priority for association assessments have never gained traction.[296]

d. Inadequacy of Limited Priority Liens

The priority law for community assessment liens varies among the states, but this problem has been insufficiently addressed in all of them. When unpaid upkeep costs are potentially unlimited, capped losses for the lender necessarily result in unlimited losses allocated to the members of the community. Thus, even a "super-priority" piece allocated to assessment liens becomes inadequate once that period has expired.

When foreclosure takes longer than six months and when foreclosure proceeds are inadequate to pay off a first mortgage—and both of these factors are more and more common today—only a fraction of unpaid assessments are paid, requiring paying members of the association to fund the remainder.[297] Furthermore, even in some jurisdictions with a limited association lien priority, proceeds at foreclosure do not automatically apply to unpaid assessments (the capped portion being deemed a durability rather than payment priority provision), and thus the association has to bring a lawsuit—and incur more community costs—just to recover the amounts that are legally theirs. Miami Beach Commissioner Jerry Libbin calls this problem an "outrageous loophole" in the law.[298]

DISPATCH, July 5, 2009, at 01B.

295. *See id.* ("Banks and other lenders typically have opposed such laws, contending that they increase the cost and complexity of lending.").

296. *See, e.g.*, S.B. 411, 2010 Gen. Assemb., Reg. Sess. (Va. 2010) (stricken Jan. 27, 2010) (establishing limited lien priority for condominium association assessments).

297. *See* Coleman, *supra* note 104, at 1A (noting that condominium owners in good standing are often charged "special assessments" to make up for unpaid fees from delinquents owners).

298. Admin, Comment to *Ruling May Help Homeowner Associations*, HISTORIC CITY NEWS (Feb. 6, 2010, 2:31 PM), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546. Libbin heralded the reverse foreclosure tactic, *see infra* Part II.A.2, as an important step toward protecting owners in condominiums. *See id.* (noting that Libbin applauded a Miami-Dade Circuit court ruling ordering a "reverse foreclosure"). Florida's legislature considered a bill that would have required banks to complete foreclosure after a year of filing or pay all unpaid assessments, but this proposal never came to a vote. *See* Rob Samouce, *Laws Needed to Get Delinquent Properties Back on Market*, NAPLES DAILY NEWS (Jan. 2, 2010), http://www.naplesnews.com/news/2010/jan/02/laws-needed-get-deliquent-properties-back-market/ (noting that strong bank lobbying was the cause of legislative inaction on the bill); *see also HOA's Forcing "Reverse Foreclosures,"* TITLE SEARCH BLOG (Mar. 1, 2010, 10:26 AM), http://titlesearchblog.com/2010/03/01/hoas-forcing-reverse-fore closures/ (remarking that the bill

The general problem of unpaid assessments is dramatically exacerbated in the current market context where lenders (sometimes deliberately) delay foreclosure on defaulting properties.[299] Lenders can—and today often do—delay foreclosure. It is true that foreclosure can take a long time for other reasons: mortgage loan servicers are currently overwhelmed with the number of defaulting borrowers, and lenders look hopefully to future market price rebounds to recover under-collateralized loan amounts. In addition, mortgage servicers' faulty record-keeping and failure to follow legally-mandated procedures operate to stretch out the foreclosure timeline as well.[300]

But lenders also sometimes strategically delay based on their calculation that they will be unable to sell the property at foreclosure or resell the property afterwards because of the sluggish housing market.[301] Procrastination can help lenders avoid incurring the obligations of home ownership, including property taxes and community association assessments. This is particularly true in cases where there is a very real risk that the ultimate sale price for the property will not reimburse such costs. Once the lender owns the real estate (real estate owned, or "REO" properties), the lender itself is responsible for assessment charges and, unlike insolvent mortgage borrowers, can typically be sued successfully for assessment payments they neglect to make.[302] Because this obligation is assumed upon taking title, lenders in many cases prefer to postpone foreclosure,

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"never saw the light of day for a vote by the legislature").

299. *See, e.g.*, Marshall L. Jones, *Condo Associations Battle Deadbeat Owners, Balky Banks in Collecting Fees*, REAL EST. L. & INDUS. REP., Apr. 6, 2010, at 3 ("As lenders institute foreclosure proceedings against defaulting condominium owners, some condominium associations are seeing lenders delay in completing the foreclosure process.").

300. *See supra* note 3 and accompanying text. In addition to servicer and bank moratoriums on foreclosures, several states, including Connecticut and Texas, froze all foreclosures in October 2010 pending inquiry into faulty and fraudulent loan servicing procedures. Several other states stopped foreclosures by J.P. Morgan Chase, GMAC and Ally Financial, the institutions tainted with the "robo-signing" scandal. *See* Cha, *supra* note 3, at A9 (noting that the moratoriums have now been lifted, but the pace of foreclosure remains slow).

301. *See* Coleman, *supra* note 104, at 1A (noting that some banks deliberately delay taking back property worth less than the outstanding mortgage); Benny L. Kass, *Condo Associations Saddled with Unpaid Dues Demand that Banks Stop Delaying Foreclosures*, WASH. POST, Nov. 20, 2010, at E3 (noting that condo associations are often left with unpaid dues when banks, wanting to avoid assuming liability on unpaid condominium dues and taxes, delay foreclosure on a unit).

302. *See, e.g.*, Leigh Katzman, *Waiting for the Bank to Foreclose: A Modern Day Story*, KATZMAN GARFINKEL ROSENBAUM, 1–3, http://kgblawfirm.com/pdfs/Waiting for the bank to foreclose-LCK.pdf (last visited Oct. 30, 2011) (detailing all the costs that a lender will incur upon taking title to real estate at a mortgage foreclosure sale and concluding that "the bank can comfortably delay completing its foreclosure action knowing the full extent of its liability for past due assessments").

hoping that the market will improve and property resale will be more quickly forthcoming. As Florida attorney Ben Solomon explains, "[t]he bottom line is the banks don't want to assume the liability associated with the unit, including the obligation to pay maintenance assessments to the association."[303] In the meantime, collateral values are preserved through assessments that lenders neither pay nor reimburse.

Today, the delay between initial mortgage default and actual foreclosure sale is longer than ever before. Since bank liability for previously unpaid assessments is capped—or, in many places, non-existent—mortgage lenders receive an unjust enrichment of collateral upkeep at the cost of other members of the community. Currently, there is nothing in the law to prevent such an outcome.

Foreclosure delays increase the ultimate charges borne by the non-defaulting neighbors but also cause neighboring owners to suffer in other ways. As unpaid assessments increase, dues increase, units fall into disrepair, and abandonment increases the likelihood of vandalism and squatters. When foreclosure finally happens, both property values and quality of life for the community have declined.[304]

Focusing on the complete lack of even a capped assessment priority in a majority of states, Washington, D.C. association law expert and syndicated columnist Benny Kass has publicly called for nationwide campaigns to create UCIOA-like provisions in those states that have not yet passed such a law.[305] But even if the thirty-three states with no limited priority passed UCIOA-based six-month (or larger) caps, the underlying problem would persist: lenders can offload a theoretically unlimited amount of upkeep costs of their collateral onto innocent members of the community with no adequate recourse at law for the community and its paying members. And since the limited priority of assessment liens under UCIOA and similar statutes only takes effect upon a first mortgage foreclosure, the limited priority lien fails to force the bank's hand and achieve a more expeditious resolution through conveying the unit to an owner willing and able to contribute to community costs.[306]

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303. Sutta, *supra* note 6.

304. *See, e.g.*, Rogers, *supra* note 181, at 1–3 (describing the course of foreclosure proceedings); *supra* Part I.B.2 (discussing the financial tragedy of the commons associated with foreclosures in condominium associations).

305. *See* Kass, *infra* note 356 (stating that such monthly-based limited priority lien systems "must be enacted all over the country as soon as possible").

306. Note that some creative litigators have attempted to do just that, with some limited success in Florida. *See infra* Part II.A.2.

State legislatures could close this "loophole" by mandating true priority for community assessment liens (at least with respect to dues that are unpaid during a period of mortgage default) or by making CIC assessment liens non-extinguishable in foreclosure. Capping community losses rather than lender losses would eliminate the distortion that the current potential "free ride" creates for lenders weighing the costs of foreclosure. This would encourage lenders to pay community assessments during borrower defaults, whether or not it also encourages the pace of foreclosure to increase. Either way, the community's losses and contagion effects of the distressed properties is contained: at some defined point in time, a solvent interest-holder in a unit will be encouraged to pay the unit's equitable allocation of costs. This type of limited priority would be vastly more equitable than the UCIOA-type of total-amount capped lien, both in terms of allocating upkeep costs and in terms of efficiently motivating housing rollover and market stability.

2. Creative Litigation Strategies

Florida is perhaps the epicenter of the CIC assessment crisis.[307] Florida was the site of one of the largest housing booms over the past few decades.[308] In particular, condominium development and financing flourished in Florida through 2007.[309] Condominiums in Florida

307. *See* ElBoghdady, *supra* note 10, at A14 (noting that nine of the twenty regions with the worst foreclosure rates were in Florida); Brad Heath, *Most Foreclosures Pack into a Few Counties*, USA TODAY, Mar. 6, 2009, at 1A (noting that eight counties in Arizona, California, Florida, and Nevada were responsible for one quarter of all foreclosures in the U.S. in 2008). *See generally* Prashant Gopal, *Florida Condo Owners Footing Bill for Foreclosures*, BLOOMBERG BUS. WK. (Nov. 29, 2007), http://www.businessweek.com/the_thread/hotproperty/archives/2007/11/florida_condo_o.html (detailing results of the 2009 Florida Community Association Mortgage Foreclosure Survey). Florida is also one of the states most impacted by the housing crisis in general.

308. *See* MAUREEN F. MAITLAND & DAVID M. BLITZER, S&P/CASE-SHILLER HOME PRICE INDICES 2009, A YEAR IN REVIEW 5–6 (2010), *available at* http://www.standardandpoors.com/indices/index-research/en/us/?type=All&category=Economic (follow "S&P/Case-Shiller Home Price Indices: 2009 A Year In Review (PDF)" hyperlink) (showing double-digit rise in home prices in Florida, followed by a precipitous decline as the real estate market went into crisis); Haya El Nasser, *Florida Growth Outpaces National Trend*, USA TODAY (Mar. 22, 2011, 3:25:38 PM), http://www.usatoday.com/news/nation/census/2011-03-17-florida-census_N.htm (comparing growth rates in Florida to the rest of the country); *see also South Florida Absorbs Growth Across the Board*, SE. REAL EST. BUS. (Sept. 2005), http://www.southeastrebusiness.com/articles/SEP05/highlight2.html (enthusiastically discussing the robust growth of the real estate market in Florida—which in hindsight seems ironic and naïve).

309. *See, e.g.*, Richard Peep, *Condo Culture: How Florida Became Floridistan*, NEWGEOGRAPHY (May 22, 2011), http://www.newgeography.com/content/002245-condo-culture-how-florida-became-floridastan (telling of the appeal and growth of condominium developments and investment properties in Florida in the 1990s).

attracted many real estate investor-buyers,[310] and the demographics of the state—in particular, the high percentage of retired persons—made low-maintenance/high amenity housing particularly appealing. But this same demographic makes the population more vulnerable to escalating monthly housing costs. Because of these factors, Florida today presents the most extreme case of foreclosure delay spillovers and community governance insolvency. This foreclosure delay is rampant: there are ample news reports of lenders' strategic postponement of public auctions,[311] and the average foreclosure now takes longer than a year and a half.[312] Although the amended Florida law permits a capped recovery after mortgage foreclosure of an amount equal to the lesser of twelve months' worth of unpaid association assessments or 1% of the outstanding mortgage loan amount,[313] in most cases this limited amount will not cover all of an association's unpaid assessments.

Florida attorneys representing community associations have become very creative in seeking recovery for their clients. One particularly interesting tactic has been termed a "reverse foreclosure."[314] To achieve a reverse foreclosure, the association must first foreclose on its assessment lien and take title to a delinquent unit subject to the first mortgage lien.[315] The association, as now-owner of the property, files a motion for summary judgment in the mortgage lender's own foreclosure action, seeking judgment in favor of the lender.[316] The association

310. A majority of the condominium units in Florida in 2007 were non-owner occupied (investor properties). *See* Shimberg Ctr. for Affordable Hous., *State of Florida's Housing, 2007 Executive Summary*, AFFORDABLE HOUS. ISSUES, Apr. 2008, at 1, 3, *available at* http://www.shimberg.ufl.edu/pdf/Newslet-Apr08.pdf (listing statistics for owner-occupied condos in Florida).

311. *See, e.g.*, Coleman, *supra* note 104, at 1A ("[L]enders are in no hurry to take back delinquent units, only to have to turn around and sell them amid a market that has crashed.").

312. Interview with Kevin Miller, Attorney (Oct. 2010) [hereinafter Miller Interview] (notes on file with author).

313. S.B. 1196, 2010 Sess. (Fla. 2010) (codified at FLA. STAT. § 718.116 (2010)).

314. *See* Coleman, *supra* note 104, at 1A (describing reverse foreclosures as a "a tool that can force banks to pay association maintenance fees when unit owners don't); Susannah Nesmith, *Ruling Could Give Embattled Associations Relief*, DAILY BUS. REV. (Jan. 27, 2010), http://www.law.com/jsp/article.jsp?id=1202466596282 (describing a "reverse foreclosure" ruling in a Miami-Dade Circuit Court case forcing a bank to take title to a property from a homeowner association); Paul Brinkman, *Miami Judge Grants Reverse Foreclosure*, S. FLA. BUS. J. (Jan. 25, 2010, 4:04 PM), http://www.bizjournals.com/southflorida/stories/2010/01/25/daily10.html (quoting attorney Ben Solomon, who notes that reverse foreclosures reverse "will finally help associations force banks to take title to financially upside down units much faster than ever before"); *"Reverse Foreclosure" Makes Banks Accountable to HOA*, FLA. L. J. (Jan. 25, 2010), http://www.thefloridalawjournal.com/2010/01/reverse-foreclosure-makes-banks-accountable-to-hoa/ (noting reverse foreclosure is a legal strategy for condominium and homeowners associations to prevent banks from stalling foreclosures).

315. *See* Nesmith, *supra* note 314 (describing the procedures for enforcing a reverse foreclosure).

316. *Id.*

waives all claims for notice and sale of the property under Florida's foreclosure laws and moves that the court immediately order the title to be transferred to the lender.[317]

Keys Gate Community Association successfully employed the reverse foreclosure approach on a home to which it had taken title in 2007 after the owners stopped paying assessments.[318] The first mortgage lender on the unit, HSBC Bank USA, filed its own notice to foreclose two months after the association took title, but the foreclosure sale never happened.[319] Finding itself stuck with an empty house and two-and-one-half years worth of unpaid dues (over $5000), the association attempted the new strategy of moving for summary judgment in favor of the mortgage lender.[320] In January 2010, Miami-Dade Circuit Judge Jerald Bagley accepted the association's argument and ordered title immediately transferred to HSBC, making it liable for all future community assessments.[321] The court also ordered HSBC to pay the association's legal fees and court costs in connection with the reverse foreclosure action as well as the capped lien priority amount that trumped the first mortgage lien. Because this amount was capped, the association had to write off $3820 in unpaid fees, but at least the long delay in finding a financially responsible unit owner was finally over.[322] As Keys Gate attorney Ben Solomon put it, "[t]he quicker we can move these distressed properties through the process and into the hands of somebody who will pay a mortgage and pay taxes and pay their dues, the quicker we can get the economy back on track."[323]

In the wake of the Keys Gate success, the reverse foreclosure strategy gained popularity during early 2010.[324] Ben Solomon's firm, Association Law Group, filed eighty-three foreclosures around the state,

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317. *Id.*; Paul Owers & Lisa J. Huriash, *Fighting Over Foreclosures—Homeowner Associations Target Delinquent Tenants, Lax Lenders*, SUN SENTINEL, Aug. 10, 2010, at 1A.

318. HSBC Bank USA v. Keys Gate Cmty. Ass'n, Inc. No. 07-18411 CA 09 (Fla. Jan. 12, 2010).

319. *Id.*

320. Coleman, *supra* note 104, at 1A.

321. Peter L. Mosca, *Florida Court Decision Could Impact Builders and Bank Foreclosure Processes*, REALTY TIMES (Feb. 17, 2010), http://realtytimes.com/rtpages/20100217_florida court.htm.

322. *Id.*; *see also* Coleman, *supra* note 104, at 1A (describing Keys Gate Community Association's use of the reverse foreclosure tactic).

323. Nesmith, *supra* note 314.

324. *See Ruling May Help Homeowner Associations*, HIST. CITY NEWS (Feb. 5, 2010), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546 (noting that some firms have been in favor of reverse foreclosure to avoid paying past due fees).

with varying success.[325] The reverse foreclosure concept is novel, and both judges and lenders were confused by the summary judgment motion.[326] Some courts did not realize that the association in such cases was arguing for judgment for the lender; some lenders did not realize this either. While the Miami-Dade judges have been receptive to the idea of a reverse foreclosure, no district court has yet considered and approved the tactic.[327]

In some cases, the exotic nature of the reverse foreclosure claim caused lenders to just walk away. For example, Citibank responded to a reverse foreclosure motion by just writing off the entire mortgage debt, leaving the association owners owning the unit.[328] However, the association had hoped to win a financially competent owner by losing the foreclosure case, and by winning the case, the association lost access to the bank's deep pocket for future assessment costs.[329]

The reverse foreclosure strategy is interesting, but it is legally cumbersome and unpredictable. In addition, this judicial tactic is limited to situations where (a) the association has previously foreclosed on its lien, subject to a first mortgage lien, and (b) the first mortgagee has already filed a foreclosure action. If a lender has not yet commenced a court action for foreclosure, no summary judgment motion can be filed. In addition, the reverse foreclosure requires the unreimbursed costs of the association's own foreclosure action. Furthermore, the entire recovery by the association in Florida is capped at 1% of the outstanding mortgage loan or twelve months of assessment costs.[330] If the unit in default already has a tenant, there is an even better option available to the association. Under the 2010 amendment, the association can collect rents from a defaulting unit without having to foreclose or file a motion in a lender's proceeding, which may permit a more immediate and greater recovery for the community.[331]

Association lawyers in Florida have made other attempts to find an avenue for recourse within the existing legal framework. The Association Law Group pioneered a tactic they call "The Mortgage Terminator" to wipe out a mortgage lien in cases where an association has foreclosed on the unit and the mortgage lender has not commenced

325. Solomon Interview, *supra* note 281.
326. *Id.*
327. Miller Interview, *supra* note 312.
328. Sutta, *supra* note 6.
329. *See id.* (discussing Citibank's willingness to hand over title).
330. FLA. STAT. ANN. § 718.116.(1)(b)(1)(a)-(b) (West 2011).
331. *Id.*

foreclosure proceedings.[332] The association title-holder of the property brought its own case against Wells Fargo in a Broward County case in 2010, claiming that the bank lost its equitable claim to its real estate collateral by deliberately delaying commencement of foreclosure proceedings.[333] The court agreed and wiped out the mortgage lien.[334]

In another case where the lender strategically delayed foreclosure, the condominium association sued to force the lender to act. The trial court, in *United States Bank National Ass'n v. Tadmore*, found the association's arguments compelling and ordered the lender to "diligently proceed with the pending foreclosure action . . . or pay monthly maintenance fees on the condominium unit in foreclosure."[335] The court based its holding on its general equitable powers, concluding that the association was unreasonably prejudiced by the lender's deliberate delay in pursuing foreclosure.[336] Thus, the court reasoned that it was fair and equitable to order the lender to pay monthly assessments even prior to foreclosure.[337] The trial court decision in *Tadmore* at first sparked a flurry of interest in the concept of using equity to force an expeditious foreclosure, but the holding was short-lived. The appellate district court in *Tadmore* reversed, holding that the lender could not be obliged to pay condominium assessments on a unit it did not (yet) own.[338] There was no contractual obligation to pay those fees, and no obligation would arise until the lender acquired title.[339] Although the association's claim was made in equity, the court of appeals held that equity could only follow the law, not divert from it.[340]

Other associations pin their hopes on provisions in the Florida foreclosure statute that mandate a foreclosure sale to be scheduled no sooner than twenty and no later than thirty-five days after court

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332. Daniel Vasquez, Broward *Case May be First of Many*, MIAMI HERALD (Oct. 10, 2010), http://www.algpl.com/news/press/MH-Oct-10-2010.pdf.

333. *Id.*

334. *Id.*

335. U.S. Bank Nat'l Ass'n v. Tadmore, 23 So. 3d 822, 822 (Fla. Dist. Ct. App. 2009).

336. *Id.* at 823.

337. *Id.*

338. *Id.*

339. *Id.*

340. The court noted that "equity follows the law" and reasoned that therefore, equity "cannot be utilized to impose this obligation without limitation before title is passed." *Id.* While the *Tadmore* approach was creative, it is unsurprising that the trial decision was reversed. There is a long-standing view that each lienholder can determine its own foreclosure timing. *See* NELSON & WHITMAN, *supra* note 58, at 612 (stating that a foreclosure on a junior lien cannot affect a senior mortgagee's interest because the senior should be allowed to choose when to sell).

filing.[341] Although Florida attorney Kevin Miller opines that an association might be able to claim violation of this provision when foreclosure is unduly delayed, lenders uniformly have maintained that the provision creates remedies for the mortgagee alone.[342] In addition, an association, as a junior lienholder, could ask the court for a management conference for the foreclosure case according to a procedural rule designed to move cases along.[343]

The Florida statute leaves unanswered the question of how far association documents can go to enhance the scope and priority of the assessment lien.[344] Citing the statutory provision giving mortgage lenders priority over association liens,[345] the court in *Coral Lakes Community Ass'n, Inc. v. Busey Bank, N.A.*, for example, refused to hold a foreclosing lender jointly and severally liable with its borrower for unpaid assessments despite language in the declaration to that effect.[346] In an earlier case with similar declaration language, however, a Florida district court held that a wholly-owned subsidiary of the mortgage lender who acquired title at foreclosure would be deemed a third party not entitled to protection by the assessment priority cap[347] and thus, could be sued personally for the entire unpaid assessment amount.[348] The details of which entities could and could not be sued personally for unpaid assessments, based on language in the association's declaration, could end up being quite complicated as the disputes regarding transfer of mortgages muddy the question of which entity holds what interest in the property. The Florida statute is unclear, and Florida laws are inconsistent on this point.

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341. FLA. STAT. ANN. § 45.031 (1) (a) (West 2011).

342. Miller Interview, *supra* note 312. Even if courts agreed with the association's arguments with respect to this provision, there would be no way to use the statute to force lenders to commence a foreclosure proceeding.

343. *Id.*

344. A fifteen-year-old Florida case suggests that total super-priority of an association lien could be created by the association declaration. Holly Lake Ass'n v. Fed. Nat'l Mortg. Ass'n, 660 So. 2d 266, 269 (Fla. 1995). The hope that such precedent would endure has been chilled by a more recent Florida decision where the association documents provided that any subsequent parcel owner "regardless of how his or her title has been acquired, including by purchase at a foreclosure sale" is personally, jointly and severally liable for all unpaid assessments, along with the prior delinquent owner. Coral Lakes Cmty. Ass'n, Inc. v. Busey Bank, N.A., 30 So. 3d 579, 582 (Fla. Dist. Ct. App. 2010).

345. FLA. STAT. ANN. § 720.3085 (6) (West 2010).

346. *Coral Lakes Cmty. Ass'n, Inc.*, 30 So. 3d at 584.

347. FLA. STAT. ANN. § 718.116(1) (West 2010).

348. Strangely, the court held that the statutory limitation on post-foreclosure recovery of assessments applied only to limit a lender-purchaser at foreclosure, leaving a third-party foreclosure purchaser fully responsible for unpaid assessments. Bay Holdings, Inc. v. 2000 Island Blvd. Condo. Ass'n, 895 So. 2d 1197, 1197 (Fla. Dist. Ct. App. 2005).

3. True Lien Priority: An Analogy to Property Taxes

Community associations function like governments: they perform public functions and are funded by assessments paid by their citizenry. In fact, the trend over the past few decades has been for public governments to assign to private communities more and more responsibility for services that a municipality would otherwise provide.[349] Community governance and upkeep costs incurred by municipalities are funded through property taxes, and unpaid property taxes are secured by a lien on the subject property that enjoys true super-priority status. Unpaid taxes are therefore paid first (or remain burdening the property) at the foreclosure sale. The simplest solution to the CIC tragedy of the commons posed by unpaid and uncollectable assessments would be to grant true priority to liens securing such amounts, analogizing the assessments to property taxes. If association liens were granted complete and true priority over mortgage liens, then the association foreclosure would necessarily bring mortgage lenders "to the table" to pay for their collateral upkeep charges or to participate in a joint foreclosure proceeding.

On the one hand, an analogy between community assessments and property taxes is compelling; both governments offer public upkeep to a community such as paving, snow removal, and open space maintenance. In these ways, the community functions like a municipality proxy by providing services to the public.[350] In fact, taxpayers who live in New Jersey CICs have successfully claimed the right to offset a portion of their community assessments from property taxes based on a double taxation complaint.[351] However, this analogy can only be taken so far. Many community-provided amenities are actually a supplement to municipal services rather than their replacement, and in the vast majority of states, assessments are not legally considered local "taxes."[352] To the extent that community services provide private community benefits (such as amenity upkeep), they represent individual

349. *See* TREESE ET AL., *supra* note 16, at 6 (stating that government privatizes its functions, requiring community associations to fulfill an otherwise municipal obligation).

350. The town of Reston, Virginia was the first CIC and provides many municipal government services. RESTON ASSOCIATION, http://www.reston.org/default.aspx?qenc=HzT9ACzZbNs%3d&fqenc=HzT9ACzZbNs%3d (last visited Aug. 1, 2011).

351. *See* HYATT, *supra* note 15, at 133 (citing Borough of Englewood Cliffs v. Estate of Allison, 174 A.2d 631, 640 (N.J. Super. Ct. 1961)) (reasoning that a property's true value does not include value of public rights transferred to a community).

352. Assessments are not deductible from federal and state tax impositions, for example, even when the community association services are a proxy for services normally provided by local municipalities. *See* HYATT, *supra* note 14, at 106 (arguing that community associations target assessments in a manner that local government cannot).

property-carrying costs rather than funding a benefit to the broader public, akin to property taxes.

Lenders would likely have strong objections to the idea that community assessments should be granted true priority by virtue of their tax-like function and likely will predict the disappearance of home mortgage credit should such a rule be adopted.[353] Nevertheless, having property taxes prime the mortgage lien has not dissuaded lenders from making mortgage loans. Lenders routinely protect themselves against any superior-priority payment obligation of their borrowers through establishing property tax escrow accounts. Lenders could demand similar escrow accounts for community assessments.[354] In fact, current Fannie Mae and Freddie Mac forms already specifically anticipate escrow account mandates for such amounts.[355]

4. Consent and Control by Community Members

Unlike a mortgage lender, who has the ability to perform a credit inquiry and refuse to lend money to a financially risky borrower, homeowners in condominiums and homeowner associations have no ability to force their neighbors to disclose the details of their finances. Even if this information were available, owners currently have little ability to control who buys properties in their community. One potential solution to the problem of financial interdependence in privately governed communities, however, would be to permit communities to perform credit diligence regarding prospective new members and control entry into the association. Washington, D.C. lawyer Benny Kass has suggested this type of solution: enable community boards of directors to approve or disapprove all potential purchasers of units.[356]

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353. The vigorous opposition mounted by the mortgage banking lobbyists to attempts to institute even a limited lien priority in states such as Ohio is a case in point. *See* Fisher, *supra* note 294, at 01B.

354. Such escrow accounts, however, might be more administratively expensive than those for insurance and taxes because many CICs assess monthly rather than yearly or bi-yearly.

355. *See* EFANNIEMAE.COM, https://www.efanniemae.com/sf/formsdocs/documents/sec instruments/ (last visited July 30, 2011) (providing mortgage documents by state). Associations, on the other hand, are vastly more limited in their ability to create property-specific escrow accounts upon, say, resale. Unless community documentation so provides, any efforts would be struck down as *ultra vires*.

356. Benny Kass, *Foreclosures are Impacting Condominium Projects*, REALTY TIMES (Apr. 30, 2007), http://realtytimes.com/rtnews/reu2pages/bennykass.htm?open&Vol=32&ID=715 realty (posing the question: "If the lenders will not screen their borrowers, why should a community association have to suffer by having a new owner who will not be able to meet his/her financial obligations to the association?").

Cooperatives have long had such ability to control the identity of their members.[357] New York cases have repeatedly upheld pre-approval provisions in cooperative documents and even individual denials of approval for cooperative membership based on criteria as indirectly relevant as an applicant's fame or legal training.[358] The justification for legally permitting such practices in cooperatives is typically its disparate ownership structure: owners are co-investors in an entity that holds title to the building in addition to being tenants of their particular unit. Financing of the building occurs at two levels: through the entity title holder and at the individual-unit-owner level. Because of this increased financial interconnectedness, courts have opined that cooperatives should be able to self-select their members.[359] In the context of condominiums and homeowner associations, however, power to disapprove would-be unit purchasers would be more problematic, opening a Pandora's Box of discrimination. The possible danger posed by such a solution underscores the importance of finding and enacting a viable solution through the priority law instead.

Property law is hostile to restraints on alienation, and courts suspiciously scrutinize restrictive covenants limiting the ability of an owner to sell his or her property. Economic theory in general argues for

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357. Cooperatives must still abide by the Fair Housing Act and may not discriminate based on membership in a protective class. Robinson v. 12 Lofts Realty, Inc., 610 F.2d 1032, 1036 (2d Cir. 1979).

358. *See, e.g.*, Weisner v. 791 Park Ave. Corp., 160 N.E.2d 720, 724 (N.Y. 1959) ("[T]here is no reason why the owners of the co-operative apartment house could not decide for themselves with whom they wish to share their [building]."); DeSoignies v. Cornasesk House Tenants' Corp., 800 N.Y.S.2d 679, 682 (N.Y. App. Div. 2005) (upholding the board's absolute right to control leasing "for any reason or no reason"); Simpson v. Berkley Owner's Corp., 623 N.Y.S.2d 583, 583 (N.Y. App. Div. 1995) (the cooperative board "had the right to withhold their approval of petitioners' purchaser for any reason or no reason"); Bachman v. State Div. of Human Rights, 481 N.Y.S.2d 858, 859–60 (N.Y. App. Div. 1984) (upholding the denial of a transfer of shares in an apartment because it was not discriminatory); Goldstone v. Constable, 443 N.Y.S.2d 380, 381–82 (N.Y. App. Div. 1981) (holding that "directors of this cooperative housing corporation have the contractual and inherent power to approve or disapprove the transfer of shares and the assignment of proprietary leases, absent discriminatory practices prohibited by law"). Cooperative boards have refused to permit owners to transfer units to many famous individuals, including Madonna, Gloria Vanderbilt, Mariah Carey, Calvin Klein, Antonio Banderas, Melanie Griffith, and former President Richard Nixon. MARRIANE M. JENNINGS, REAL ESTATE LAW 255 (8th ed. 2008) (citing Ellen Wulthorst, *New York Apartment Buyers Face Powerful Co-Op Boards*, EPOCH TIMES, Jan. 27–Feb. 2, 2005, at 13); *see also* Harvey S. Epstein, Note, Weisner *Revisited: A Reappraisal of a Co-op's Power to Arbitrarily Prohibit a Transfer of its Shares*, 14 FORDHAM URB. L.J. 477, 481–85 (1985–1986) (explaining that cooperative boards in New York arbitrarily prohibit transfer of residences, and applicants are subject to increasing scrutiny). For a current dispute involving the famous Dakota complex in Manhattan's Upper West Side, see Basil Katz, *Lawsuit Peeks into World of New York City Co-ops*, REUTERS, Feb. 3, 2011, *available at* http://www.reuters.com/article/2011/02/03/us-housing-newyork-idUSTRE7129IR20110203.

359. Subject to anti-discriminatory limitations imposed by the Fair Housing and the Civil Rights Acts.

free alienation of property so that society may achieve the property's highest and best use, as well as maximize its value.[360] Although free alienation increases individual member risks in the context of the entangled finances of a common interest community, courts typically strike down consent requirements as incompatible with fee simple absolute ownership rights.[361] Even explicit contract regimes restricting free transferability in the name of community, harmony, and joint objectives have been struck down as a restraint on alienation that is repugnant to the fee simple.[362] Retaining the right to approve purchasers through a covenant regime impermissibly recalls feudal controls; courts have consistently refused to enforce such restrictions.[363]

An association's right of first refusal to purchase a unit has been upheld, however, because an owner can be made economically whole by selling to the association in lieu of an objectionable buyer.[364] But such a provision will inadequately protect the financial interests of the community because it requires the community itself to fund the purchase and upkeep of a unit as the only way to block a prospective buyer. This is even more financially burdensome than permitting a prospective buyer to take title and then incur the costs of enforcing assessment obligations.

Although it is difficult to force bare approval requirements limiting an owner's ability to sell his unit in a condominium or homeowner association, it is very ordinary in a common interest community to control an owner's ability to rent a unit. Absolute prohibitions on renting are sometimes claimed to be an unreasonable restriction of fee title, but courts typically enforce initial limits on renting (an owner must occupy the unit for the first year, for example); limits on short-term

360. JOSEPH WILLIAM SINGER, PROPERTY LAW: RULES, POLICIES, AND PRACTICES 450 (4th ed. 2006).

361. *See, e.g.*, Northwest Real Estate Co. v. Scrio, 144 A. 245, 246 (Md. 1929) (holding that limitations on restraint of alienation are invalid).

362. *See, e.g.*, Riste v. E. Wash. Bible Camp, Inc., 605 P.2d 1294, 1295 (Wash. Ct. App. 1980) (holding that a clause preventing a grantee from transferring title for fee simple without approval from the grantor is a restraint on alienation and therefore void).

363. *See, e.g.*, Aquarian Found., Inc. v. Sholom House, Inc., 448 So. 2d 1166, 1169 (Fla. Dist. Ct. App. 1984) (holding that an association's right to withhold consent to a unit's transfer was "obviously an absolute restraint on alienation" because the association was not required to purchase the unit at fair market value itself upon refusing consent); *Northwest Real Estate Co.*, 144 A. at 246 (striking down as "clearly repugnant to fee-simple title" a deed covenant providing that land may not be subsequently sold without consent of the grantor); *Riste*, 605 P.2d at 1294 (refusing to enforce a restriction for a CIC limiting sale of land to persons approved by the seller church).

364. *See, e.g.*, Wolinsky v. Kadison, 449 N.E.2d 151, 155 (Ill. App. Ct. 1983) (holding that an association may exercise its right of first refusal after considering a prospective buyer's qualifications).

leasing (no leases with a term less than six months, for example); and even limits on the number of units in a community that can be rental-occupied at any time.[365] Such leasing limitations are typically upheld even when they are created in non-unanimous amendments to the governing documents.[366] Not only do courts enforce aggregate limitations on the percentage of units in a CIC that can be rented at any one time, but Fannie Mae, Freddie Mac, and the FHA have issued guidelines that limit the percentage of a community that can be rented out, likely as a proxy for financial health of the community.[367]

Although permitting association boards to exercise approval rights over sales might be judicially justified as an extension of the broad enforcement of leasing restrictions boards already can exercise in any case, it would be bad policy to rely on board diligence and approval as a way to protect the community's financial health, and this approach should be avoided. From a legal standpoint, requiring prior approval of purchasers would create a hardship for owners who are trying to sell, and indeed the approval right is repugnant to the fee. Such a requirement would mean that a would-be seller would not only have to find a willing buyer, but would also have to prove that the candidate was a credible financial risk. In a tight market, the hardship and delay caused by this requirement would further freeze out sales of units and would increase the possibility that an owner would default instead of re-selling.

In addition, the power to approve buyers is fraught with the potential for abuse by other members of the association, and to solve one problem (uncollectable assessments) by creating others (too much board power limiting freedom to transfer property and the potential for insidious discrimination) is nonsensical. These problems are already rampant and difficult to resolve in co-ops.[368] Further, using the CIC structure to

365. Woodside Vill. Condo. Ass'n, Inc. v. Jahen, 806 So. 2d 452, 462 (Fla. 2002) (holding that a leasing restriction was reasonable).

366. *See* Apple II Condo. Ass'n v. Worth Bank & Trust, 659 N.E.2d 93, 97 (Ill. App. Ct. 1995) (holding that the leasing restrictions were a valid exercise of association authority). Even disparate impact based on race does not invalidate a leasing restriction. *See* Villas West II of Willowridge v. McGlothin, 841 N.E.2d 584, 601 (Ind. Ct. App. 2006) (refusing to hold that every discriminatory action is illegal), *vacated*, 885 N.E.2d 1274 (Ind. 2008).

367. Fannie Mae and Freddie Mac will not buy loans secured by properties in common interest communities where more than 49% of the units are occupied by tenants rather than owners. *See* FANNIE MAE, CONDOMINIUM PROJECT REVIEW: OPTIONS FOR PROJECT APPROVAL 1–2 (2010), *available at* https://www.efanniemae.com/sf/refmaterials/approvedprojects/pdf/condoprojectreview.pdf (outlining the requirements for project approval); FREDDIE MAC, FREDDIE MAC CONDOMINUM UNIT MORTGAGES 3 (2011), *available at* http://www.freddiemac.com/learn/pdfs/uw/condo.pdf (outlining more requirements for project approval).

368. *See* Matt Chaban, *Board to Death: As Co-ops Swagger Back from the Brink, Brooklyn Pols Plot Their Demise*, N.Y. OBSERVER (Apr. 26, 2011), http://www.observer.com/2011/real-

create legal limits on a seller's right to transfer to certain types of borrowers harkens back to the days of racial discrimination because the perpetuation of racial segregation was the initial motivation for forming many early suburban CICs.[369]

The unsavory history of homeowner associations—still obvious from many first-generation restrictive covenants in the land records—reveals a dark side of private governments: racially segregated neighborhoods where restrictive covenants contractually barred would-be sellers from selling to certain would-be buyers based on pernicious discriminatory criteria. The U.S. Supreme Court in *Shelley v. Kraemer* held with tortured legal reasoning that racially-based restrictive covenants were unenforceable under the Fourteenth Amendment because the enforcement of a contract to discriminate would amount to government action.[370] Then, Congress passed the Fair Housing Act, which made discriminatory sale restrictions illegal and invalid.[371] Today, because of that Act, decisions to rent or sell housing may not lawfully be based on "race, color, religion, sex, familial status, or national origin."[372]

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estate/board-death-co-ops-swagger-back-brink-brooklyn-pols-plot-their-demise (reporting that cooperative boards in New York need not disclose the reason for disapproving a prospective member and that it remains difficult and unpredictable to obtain board approval and sell or buy in a cooperative in New York); *see also* Bay Holdings, Inc. v. 2000 Island Blvd. Condo. Ass'n, 895 So. 2d 1197, 1197 (Fla. Dist. Ct. Ap. 2005) (upholding a statutory cap that limits a first mortgagee's liability for unpaid assessments). A current bill proposes requiring cooperatives to provide a statement of the reasons for refusing consent to a transfer. A. 8347 § 1, 2011–2012 Reg. Sess. (N.Y. 2011), *available at* http://open.nysenate.gov/legislation/api/1.0/lrs-print/bill/A8347-2011. Several such bills have been introduced in the past. John Barone, *Limiting the Autonomy of Cooperative Apartment Corporation Governing Boards*, 2 CARDOZO PUB. L. POL'Y & ETHICS J. 179, 179 (2004).

369. In fact, many community association documents on the land records still contain racial occupancy clauses. Even though such clauses have no legal force today, their continuing existence in the chain of title serve as an unfortunate reminder of one of the initial motives of community ownership structures. It is well near impossible to strike such language from the record. *See* Stephen Magagnini, *Reminders of Racism, Old Covenants Linger on Records*, SACRAMENTO BEE, Jan. 17, 2005, at A1 (reporting on the difficulty of removing a restrictive racial occupancy clause from a Sacramento community association's property records).

370. 334 U.S. 1, 19 (1948) (holding that state action existed when a court enforced racial restrictions). The holding of *Shelley* has continually perplexed legal theorists because it was decided in the 1940s. *See, e.g.*, Francis A. Allen, *Remembering* Shelley v. Kraemer*: Of Public and Private Worlds*, 67 WASH. U. L. Q. 709, 710–12 (1989) (arguing that the significance of *Shelley* changes over time); Lino Graglia, *State Action: Constitutional Phoenix*, 67 WASH. U. L. Q. 777, 787 (1989) (stating that of the Supreme Court cases regarding state action, the *Shelley* holding is the most criticized); Mark Tushnet, Shelley v. Kraemer *and Theories of Equality*, 33 N.Y. L. SCH. L. REV. 383, 384–85 (1988) (arguing that the substantive holding in *Shelley* was identical to the state action holding).

371. Fair Housing Act of 1968, 42 U.S.C. §§ 3601–3619 (2006).

372. 42 U.S.C. § 3604 (2006).

On the one hand, it is perhaps too soon in our history to give blanket membership approval power to community associations because the original *raison d'etre* of homeowner associations was to keep certain people out of them.[373] If such power existed, courts would necessarily need to exercise some sort of oversight scrutiny to assess the reasonableness of any approval or denial to make sure it did not violate the provisions of the Fair Housing Act or otherwise impermissibly bar alienability of property. The benefits of any self-protecting membership approval empowerment, therefore, must be balanced against the costs of potential discrimination and the cost of judicial efforts needed to police appropriate disapprovals of neighbor sales.

Mortgage lenders (theoretically) already do credit diligence on would-be buyers in communities as part of their underwriting.[374] It would be costly and difficult to force an association to inquire as to credit scores, employment, and salary. Such inquires would also be unnecessary in cases where another entity is already assessing these exact same criteria for a would-be buyer—namely, his or her mortgage lender. It would be wasteful and inefficient to require the non-expert volunteer directors to try to replicate this effort.

Because neighbors do not (and probably should not) have the ability to do financial investigations of would-be buyers in their community, association members cannot manage their own risks in this regard. Mortgage lenders, on the other hand, are best able to do such investigations at the lowest cost because they specifically assess the financial health of potential borrowers and can set the terms or limit the availability of mortgage loans accordingly.[375]

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373. *See supra* note 370 and accompanying text.

374. From 2000 to 2007, many mortgage originators neglected to do any credit diligence or at least did a terrible job. *See* Yuliya Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, 24 REV. FIN. STUD. 1848, 1873–75 (2011) (showing a decrease in the spread between prime and subprime mortgages, which is typically used to compensate lenders for the increased risk of subprime mortgages, concluding that the decrease in this spread was not sustainable, and indicating that loosening underwriting standards was one of the factors). In 2006, Steven Krystofiak, president of the Mortgage Brokers Association for Responsible Lending, submitted a written statement into the record of a Federal Reserve public hearing on mortgage regulation, reporting that his organization had compared a sample of 100 stated income mortgage applications to IRS records and found almost 60% of the sampled loans had overstated their income by more than 50%. *Inside the Liar Loan: How the Mortgage Industry Nurtured Deceit*, SLATE MAG. (Apr. 24, 2008, 11:25 AM), http://www.slate.com/id/2189576 (citing Written Statement of Krystofiak, President, Mortgage Bankers Association for Responsible Lending, Building Sustainable Homeownership: Public Hearing on the Home Equity Lending Market Before the Federal Reserve Bank of San Francisco (June 16, 2006), http://www.federalreserve.gov/secrs/2006/august/20060801/op-1253/op-1253_3_1.pdf).

375. Mortgage lenders also perform collateral due diligence (property appraisals) and are therefore well-situated to prevent a property from being so over-burdened with debt that a

B. Eroding Mortgage Priority

1. Equitable Reallocation of Payment Default Costs

Capped recoveries and limited priority liens are ineffective in a climate of underwater loans and long foreclosure timelines. Reverse foreclosures and other creative litigation strategies may obtain relief in certain situations but are inadequate to generally protect communities from the fallout of foreclosure freezes. Although there is some appeal to analogizing assessments to property taxes and granting a true priority status to assessment liens, it would be almost impossible for such a proposal to garner sufficient political support to pass. Allowing community members more extensive approval rights over property transfers within their community raises property and liberty rights concerns that vastly outweigh the benefits of permitting self-policing due diligence in sales. The best party to perform credit diligence of new (or refinancing) members in a CIC is the party already performing this role: the mortgage lender.[376] The best party to control for unrealistic loans, sloppy foreclosure proceedings, and unwarranted delays is also the mortgage lender. Thus, the mortgage lender should bear costs occasioned by its failure to diligently protect against the foreseeable externalities of its lending activities. In a situation where the property is underwater, the only party with a valuable interest in the property is the mortgage lender. The lender, as the sole property interest holder in this case, should bear the upkeep costs that protect and enhance the value of its security pending foreclosure.

Statutes should be passed in each state to create proper incentives for lenders to monitor or pay assessment delinquencies. Rather than relying on limited-priority liens, this proposal—an eroding first priority for first mortgage liens—would treat the priority position of a lender's first lien as conditioned upon foreclosure within a certain amount of time after mortgage default (e.g., six months). Thereafter, every month of unpaid assessments would become secured by a lien superior in payment priority to the first mortgage. Importantly, such a lien would have no upside cap, meaning recovery by the association would theoretically be unlimited, while the maximum paid by the neighbors would be limited. Such an eroding mortgage approach would cap the loss to the association rather than the loss to the lender, which is appropriate because it is the lender who controls the timing of the foreclosure sale.

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foreclosure sale will not net sufficient proceeds to cover obligations secured by the property.

376. *See supra* note 375 and accompanying text (noting that mortgage lenders perform collateral due diligence).

Under this proposal, the priority of the assessment lien would effectively erode the first priority of the mortgagee. This would likely incentivize lenders to pay assessments on behalf of their borrowers who are delinquent and add such costs to the debt. Most mortgage instruments already permit lenders to do this. Increased lender responsibility for its share of community upkeep might also motivate more expeditious foreclosure proceedings. Either way, the costs borne by an association would be minimized.[377] This better cost allocation regime would make sure that lenders are no longer distorted in their foreclosure timing analyses, which would ensure that delays in foreclosure result from relevant loan and market factors, not from a lender's mere desire to free-ride by avoiding collateral upkeep costs.

Lenders would reasonably respond to such a law by making a better credit evaluation prior to advancing funds regarding a borrower's ability to pay not only the mortgage loan but also the applicable assessments. Lenders would also have even more reason to ensure an accurate appraisal of collateral value. Any change in the legal framework of home lending that achieves this outcome is likely beneficial to individuals and the economy as a whole.[378] Also, such an evaluation currently cannot be done by the association itself, but it can be easily and cheaply achieved by lenders.[379] Lenders might respond to such a law by establishing an escrow account for association assessments, similar to accounts lenders already require for property tax and insurance amounts (and as already anticipated by Fannie Mae and Freddie Mac form instruments).[380] Finally, this law would motivate lenders during foreclosure to pay outstanding assessments to avoid incurring additional costs and fees. Having an assessment back-up source would benefit all property values in the community and keep other owners from being penalized for having delinquent neighbors. Lender-funded upkeep also avoids the situation of unjust enrichment that currently exists when neighbors end up paying for the upkeep on mortgaged properties for which they hold no interest.

Allowing a first mortgage lender's priority to erode over time as foreclosure is delayed is therefore both equitable and efficient.

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377. Reasonable collection costs should be included in the priority lien amount; however, this proposal does raise the important question of collection cost and late fee abuses, discussed *infra* Part II.B.4.

378. *See generally supra* Part I.A.2 (discussing the negative externalities of constructive abandomnent).

379. Lenders today are evaluating not only their borrowers' ability to pay assessment obligations, but also the ability of all other owners in the community to pay their assessments.

380. *See supra* note 354 and accompanying text (noting that lenders routinely establish property tax escrow accounts to protect themselves against superior priority payment obligations).

Uncapping lender liability for assessments will lead to assessment obligations being met more frequently by someone. This approach will also create a disincentive for irresponsible delays in foreclosure and, unlike the six-month limited-priority regime, will continue to be effective even if foreclosure does take a long time to complete. A system of eroding mortgage priority could allocate some limited portion of unpaid assessments to a community or could allocate all unpaid amounts to the lender, depending on when the lien erosion "clock" would start.[381]

Unlike the limited lien priority system, an eroding first priority system will not merely reduce association losses—it will tangibly improve community stability. Because responsible neighbors will be insulated from default spillover, recovery can occur; investors can purchase units secure in the knowledge that their investment is not subject to the unforeseeable and uncontrollable default rates of neighboring property loans. Lenders can lend on units in CICs knowing that the community will continue to be maintained and property values will be preserved, all at a cost allocation that is fair and equitable.

Ultimately, this system even benefits the first mortgage lenders who bear priority erosion losses as well because the value of their collateral will be preserved. Eroding lien priority should lead to a better recovery in foreclosure sales, which should offset the priority losses the system entails. For this reason, the GSEs should revise their policies and permit uncapped lender responsibility for collateral upkeep. Although a six-month limit is easier for a lender to prospectively quantify (because the maximum amount of foreclosure proceeds paid to an association is pre-determined), this approach depresses the property's value and limits capital availability to the entire community. Allowing a fairer allocation of community costs justifiably supports values and stability in the community—an outcome beneficial for the community's lenders as well as its owners.

2. Promoting Foreclosure as Policy

One effect of the eroding mortgage priority solution is that lenders will be discouraged from delaying foreclosure just to avoid payment of community assessments. A possible result is that foreclosures of community association properties may proceed more expeditiously,

381. In lieu of having a front-end delay before erosion of a lien begins, a state could choose a shared-liability approach to assessments, mandating that a certain percentage of all unpaid assessments at foreclosure enjoy a payment priority. Under this system, the cost to a neighborhood would continue to grow as foreclosure is delayed, but so would the cost to a lender. This approach, however, would at least somewhat curtail the lender's collateral upkeep free-ride.

which is arguably harder on defaulting homeowners who face losing their homes more quickly. Although it is politically difficult for governments to push for quicker foreclosures (which is seen as making the poor owners lose vis-à-vis the banks), providing an incentive for banks to foreclose promptly is actually good in terms of the neighbors and the community as a whole.[382]

In some ways, both defaulting borrowers and mortgage lenders benefit from foreclosure delays, all at the expense of the community.[383] Delinquent owners can stay in their homes, cost-free,[384] and lenders can wait out a bad market while avoiding the carrying costs on a property.[385] The people who really lose from this delay are those least able to control for it: the innocent neighbors who fund the unpaid assessment bills.

Undue foreclosure delays adversely affect the wider market as well. Without lower-priced sales to pull down comparable sale values of homes, housing prices remain propped up at unsustainable levels. Delaying foreclosure sales, therefore, also delays the housing market

382. Politicians frequently balk at this approach of "getting it over with," and economists disagree about whether it is better to allow borrowers rent-free possession during a general market downturn or not. *See, e.g.*, Brady Dennis & Ariana Eunjung Cha, *Pelosi Calls for Federal Inquiry on Mortgage Lenders*, WASH. POST, Oct. 6, 2010, at A15 (discussing political reasons to push for foreclosure moratoriums while quoting Guy Cecala, the publisher of *Inside Mortgage Finance*, as warning that further slowdown in foreclosure sales would "delay significantly any recovery of the housing market"); Dina ElBoghdady, *Anxiously Waiting for the Sale to Go Through*, WASH. POST, Oct. 9, 2010, at A11 (discussing why foreclosure delays increase market uncertainty and the problems that result); Pearlstein, *supra* note 121, at A09 (explaining that "the longer the foreclosure process goes on, the longer it will take for the excess supply of houses to be absorbed, for prices to stabilize and for the real estate market to return to something closer to a normal equilibrium").

383. At the least, the parties benefit from delays where there is not a third party to buy the property from the lender at foreclosure or soon thereafter.

384. News stories tell of increasing numbers of homeowners who stop paying their mortgages, betting that it will take the lender a very long time to foreclose and explain that the threat of foreclosure is so temporally remote that it becomes merely "theoretical." *E.g.*, David Streitfeld, *Owners Stop Paying Mortgages . . . and Stop Fretting About It*, N.Y. TIMES, June 1, 2010, at A1 ("A growing number . . . are fashioning a sort of homemade mortgage modification, one that brings their payments all the way down to zero.").

385. *See* Ruger, *supra* note 2, at A1 ("[B]anks put off the foreclosure sales in many cases because once they take the property, they become liable for taxes, fees and maintenance."). Some banks even delay after acquiring the property at a foreclosure sale, waiting as long as possible to record the deed in order to procrastinate the day they are legally required to contribute to property upkeep. In the past year, some states legislatures have proposed laws to address this trend, requiring that deeds be filed within thirty or ninety days of a foreclosure sale. *See, e.g.*, S.B. 141, 150th Gen. Assemh., Reg. Sess. (Ga. 2009) (requiring foreclosure deeds to be recorded within ninety days); S.B. 128, 75th Sess. (Nev. 2009) (requiring foreclosure deeds to be recorded within thirty days).

from reaching equilibrium.[386] Only when prices reflect fundamental values will the market start recovering in earnest.

Undue foreclosure delays also discourage home buyers and investors who face uncertain timing and title.[387] Lenders avoid financing because of the uncertainty posed by community properties left in limbo.[388] In addition, delaying foreclosures also keeps the capital markets from establishing accurate pricing for mortgage-backed securities products, slowing the recovery in that market as well.[389]

During the limbo of threatened foreclosure, properties are generally not maintained at the optimal level.[390] This threat to quality of our housing stock is nowhere greater than in CICs, where a few delinquent properties can actually cause a decrease in the upkeep of the entire community. Our housing stock is at risk of deterioration if responsible "gatekeepers" are not funding its upkeep. The longer the limbo is drawn out, the more extreme upkeep problems will be.

It sounds draconian, but the best thing for the community in the case of a nonpaying unit owner facing foreclosure is to have the foreclosure sale take place as swiftly as possible. Unnecessary delay costs the entire community money and increases uncertainty. Any benefits accruing to the lender (or borrower) from such delay are purchased with other people's money. Plus, perceived lender benefits may be illusory because decline in collateral upkeep and increase in community assessment deficiencies will significantly drive down the value of the property and the lender's ultimate recovery at foreclosure.

3. Lender Disorganization and Misbehavior

Blame for the financial troubles of associations—like blame for the housing crisis—targets the mortgage lenders,[391] but the eroding lien

386. In 2006, the Office of Federal Housing Enterprise Oversight ("OFHEO") calculated the ratio of equivalent rents to home prices (comparing the amount for which a given home would rent to the home's purchase price) and found that nationwide, the average rental value of homes was only 70% of the purchase price. Stewart & Brannon, *supra* note 40, at 16 fig.1.

387. *See supra* note 122 and accompanying text (discussing how the uncertainty of assessments affects would-be buyers and new investors).

388. *See supra* notes 260–64 and accompanying text (describing the obstacles to financing faced by condominiums that are in limbo).

389. *See supra* notes 4 and 10 and accompanying text (discussing how many foreclosure sales do not even cover the amount owed on the mortgages and how the amount of mortgages in default force a fewer number of individuals to cover the burden of upkeep costs).

390. *See supra* Part I.A.2 (noting that a defaulting homeowner facing foreclosure has little incentive to make improvements on the home).

391. Miami Beach City Commissioner Jerry Libbin, for example, blames "greedy banks" that "refuse to take financial responsibility for their reckless lending" for causing the mass of association delinquencies that end up saddling the remaining owners of condominium units with

proposal is not punitive. Rather, proper upkeep allocation is a prerequisite to market recovery. Thus far, mortgage lenders have strongly objected to being forced to pay assessments on behalf of properties they are unable to sell quickly,[392] although their own self-interest leads banks to take on maintenance obligations for collateral not located in privately-governed communities. Governments and consumer protection groups have begged lenders to cut homeowners a break, yet homeowners face being sued by Florida associations for not foreclosing quickly enough.[393] The volume of defaulted properties is itself a barrier to expeditious foreclosure.[394] Servicers are overwhelmed with as many new mortgage defaults each month as previously occurred in an entire year.[395]

In the case of homes not located in CICs, lenders cannot avoid maintenance of constructively (or literally) abandoned properties prior to foreclosure. To prevent the ravages of permissive waste, lenders hire a manager to maintain such properties, buy insurance on the properties, and even pay to have necessary repairs done. Such collateral preservation steps are merely prudent business decisions and do not necessarily force lenders to foreclose at a time other than their choosing. Alternately, lenders can decide to modify loan obligations to free up borrower capital to meet needed upkeep costs. Lenders outside of CICs regularly act upon the clear understanding that maintenance of collateral value is in their own best interest. The only reason lenders do not incur such costs in CIC properties is that someone else is already doing the maintenance and picking up the tab.

"huge special assessments." *Miami Beach Commissioner Jerry Libbin Applauds 'Reverse Foreclosure' Ruling, Renews Call for State Lawmakers to Enact Comprehensive Foreclosure Reforms*, PR NEWSWIRE (Jan. 27, 2010), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546. Libbin has been "spearheading a state-wide campaign to protect condominium unit owners from unfair assessments levied on them" because of the housing meltdown, claiming that "loopholes in laws have allowed banks to escape from paying their fair share—forcing tens of thousands of Florida condo unit owners in good standing to pick up the tab." *Id.*

392. Alex Sanchez, president and CEO of the Florida Bankers Association, explains the lender perspective: "We get hit from every side. Some people say we're foreclosing too fast; others say we're foreclosing too slow [sic]. Bankers want to keep Florida families in their homes. Foreclosure is a last remedy." Coleman, *supra* note 104, at 1A.

393. *See supra* Part II.A.1.c (discussing government efforts to extend foreclosure timelines).

394. *See* Eunjung Cha & Dennis, *supra* note 3, at A9 (warning that uncertainty in foreclosure procedures scares away buyers and creates an even more "traumatic market" situation, where foreclosure buyers are even more scarce); Gretchen Morgenson & Geraldine Fabrikant, *Florida's High Speed Answer to a Foreclosure Mess*, N.Y. TIMES, Sept. 5, 2010, at BU1 (explaining that the huge backlog of foreclosure cases in Florida has led to some corner-cutting by the judicial department as well as lenders and that the backlog continues to increase anyway).

395. Viega, *supra* note 9.

Foreclosures cannot proceed when it is unclear who owns what loans.[396] Because a mortgage follows the note, only ownership (and, typically, possession) of the note evidencing the debt can permit an entity to foreclose on the mortgage. Before the advent of the secondary mortgage market and securitization, note ownership was easy to track because in most cases loan originators remained holders of the instrument. But with the growth of the secondary market and the innovation of mortgage-backed securitization and its related products, ownership of mortgage debt was passed on post-closing and became segmented through pools of loans.[397] By the mid-1990s, most mortgage

396. On October 13, 2010, all fifty states began a joint investigation into mortgage foreclosures. This investigation was sparked by the "robo-signing" scandal. Robo-signing refers to the practice of having employees sign off on thousands of foreclosure affidavits, stating that they had reviewed the underlying paperwork when, in fact, they had not. *See* Ennjung Cha & Dennis, *supra* note 382, at A15 (discussing House Speaker Nancy Pelosi's call for the Justice Department to investigate mortgage lenders and how Maryland joined other states that sought to halt foreclosure sales while lender forgery and fraud claims were fully explored). The robo-signing scandal and associated moratoriums slowed down the foreclosure process significantly and left millions of homes "in limbo." *Id.*; *see also Congressional Oversight Panel: Hearing on TARP Foreclosure Mitigation Programs*, 111th Cong. 3 (2010) (testimony of Julia Gordon, Center for Responsible Lending) (stating that servicers engaged in "shoddy, abusive, and even illegal practices related to the foreclosure process" cause a lack of confidence in the process among buyers, which slows the absorption of real estate-owned inventory and an overall recovery of the housing market); Eunjung Cha, Mufson & Yang, *supra* note 3, at A11 (discussing the political pressure for the federal government to impose a full moratorium on foreclosures due to concerns over banks' foreclosure procedures); *supra* note 3 and accompanying text (discussing the moratoriums on mortgage foreclosures announced by large lenders due to sloppy or fraudulent servicer foreclosure procedures, describing the political reaction to the moratoriums, and stating that the procedural concerns prompting the moratoriums still linger despite the fact that the moratoriums have since been lifted). Although the moratoriums have now been lifted, the pace of foreclosure has significantly slowed in the wake of such scandals, resulting in a renewed focus on foreclosure procedure and mortgage ownership. For a more detailed discussion of some of the problems of note ownership and chain of title for mortgage notes in the secondary market and a proposal regarding possible future systemic solutions, see Dale A. Whitman, *How Negotiability has Fouled up the Secondary Mortgage Market, and What to Do About It*, 37 PEPP. L. REV. 737, 757–69 (2010).

397. The securitization concept basically holds that by splitting a group (pool) of mortgage loans into multiple classes (tranches) with a hierarchy of repayment rights (the top tranche has the least risky position in terms of credit and repayment risk), the mere grouping and tranching of the pool will dramatically reduce risks for investors holding the top tier position because the lower-positioned investors provide a buffer by bearing the first loss. Theoretically, this is true even if the entire pool is made up of risky mortgage loans: the lower tranches act as a risk shock absorber. Wall Street opined that pooling and tranching can be done several times, supposedly reducing risk of top-tiered securities with each re-tranching. This theory, widely accepted in the dawn of the twenty-first century, seems to work less well under real market stress—as seen in the meltdown of the subprime market. The structure of securitization in the abstract was not the problem, it was rather the valuation model for securitized products that was inadequate. For an overview comparison of securitization and traditional bank lending, see Gerald Hanweck, Anthony Sanders & Robert Van Order, *Securitization Versus Traditional Banks: An Agnostic View of the Future of Fannie Mae, Freddie Mac and Banks*, FINREG21 (Sept. 28, 2009), http://www.finreg21.com/lombard-street/securitization-versus-traditional-banks-an-agnostic-

banks no longer intended to originate mortgages for their own portfolios but rather acted as intermediaries—originating mortgages in order to sell them on the secondary market in turn.[398]

Loan ownership changes, through secondary market sales of mortgage loans, pooling, tranching, and securitization sales of pieces of those loans, were supposedly all tracked through the Mortgage Electronic Registration System ("MERS").[399] Although MERS records of loans often do permit ownership to be tracked, the individual notes have in many cases become lost along the way.[400] Because the lien (the mortgage) follows the payment obligation (the note), production of the note or a court-allowed substitute is a prerequisite to commencing a foreclosure proceeding.[401]

The delay is unfortunate but unavoidable: foreclosure as a process requires strict adherence in order to assure the fairness of the result.[402] If foreclosures must slow down to ensure procedural due process, then a slower timeline is esseutial.[403] The costs of these foreclosure delays, however, should be borne by the entities who could have avoided the problems causing the delays—namely, the lenders or servicers. Hopefully, foreclosures will not be delayed more than necessary as a result of political posturing because foreclosure delay causes far more problems than it solves.[404]

Many of the problems plaguing the housing market today—from the robo-signing scandal to the poorly-underwritten loans in the first place—are products of lender sloppiness, disorganization, and (sometimes) misbehavior. The structure of the market itself encouraged

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view-future-fannie-mae-freddie-ma (providing a concise description of the development of mortgage-backed securitization); *see also* Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 535–51 (2002) (providing a summary of the basics of loan securitization).

398. ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 381–82 (3d ed. 2007). *See generally* ANDREW DAVIDSON, ANTHONY B. SANDERS & LAN-LING WOLFF, SECURITIZATION: STRUCTURING AND INVESTMENT ANALYSIS (2003).

399. *See* Whitman, *supra* note 396, at 765 n.157 (describing MERS, which was "created by the major participants in the secondary mortgage market to maintain an electronic, on-line registry of mortgage assignments").

400. *Id.* at 757.

401. *Id.* at 757–59.

402. This is very similar to how election law procedures assure fair election results and how trial procedures assure viable findings of fact.

403. It is paramount to ensure that foreclosure sales are valid because flawed foreclosures raise three problems that threaten housing markets and the broader economy: the foreclosure itself may not be warranted or conducted correctly (with proper parties); buyers at foreclosure are not assured of good title; and lack of confidence in titles to land slows housing market recovery.

404. *See supra* Part I.A.2 (discussing the negative impact of constructive abandonment).

risk-taking at the originating lender level. Because borrower credit risk was assumed by the secondary market purchaser and securitizer of the loans, often with insurance companies providing credit enhancement to the mortgage pool, and was then passed on (in whole or in part) to investors in the pool that provided the actual funds through purchasing mortgage-backed securities,[405] there was very little incentive for mortgage lenders to perform sufficient due diligence before advancing funds. The *New York Times* decries sloppy lending, property appraisals, and securities ratings, pointing out that "[s]ince we trust, why verify?" seems to have been the industry motto.[406]

Again, there were many guilty parties in sloppy lending and loan transfers. But as between the mortgage lenders and the borrower's neighbors, the lenders clearly emerge as more culpable. Thus, between these two categories of parties, the choice for cost allocation is likewise clear: the mortgage lender is the only party who can avoid similar problems in the future. As the least-cost avoider, economic theory supports the equitable judgment here: lenders should bear costs caused by their failure to carefully underwrite their lending, properly document their mortgage sales and securitizations, and promptly and correctly foreclose.[407]

Lenders uniformly lobby to keep the system as-is, particularly in states with no limited lien priority for assessments. But in reality, bankers' associations that decry a viable solution to private governance failure are acting against their own long-term interest. Although lenders may see themselves as paying the price of revisions in the lien priority scheme, they very well could also be lenders on non-defaulting units currently being burdened with increasing assessments or, at the very least, facing the uncertainty of assessment increases in the future. A lender may desire to make a loan on a unit in a community where a large percentage of owners could stop paying assessments at any time. This uncertainty hurts owners and their lenders.[408]

Alternatively, if the community could ensure the expected revenue stream, the risk to all lenders decreases even though their exposure in

405. *See supra* note 397 (describing the securitization concept involving pools and tranches).

406. Floyd Norris, *Banks Stuck with Bill for Bad Loans*, N.Y. TIMES, Aug. 20, 2010, at B1.

407. This is not to say that uncertain foreclosures should be permitted. Strict procedural protections and requirements must be maintained. But any additional community costs incurred by lender missteps must be borne by lenders alone—not by the neighborhoods in which their collateral is located.

408. This is why Fannie Mae, Freddie Mac, FHA, and other lenders impose a limit on the percentage of delinquencies before they will purchase or insure (or originate) loans in a community association. It is also why the GSEs want to approve community reserves levels. *See supra* Part II.A.1.b (discussing how lender policies affect assessment recovery).

terms of their non-paying borrowers goes up. The downside, however, should not pose a problem; lenders can manage this risk much more easily than the uncertainty risk related to potentially unrecoverable assessments. Lenders already take measures to protect themselves against property tax amounts that can accrue and are payable prior to their mortgage loan out of foreclosure proceeds. Lenders need only to set up reserve accounts and affirmatively require payment of association assessments to control for borrower misbehavior and their own loss exposure from the loss of lien priority.

Lenders also benefit from legislation empowering associations to ultimately recover their upkeep costs because, by keeping the community association solvent and active, lenders reap the benefits of supported property values and well-maintained communities. Even when lenders "save" money by delaying foreclosure to avoid paying assessments, they drive down the property value of their own collateral by causing community assessments to increase while services decline. In essence, lenders commit their own waste when they fail to ensure payment of association assessments.

4. Association Assessment Abuses

Some commentators target association expenditures in general as wasteful spending, but statutory oversight of association budgeting and amenities is not a good idea. Rather than pass laws requiring communities to tighten their belts, this is best left to the governance system in place. There is nothing preventing members from voting to cut back services and save community funds. Furthermore, if a lender begins paying assessments after foreclosure, the lender will be able to assert the unit's voting rights and have some input into community costs and fees.

Associations are typically empowered to charge late fees and collection costs in addition to delinquent assessments.[409] Clearly, associations must be able to recoup the costs of collecting delinquent assessments. Some assert, however, that late fees and collection costs are out of control.[410] Allegations abound that community associations hire lawyers who abuse the system by charging outrageous fees.[411]

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409. HYATT, *supra* note 15, at 121–22 (describing two methods of imposing late fees in CIC associations: flat rate and monthly interest fees).

410. *See, e.g.*, Ngoc Nguyen, *Hard-Pressed Homeowners Facing Another Financial Threat*, N.Y. TIMES, Apr. 15, 2011, at A19A (depicting cases where association debts were "turned over" to collection agencies and the tenfold increase in the amount owing due to fees and interest).

411. *Id.*; *see also* Shirley Wise, *Reverse Foreclosures—Are the Associations the Victims Here?*, EZINEARTICLES (Aug. 30, 2010), http://ezinearticles.com/?Reverse-Foreclosures---Are-the-Associations-the-Victims-Here?&id=4879390 (reporting that "the association attorneys add

Some California lawmakers, for example, have highlighted the danger of so-called "foreclosure factories"—law firms and collection agencies that charge an association $1500 to $2000 for taking over a foreclosure proceeding against a delinquent owner.[412] The associations tack the amount paid to assessment collectors onto the delinquent charges, and the collection cost amounts can be "shockingly high."[413]

Current government oversight of collection cost charges is minimal: only the California State Legislature has considered specifically limiting debt collection practices of CIC associations.[414] Recent attention to the plight of both association residents and nonpaying owners facing foreclosure suggests that additional state regulation of assessment collection may be on the horizon.[415]

Concern over unconscionably high late fees and collection costs may be warranted, as there are few legal limits on what a CIC association can impose on its members as long as it follows the procedures set forth in its governing documents.[416] If mortgage lenders are on the hook for

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outrageous fees for their services," are "unwilling to discount the amount not even by a dollar" and that these unfair practices "need to be questioned"). *See generally* EVAN MCKENZIE, PRIVATOPIA: HOMEOWNER ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENT (1996) (criticizing the entire governance system of CICs as prone to abuse).

412. *Id.*; *see also* Wasserman, *supra* note 12 (describing the problems related to associations that can easily foreclose on homes and describing recent legislative efforts to make foreclosure more difficult).

413. Ngai Pindell, *Tensions Between HOA Super Liens and Purchasers at Foreclosure*, LAND USE PROF BLOG (Jan. 29, 2010), http://lawprofessors.typepad.com/land_use/2010/01/tensions-between-hoa-super-liens-and-purchasers-at-foreclosure.html. Collection costs charged by associations are much maligned. Professor Pindell opines that "the only entities capable of engendering more ill will than over-zealous lenders are HOAs" and notes that "many see these perceived, excessive HOA charges as yet another manifestation of unchecked and intrusive power over homes and communities." *Id.*

414. *See* S.B. 561, 2011–2012 Reg. Sess. (Cal. 2011) (providing that "an association shall not voluntarily assign or pledge the association's right to collect payment or assessments to a third party . . . [unless] the third party agrees in writing to collect payments or assessments on behalf of the association in the manner set forth in this chapter" and prohibiting "a third party that has contracted with an association to collect assessments, fees, or payments . . . [from] act[ing] as trustee in foreclosure proceedings"); *see also* Nguyen, *supra* note 411, at A19A (reporting that "the California Senate Judiciary Committee passed a bill to curtail predatory practices by collection agencies" for homeowner association debt). The federal Fair Debt Collection Practices Act may also apply to limit the tactics an association may employ to collect unpaid assessments. *See* Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692–1692p (2006); *supra* note 162 and accompanying text (discussing the Fair Debt Collection Practices Act).

415. Pending bills in Utah and Arizona bar the use of debt collectors to obtain unpaid assessments. Conlin & Lush, *supra* note 5.

416. *See, e.g.*, O'Buck v. Cottonwood Vill. Condo. Ass'n, 750 P.2d 813, 818 (Alaska 1988) (upholding association rule banning television antennae in spite of no showing of adverse effect on the value of units and holding that owners of units in CICs "consciously sacrifice some freedom of choice in their decision to live in this type of housing"); Villa de las Palmas Homeowners Ass'n v. Terifaj, 90 P.3d 1223, 1234–35 (Cal. 2004) (upholding amendment to

unpaid assessments plus fees, such lenders might validly complain that an association might manipulate costs in order to obtain coverage of community expense from lenders' deep pockets. There may therefore be compelling reasons to have statutory limits on late fees and charges that an association can impose in order to prohibit a paying majority from unfairly allocating association costs. Some statutory oversight would be particularly warranted in cases where such charges are ultimately recoverable in full from a first mortgage lender in its foreclosure sale. Just as the current inequitable allocation of costs among members is unfair, it would be equally unfair to pass on a lion's share of community costs to lenders.

CONCLUSION

Today's unprecedented delay in foreclosures of vast numbers of financially underwater property harms non-defaulting owners in privately governed communities. The financial "commons" of entangled fiscal fortunes in such neighborhoods illustrates a fundamental flaw in the common interest community system of ownership that must be remedied to prevent the potential failure of such governance forms during periods of great economic stress. The adverse external impact of community assessment delinquencies is an important but often overlooked problem, which under the current housing crisis is reaching critical levels in some localities. Certain government and market actions, including current foreclosure moratoriums and delays, exacerbate the problem, spreading financial distress to innocent homeowners and bringing property values down in a tangible and significant way. Leaving community associations effectively bankrupt is a lose-lose scenario and we need prompt legislative action to prevent this result.

Current lien priority laws fail to protect the interests of such communities and their paying members. Even in the handful of states that have enacted protective limited lien priority provisions with respect to community association assessments, assessment lien priority is almost always capped at six months' worth of delinquent assessments. Because foreclosures take months or years longer than the time period representing the recoverable assessment amounts, such laws provide no real incentive for lender responsibility or expeditious foreclosure sales. As foreclosure is delayed, costs continue to mount while neighbors pay the costs left unpaid by delinquent owners.

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condominium declaration banning pets despite statute providing that no declaration can prohibit all pets).

To effectively preserve property values and protect blameless homeowners in planned communities, states across the nation must adopt measures to enable private governments to perform their roles. Allowing delayed foreclosures to erode the lien priority of a first mortgage achieves the needed result with the most contained and best-allocated costs. Although creating incentives for prompt foreclosures may at first glance seem perverse in a difficult economy, it is the only answer to the insolvency contagion threatened by assessment delinquencies and foreclosure delays. Finding solvent owners to replace those who hold title to houses they can ill afford—both in terms of financing and upkeep costs—is paramount. Continuing to mandate that paying members of a community association provide private financial support to the defaulting homeowners is unfair, inefficient, and poor policy indeed.

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DISTRICT COURT

CLARK COUNTY, NEVADA

WINGBROOK CAPITAL, LLC., Plaintiff, vs. PEPPERTREE HOMEOWNERS ASSOCIATION; and DOES 1-10 and ROE ENTITIES 1-10, INCLUSIVE Defendants.	Case No. A-11-636948-B Dept. No. XI **ORDER**

This matter came before the Court on May 24, 2011 at 9:00 a.m., upon the Plaintiff's Motion for Summary Judgment on Claim of Declaratory Relief. James R. Adams, Esq., of Adams Law Group, Ltd., and Puoy K. Premsrirut, Esq., of Puoy K. Premsrirut, Esq., Inc., appeared on behalf of the Plaintiff. Kurt Bonds, Esq., of Alverson, Taylor, Mortensen & Sanders appeared on behalf of the Defendant. The Honorable Court, having read the briefs on file and having heard oral argument, and for good cause appearing hereby rules:

WHEREAS the Parties have engaged in and have concluded a Nevada Real Estate Division mediation (ADR #11-25) wherein the Parties mediated a dispute over the sum of $13,190.33; and

WHEREAS the subject of the mediation was whether NRS 116.3116 permitted Defendant to charge to Plaintiff $14,037.83, or whether some lesser amount was due pursuant to NRS 116.3116; and

WHEREAS, the Court has determined that a justiciable controversy exists in this matter as Defendant claims it has a right pursuant to NRS 116.3116 to charge and retain proceeds in the amount $14,037.83 from Plaintiff and Plaintiff, a purchaser of a home at foreclosure which is located within the Defendant homeowners' association, contests this charge and claims that Defendant exceeded the limits of NRS 116.3116 and overcharged it for the super priority lien; and

WHEREAS there exists in this case a controversy in which a claim of right is asserted by Plaintiff against Defendant who has an interest in contesting it; and

WHEREAS Plaintiff and Defendant, the contesting parties hereto, are clearly adverse and hold different views regarding the meaning and applicability of NRS §116.3116 (including whether Defendant charged too much for the super priority lien); and

WHEREAS Plaintiff has a legal interest in the controversy as it was Plaintiff's money which had been demanded and transferred to Defendant and it was Plaintiff's property that had been the subject of a homeowners' association lien by Defendant; and

WHEREAS the issue of the meaning, application and interpretation of NRS 116.3116 is ripe for determination in this case as the present controversy is real, it exists now, and it affects the Parties hereto; and

WHEREAS, therefore, the Court finds that issuing a declaratory judgment relating to the meaning and interpretation of NRS 116.3116 would terminate some of the uncertainty and controversy giving rise to the present proceeding; and

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WHEREAS, pursuant to NRS 30.040 Plaintiff and Defendant are parties whose rights, status or other legal relations are affected by NRS 116.3116 and they may, therefore, have determined by this Court any question of construction or validity arising under NRS 116.3116 and obtain a declaration of rights, status or other legal relations thereunder;

THE COURT, THEREFORE, DECLARES, ORDERS, ADJUDGES AND DECREES as follows:

1. NRS 116.3116 is a statute which creates for the benefit of Nevada homeowners' associations a lien against a homeowner's unit for any construction penalty that is imposed against the unit's owner pursuant to NRS 116.310305, any assessment levied against that unit or any fines imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due (the "Statutory Lien"). The homeowners' associations' Statutory Lien is noticed and perfected by the recording of the associations' declaration and, pursuant to NRS 116.3116(4), no further recordation of any claim of lien for assessment is required.

2. Pursuant to NRS 116.3116(2), the homeowners' association's Statutory Lien is junior to a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent ("First Security Interest") except for a portion of the homeowners' association's Statutory Lien which remains prior to the First Security Interest (the "Super Priority Lien").

3. Homeowners' associations, therefore, have a Super Priority Lien which has priority over the First Security Interest on a homeowners' unit. However, the Super Priority Lien amount is not without limits and NRS 116.3116 provides that the amount of the Super Priority Lien (i.e., that amount of a homeowners' associations' Statutory Lien which retains priority status over the First Security Interest) is limited "to the extent" of those assessments for common expenses based upon the associations' periodic budget that would have become due in the 9 month period immediately preceding an

associations' institution of an action to enforce its Statutory Lien and "to the extent of" external repair costs pursuant to NRS 116.310312.

4. The words "to the extent of" contained in NRS 116.3116(2) mean "no more than," which clearly indicates a maximum figure or a cap on the Super Priority Lien which cannot be exceeded.

5. Therefore, after the foreclosure by a First Security Interest holder of a unit located within a homeowners' association, pursuant to NRS 116.3116 the monetary limit of a homeowners' association's Super Priority Lien is limited to a maximum amount equaling 9 times the homeowners' association's monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the institution of an action to enforce the lien (the "Assessment Cap Figure") plus external repair costs pursuant to NRS 116.310312.

6. While assessments, penalties, fees, charges, late charges, fines and interest may be included within the Assessment Cap Figure, in no event can the total amount of the Assessment Cap Figure exceed an amount equaling 9 times the homeowners' association's monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the association's institution of an action to enforce the lien.

7. The Super Priority Lien equals the Assessment Cap Figure plus external repair costs pursuant to NRS 116.310312.

8. After providing a homeowner with notice and hearing, NRS 116.310312 permits a homeowners' association to enter the grounds of a homeowners' unit and maintain the exterior of the unit in accordance with the standards set forth in the association's governing documents. Pursuant to NRS 116.310312(2)(b), a homeowners' association may also remove or abate a public nuisance on the exterior of a unit. The association may order that the costs of such maintenance or abatement, including interest, inspection fees, notification fees and collection costs for such maintenance

or abatement to be charged against the unit ("Exterior Repair Costs"). NRS 116.310312(9)(a) provides that "Exterior" of the unit includes, without limitation, all landscaping outside of a unit and the exterior of all property exclusively owned by the unit owner.

9. Therefore, the Super Priority Lien consists solely and exclusively of the Assessment Cap Figure and the Exterior Repair Costs. No other costs, fees, fines, penalties, assessments, charges, late charges, or interest or any other costs may be included within the Super Priority Lien.

10. Pursuant to NRS 116.3116, the maximum amount of the Assessment Cap Figure portion of Defendant's Super Priority Lien cannot exceed $1,552.50 which equals 9 times the Defendant's monthly assessments. As Defendant has assessed against Plaintiff $1,552.50 for past due assessments incurred prior to Plaintiff's ownership of the property, the additional late fees of $135.00 and accrued interest on the Assessment Cap Figure are impermissible and cannot be included in the Assessment Cap Figure as the addition of those costs exceed the Assessment Cap Figure of $1,552.50 and violates NRS 116.3116.

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11. The External Repair Costs portion of the Super Priority Lien shall be determined by this Court at a later date when the Court is provided with all necessary evidence to make that determination.

IT IS SO ORDERED.

DISTRICT COURT JUDGE

June 2, 2011
Date

BK

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DISTRICT COURT

CLARK COUNTY, NEVADA

PECCOLE RANCH COMMUNITY ASSOCIATION, a domestic non-profit homeowners association corporation, Plaintiff, vs. ELSINORE, LLC, a Nevada Limited Liability Company, Defendant. ELSINORE, LLC., on behalf of itself and as representatives of the class herein defined Counter Claimant, vs. PECCOLE RANCH COMMUNITY ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Counter Defendant.	CASE NO. A-12-658044-C DEPT. NO. XV Date of Hearing: August 29, 2012 Time of Hearing: 9:00 a.m. **ORDER DENYING IN PART AND GRANTING IN PART PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT**

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DISTRICT COURT

CLARK COUNTY, NEVADA

PECCOLE RANCH COMMUNITY ASSOCIATION, a domestic non-profit homeowners association corporation, Plaintiff, vs. ELSINORE, LLC, a Nevada Limited Liability Company, Defendant. ELSINORE, LLC., on behalf of itself and as representatives of the class herein defined Counter Claimant, vs. PECCOLE RANCH COMMUNITY ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Counter Defendant.	CASE NO. A-12-658044-C DEPT. NO. XV Date of Hearing: August 29, 2012 Time of Hearing: 9:00 a.m. **ORDER DENYING IN PART AND GRANTING IN PART PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT**

42798

SEP 07 2012

This matter came before the Court on August 29, 2012, at 9:00 a.m., upon the Plaintiff's MOTION FOR PARTIAL SUMMARY JUDGMENT. James R. Adams, Esq., of ADAMS LAW GROUP, LTD., and Puoy K. Premsrirut, Esq., of PUOY K. PREMSRIRUT, ESQ., INC., appeared on behalf of the Defendant/Counter Claimant. Don Springmeyer, Esq., of WOLF, RIFKIN, SHAPIRO, SCHULMAN & RABKIN, LLP., appeared on behalf of the Plaintiff/Counter Defendant. The Honorable Court, having read the briefs on file and having heard oral argument, and for good cause appearing hereby, DECLARES, ORDERS, ADJUDGES AND DECREES that Plaintiff's Motion for Partial Summary Judgment is denied in part and granted in part.

WHEREAS, the undisputed facts are as follows: Plaintiff is a Nevada homeowners association. Defendant was an owner of residential real property located within the Peccole Ranch Community Association. In particular, Defendant purchased the property located at 2209 Storkspur, Las Vegas, NV, at a foreclosure sale on or about September 8, 2008. Defendant had obtained title to the property through a trustee's sale whereby a secured first trust deed holder foreclosed on the property thereby extinguishing Plaintiff's statutory general homeowners' association lien against the property, but for the super priority portion of that general lien. According to Defendant, the Association by itself or through its authorized agents, demanded and collected amounts from the Defendant. The amount demanded was $2,580.70. The amount allegedly paid by Defendant was $2,649.90.

IT IS FURTHER ORDERED that NRCP 56(b) provides as follows: A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in the party's favor as to all or any part thereof.

The Court may enter summary judgment on questions of law where the facts are not in dispute. *Exchange Bank v. Strout Realty*, 94 Nev. 86, 525 P.2d 589 (1978). Thus, this Court may issue partial summary judgment on the declaratory issues pertaining to NRS 116.3116 and CC&Rs Section 8.3. Summary judgment is appropriate only when the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no

genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. NRCP 56(c); *Pegasus v. Reno Newspapers, Inc.*, 118 Nev. 706, 713 (2002). "A factual dispute is genuine when the evidence is such that a rational trier of fact could return a verdict for the nonmoving party." *Wood v. Safeway, Inc.*, 121 Nev. 724, 731 (2005). The substantive law controls which factual disputes are material and will preclude summary judgment; factual disputes not germane and central to the claims for relief are irrelevant. *Id.* The burden to establish the absence of a triable issue of fact is on the moving party, and the court is obligated to construe the evidence in the light most favorable to the party against whom the motion is directed. *Butler v. Bogdonovich*, 101 Nev. 449, 451 (1985); *Hidden Wells Ranch, Inc. v. Strip Realty, Inc.*, 83 Nev. 143, 145 (1967). Where the party moving for summary judgment will bear the burden of persuasion at trial, it must present evidence that would entitle it to judgment as a matter of law in the absence of contrary evidence. *Francis v. Wynn Las Vegas, LLC*, 127 Nev. Adv. Rep. 60 (2011) (quoting *Cuzze v. Univ. & Comm. Coll. Sys. of Nev.*, 123 Nev. 598, 602-03 (2007)). If the nonmoving party will bear the burden of persuasion at trial, the moving party may satisfy the burden of production by either (1) submitting evidence that negates an essential element of the nonmoving party s claim or (2) pointing out ... that there is an absence of evidence to support the nonmoving party's case. *Id.* In such instances, the nonmoving party must do more than simply show that there is some metaphysical doubt as to the operative facts to defeat a motion for summary judgment. *Wood, supra* (quoting *Matsushita Electric Industrial Co. v. Zenith Radio*, 475 U.S. 574 (1986)). When the motion is made and supported as required by Rule 56, the nonmoving party must transcend the pleadings and, by affidavit or other admissible evidence, introduce specific facts that show a genuine issue of material fact. *Francis*, 262 P.3d at 714-15. The non-moving party's documentation must be admissible evidence, and he or she is not entitled to build a case on the gossamer threads of whimsy, speculation and conjecture. *Posadas v. City of Reno*, 109 Nev. 448, 452 (1993) (quoting *Collins v. Union Fed. Savings & Loan*, 99 Nev. 284 (1983)). In considering a motion for summary judgment, the court should not regard Rule 56 as a disfavored procedural shortcut, but should instead view it as an integral part of the ... Rules [of Civil Procedure] as a whole, which are designed to secure the just,

speedy and inexpensive determination of every action. *Wood*, 121 Nev. at 730-31 (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986)). Accordingly, when the movant has met the standard and the non-moving party has failed to establish a genuine issue of material fact, it is incumbent upon the court to grant the judgment sought forthwith. NRCP 56(c); *Dzack v. Marshall*, 80 Nev. 345 (1964).

The Plaintiff Association requested the following relief:

1. That pursuant to NRS 116.3116, the Association has a Super Priority Lien over a first security interest recorded against the property for nine (9) months of assessments immediately preceding institution of an action to enforce the lien.
2. That the Association's Super Priority Lien Amount pursuant to NRS 116.3116 includes interest, late fees and costs of collection, which are in addition to, not capped by, the applicable period of common expense assessments.
3. That the Association's Super Priority Lien Amount pursuant to NRS 116.3116(2) includes costs of collection, which pursuant to NRS 116.310313 may include any fee, including legal fees and costs, and
4. That NRS 116.3116 supersedes the provisions of Section 8.3 of the Association s CC&Rs.

The Court finds that, in accordance with recent rulings by the Eighth Judicial District Court Honorable Judges Gonzalez, Denton, and Scann, Summary Judgment on requests numbers 1, 2 and 3 are DENIED.

Summary judgment on Plaintiff's request number 4 is GRANTED.

Pursuant to NRS 116.3116(2), the Association's Statutory Lien has priority over a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent the (First Security Interest) only to the extent of those assessments for common expenses based upon the Association's periodic budget that would have become due in the 9 month period immediately preceding an the Association's institution of an action to enforce its statutory general lien and to the extent of external repair pursuant to NRS 116.310312. This portion will be

referred to as the "Super Priority Lien". The Super Priority Lien amount is not without limits. The Association's Super Priority Lien Amount pursuant to NRS 116.3116 may include interest, late fees and costs of collection, but is capped by the applicable period of common expense assessments, i.e., a figure equaling 9 months of common expense assessments based upon the Association's periodic budget. The words to the extent of contained in NRS 116.3116(2) mean no more than, which clearly indicates a maximum figure or a cap on the Super Priority Lien which cannot be exceeded.

Therefore, after the foreclosure by a First Security Interest holder of a unit located within a homeowners' association, pursuant to NRS 116.3116(2), the monetary limit of a homeowners' association's Super Priority Lien is limited to a maximum amount equaling 9 times the homeowners' association's monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the institution of an action to enforce the lien, plus external repair costs pursuant to NRS 116.310312.

For the foregoing reasons, the Court denies Plaintiff's Motion for Partial Summary Judgment on requests 1, 2 and 3 and grants request 4.

IT IS SO ORDERED.

DISTRICT COURT JUDGE — Date 9.13.12

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DISTRICT COURT

CLARK COUNTY, NEVADA

PREM DEFERRED TRUST, on behalf of itself and as representatives of the class herein defined Plaintiff, vs. ALIANTE MASTER ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Defendant.	CASE NO. A-11-651107-B DEPT. NO 29 **ORDER**

This matter came before the Court on 07/24/2012, at 10:00 a.m., on Plaintiff and the Class' MOTION FOR SUMMARY JUDGMENT ON DECLARATORY RELIEF and Defendant Aliante Master Association's OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT ON CLAIM FOR DECLARATORY RELIEF AND COUNTER-MOTION FOR SUMMARY JUDGMENT. James R. Adams, Esq., of Adams Law Group, Ltd., appeared on behalf of the Plaintiff and the Class. Kurt Bonds, Esq., of Alverson, Taylor, Mortensen & Sanders appeared on behalf of the Defendant. Patrick Reilly, Esq., of Holland and Hart appeared on behalf of Nevada Association Services, Inc., and RMI Management, Inc., as Amici Curiae of the Court.

After review and consideration of all the pleadings and briefs of Plaintiff, Defendant and the Amici Curiae, including all exhibits attached thereto, and including the oral arguments of Counsel for Plaintiff and the Class, Counsel for Defendant and Counsel for the Amici Curiae, the Honorable Court hereby rules:

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Attorneys for Plaintiff and the Class

DISTRICT COURT

CLARK COUNTY, NEVADA

PREM DEFERRED TRUST, on behalf of itself and as representatives of the class herein defined Plaintiff, vs. ALIANTE MASTER ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Defendant.	CASE NO. A-11-651107-B DEPT. NO 29 **ORDER**

This matter came before the Court on 07/24/2012, at 10:00 a.m., on Plaintiff and the Class' MOTION FOR SUMMARY JUDGMENT ON DECLARATORY RELIEF and Defendant Aliante Master Association's OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT ON CLAIM FOR DECLARATORY RELIEF AND COUNTER-MOTION FOR SUMMARY JUDGMENT. James R. Adams, Esq., of Adams Law Group, Ltd., appeared on behalf of the Plaintiff and the Class. Kurt Bonds, Esq., of Alverson, Taylor, Mortensen & Sanders appeared on behalf of the Defendant. Patrick Reilly, Esq., of Holland and Hart appeared on behalf of Nevada Association Services, Inc., and RMI Management, Inc., as Amici Curiae of the Court.

After review and consideration of all the pleadings and briefs of Plaintiff, Defendant and the Amici Curiae, including all exhibits attached thereto, and including the oral arguments of Counsel for Plaintiff and the Class, Counsel for Defendant and Counsel for the Amici Curiae, the Honorable Court hereby rules:

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WHEREAS, the Court has determined that a justiciable controversy exists in this matter as Plaintiff and the Class have asserted a claim of right under NRS §116.3116(2) (the "Super Priority Lien" statute) against Defendant and Defendant has an interest in contesting said claim. The issue contained in the briefing is, therefore, ripe for determination. Further, the present controversy is between persons or entities whose interests are adverse and who have a legal interest in the controversy (*Kress v. Corey* 65 Nev. 1, 189 P.2d 352 (1948)); and

WHEREAS Plaintiff, the Class and the Defendant, the contesting parties hereto, are clearly adverse and hold different views regarding the meaning and applicability of NRS §116.3116; and

WHEREAS Plaintiff and the Class, and the Defendant have a legal interest in the controversy as it is Plaintiff's and the Class' property that is the subject of Defendant's Super Priority Lien and all parties, therefore, have a legal interest in a determination of to what extent the Super Priority Lien can exist; and

WHEREAS the issue of the meaning, application and interpretation of NRS §116.3116 is ripe for determination in this case as the present controversy is real, it exists now, and it affects the parties hereto; and

WHEREAS, therefore, the Court finds that issuing a declaratory judgment relating to the meaning and interpretation of NRS §116.3116 would terminate some of the uncertainty and controversy giving rise to the present proceeding; and

WHEREAS, pursuant to NRS §30.040 Plaintiff, the Class and the Defendant are parties whose rights, status or other legal relations are affected by NRS §116.3116 and they may, therefore, have determined by this Court any question of construction or validity arising under NRS §116.3116 and obtain a declaration of rights, status or other legal relations thereunder.

THE COURT, THEREFORE, DECLARES, ORDERS, ADJUDGES AND DECREES as follows:

1. Plaintiff's and the Class' MOTION FOR SUMMARY JUDGMENT ON CLAIM OF DECLARATORY RELIEF is granted.
2. Defendant's COUNTER-MOTION FOR SUMMARY JUDGMENT is denied.

3. NRS §116.3116(1) is a statute which creates for the benefit of Nevada homeowners' associations a statutory lien against a homeowner's unit for (a) any construction penalty that is imposed against the unit's owner pursuant to NRS §116.310305, (b) any assessment levied against that unit, and (c) any fines imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due (the "General Statutory Lien").

4. Pursuant to NRS §116.3116(2), the homeowners' association's General Statutory Lien is junior to a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent ("First Security Interest") except for a portion of the homeowners' association's General Statutory Lien which remains superior to the First Security Interest (the "Super Priority Lien").

5. Defendant, as a Nevada homeowners' association, therefore, has a Super Priority Lien which has payment priority over the First Security Interest on a homeowners' unit. However, the Super Priority Lien amount is not without limits and NRS §116.3116(2) is clear that the amount of the Super Priority Lien (that portion of the General Statutory Lien which retains a priority payment status over the First Security Interest) is limited "to the extent" of a homeowners' association's assessments for common expenses based upon the association's periodic budget that would have become due, in the absence of acceleration, in the 9 month period immediately preceding Defendant's institution of an action to enforce its General Statutory Lien (which is 9 months of regular, common assessments) and "to the extent of" external repair costs pursuant to NRS §116.310312 unless regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien.

6. The base assessment figure used in the calculation of the Super Priority Lien is the unit's un-accelerated, monthly assessment figure for association common expenses which is wholly determined by the homeowners association's "periodic budget," as adopted by the association, and not determined by any other document or statute. Thus, the phrase contained in NRS §116.3116(2) which states, "... to the extent of the assessments for common expenses

based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien..." means a maximum figure equaling 9 months of an association's regular, monthly (not annual) assessments. If assessments are paid quarterly, then 3 quarters of assessments (i.e., 9 months) would equal the Super Priority Lien, plus external repair costs pursuant to NRS §116.310312.

7. The words "to the extent of" contained in NRS §116.3116(2) mean "no more than," which clearly indicates a maximum figure or a cap on the Super Priority Lien which cannot be exceeded.

8. Thus, while assessments, penalties, fees, charges, late charges, fines and interest may be included within the Super Priority Lien, in no event can the total amount of the Super Priority Lien exceed an amount equaling 9 months of the Defendant's regular monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the association's institution of an action to enforce the lien, plus external repair costs pursuant to NRS 116.310312.

9. In addition to the arguments of counsel contained in the briefs on file, in rendering this decision, the Court considered all exhibits appended to such all briefs, including but not limited to law review articles, the legislative history of NRS 116.3116, the history of the Uniform Common Interest Ownership Act, intermediate appellate and supreme court case law of other states, and the Commission on Common-Interest Communities & Condominium Hotels' Advisory Opinion which opined that a homeowners' association may collect as a part of the Super Priority Lien interest, late fees or charges, and the costs of collecting, but did not directly opine upon the issue of whether there was a maximum limit to the Super Priority Lien regardless of the constituent elements thereof, which was the question before this Court.

10. While the Court considered all such supporting materials, the Court is bound by the precedent of the Nevada Supreme Court which directs trial courts that, "[W]here a statute is clear on its face, a court may not go beyond the language of the statute in determining the

legislature's intent." *Diaz v. Eighth Judicial Dist. Court ex rel. County of Clark*, 116 Nev. 88, 94, 993 P.2d 50 (2000).

11. The Court finds that NRS 116.3116 is clear on its face. After the foreclosure by a first security interest on a unit recorded before the date on which the assessment sought to be enforced became delinquent, a portion of a homeowners' association's statutory lien under NRS 116.3116(1) is prior to the first security interest only to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 (exterior repair costs) and only to the extent of the assessments for common expenses which are based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien. The 9 month figure is derived by taking the monthly assessment figure for common expenses as contained in the association's periodic budget which existed immediately prior to the association's institution of an action to enforce its lien, and multiplying by 9.

12. Prior to the October 1, 2009, amendment increasing the Super Priority Lien, the maximum amount of the Super Priority Lien was limited to the extent of the assessments for common expenses which are based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien.

IT IS SO ORDERED.

DISTRICT COURT JUDGE Sept. 27, 2012 Date

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DEPARTMENT OF BUSINESS AND INDUSTRY
REAL ESTATE DIVISION
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December 12, 2012

Prem Investments
520 South Fourth Street, Second Floor
Las Vegas, Nevada 89101

Dear Prem Investments:

In November, the prior Director of the Nevada Department of Business & Industry, Terry Johnson, informed you that your request for an advisory opinion from the Director's office was sent by Director Johnson to the Real Estate Division. Enclosed please find the Division's Advisory Opinion #13-01, issued in response to your request for an advisory opinion on the questions posed concerning the super priority lien in NRS 116.3116.

This advisory opinion will be posted on the Division's web site. It provides the Division's interpretation of NRS 116 statutes applicable to the questions posed.

Sincerely,

Gail J. Anderson
Administrator

Encl. Advisory Opinion 13-01

C: James R. Adams, Esq.

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STATE OF NEVADA
DEPARTMENT OF BUSINESS AND INDUSTRY
REAL ESTATE DIVISION
ADVISORY OPINION

Subject:	Advisory No. 13-01	20 pages
The Super Priority Lien	Issued By: Real Estate Division	
	Amends/ Supersedes	N/A
Reference(s): NRS 116.3102; ; NRS 116.310312; NRS 116.310313; NRS 116.3115; NRS 116.3116; NRS 116.31162; Commission for Common Interest Communities and Condominium Hotels Advisory Opinion No. 2010-01		Issue Date: December 12, 2012

QUESTION #1:

Pursuant to NRS 116.3116, may the portion of the association's lien which is superior to a unit's first security interest (referred to as the "super priority lien") contain "costs of collecting" defined by NRS 116.310313?

QUESTION #2:

Pursuant to NRS 116.3116, may the sum total of the super priority lien ever exceed 9 times the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115, plus charges incurred by the association on a unit pursuant to NRS 116.310312?

QUESTION #3:

Pursuant to NRS 116.3116, must the association institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3 in order for the super priority lien to exist?

SHORT ANSWER TO #1:

No. The association's lien does not include "costs of collecting" defined by NRS 116.310313, so the super priority portion of the lien may not include such costs. NRS 116.310313 does not say such charges are a lien on the unit, and NRS 116.3116 does not make such charges part of the association's lien.

SHORT ANSWER TO #2:

No. The language in NRS 116.3116(2) defines the super priority lien. The super priority lien consists of unpaid assessments based on the association's budget and NRS 116.310312 charges, nothing more. The super priority lien is limited to: (1) 9 months of assessments; and (2) charges allowed by NRS 116.310312. The super priority lien based on assessments may not exceed 9 months of assessments as reflected in the association's budget, and it may not include penalties, fees, late charges, fines, or interest. References in NRS 116.3116(2) to assessments and charges pursuant to NRS 116.310312 define the super priority lien, and are not merely to determine a dollar amount for the super priority lien.

SHORT ANSWER TO #3:

No. The association must *take action* to enforce its super priority lien, but it need not institute a civil action by the filing of a complaint. The association may begin the process for foreclosure in NRS 116.31162 or exercise any other remedy it has to enforce the lien.

ANALYSIS OF THE ISSUES:

This advisory opinion – provided in accordance with NRS 116.623 – details the Real Estate Division's opinion as to the interpretation of NRS 116.3116(1) and (2). The Division hopes to help association boards understand the meaning of the statute so they are better equipped to represent the interests of their members. Associations are encouraged to look at the entirety of a situation surrounding a particular deficiency and evaluate the association's best option for collection. The first step in that analysis is to understand what constitutes the association's lien, what is not part of the lien, and the status of the lien compared to other liens recorded against the unit.

Subsection (1) of NRS 116.3116 describes what constitutes the association's lien; and subsection (2) states the lien's priority compared to other liens recorded against a unit. NRS 116.3116 comes from the Uniform Common Interest Ownership Act (1982) (the "Uniform Act"), which Nevada adopted in 1991. So, in addition to looking at the language of the relevant Nevada statute, this analysis includes references to the Uniform Act's equivalent provision (§ 3-116) and its comments.

I. NRS 116.3116(1) DEFINES WHAT THE ASSOCIATION'S LIEN CONSISTS OF.

NRS 116.3116(1) provides generally for the lien associations have against units within common-interest communities. NRS 116.3116(1) states as follows:

> The association has a lien on a unit for **any construction penalty that is imposed against the unit's owner pursuant to NRS 116.310305, any assessment levied against that unit or any fines** imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due. **Unless the declaration otherwise provides, any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS 116.3102 are enforceable as assessments** under this section. If an assessment is payable in installments, the full amount of the assessment is a lien from the time the first installment thereof becomes due.

(emphasis added).

Based on this provision, the association's lien includes assessments, construction penalties, and fines imposed against a unit when they become due. In addition – unless the declaration otherwise provides – penalties, fees, charges, late charges, fines, and interest charged pursuant to NRS 116.3102(1)(j) through (n) are also part of the association's lien in that such items are enforceable as if they were assessments. Assessments can be foreclosed pursuant to NRS 116.31162, but liens for fines and penalties may not be foreclosed unless they satisfy the requirements of NRS 116.31162(4). Therefore, it is important to accurately categorize what comprises each portion of the association's lien to evaluate enforcement options.

A. "COSTS OF COLLECTING" (DEFINED BY NRS 116.310313) ARE NOT PART OF THE ASSOCIATION'S LIEN

NRS 116.3116(1) does not specifically make costs of collecting part of the association's lien, so the determination must be whether such costs can be included under the incorporated provisions of NRS 116.3102. NRS 116.3102(1)(j) through (n) identifies five very specific categories of penalties, fees, charges, late charges, fines, and interest associations may impose. This language encompasses all penalties, fees,

charges, late charges, fines, and interest that are part of the lien described in NRS 116.3116(1).

NRS 116.3102(1)(j) through (n) states:

> 1. Except as otherwise provided in this section, and subject to the provisions of the declaration, the association may do any or all of the following: ...
> (j) Impose and receive any payments, fees or charges for the use, rental or operation of the common elements, other than limited common elements described in subsections 2 and 4 of NRS 116.2102, and for services provided to the units' owners, including, without limitation, any services provided pursuant to NRS 116.310312.
> **(k) Impose charges for late payment of assessments pursuant to NRS 116.3115.**
> (l) Impose construction penalties when authorized pursuant to NRS 116.310305.
> (m) Impose reasonable fines for violations of the governing documents of the association only if the association complies with the requirements set forth in NRS 116.31031.
> (n) Impose reasonable charges for the preparation and recordation of any amendments to the declaration or any statements of unpaid assessments, and impose reasonable fees, not to exceed the amounts authorized by NRS 116.4109, for preparing and furnishing the documents and certificate required by that section.

(emphasis added).

Whatever charges the association is permitted to impose by virtue of these provisions are part of the association's lien. Subsection (k) – emphasized above – has been used – the Division believes improperly – to support the conclusion that associations may include costs of collecting past due obligations as part of the association's lien. The Commission for Common Interest Communities and Condominium Hotels issued Advisory Opinion No. 2010-01 in December of 2010. The Commission's advisory concludes as follows:

> An association may collect as a part of the super priority lien (a) interest permitted by NRS 116.3115, (b) late fees or charges authorized by the declaration, (c) charges for preparing any statements of unpaid assessments and (d) the "costs of collecting" authorized by NRS 116.310313.

Analysis of what constitutes the *super priority lien* portion of the association's lien is discussed in Section III, but the Division agrees that the association's lien does include items noted as (a), (b) and (c) of the Commission's advisory opinion above. To support item (d), the Commission relies on NRS 116.3102(1)(k) which gives associations the power to: "Impose charges for late payment of assessments pursuant to NRS 116.3115." This language would include interest authorized by statute and late fees if authorized by the association's declaration.

"Costs of collecting" defined by NRS 116.310313 is too broad to fall within the parameters of charges for late payment of assessments.[1] By definition, "costs of collecting" relate to the collection of past due "obligations." "Obligations" are defined as "any assessment, fine, construction penalty, fee, charge or interest levied or imposed against a unit's owner."[2] In other words, costs of collecting includes more than "charges for late payment of assessments."[3] Therefore, the plain language of NRS 116.3116(1) does not incorporate costs of collecting into the association's lien. Further review of the relevant statutes and legislative action supports this conclusion.

B. PRIOR LEGISLATIVE ACTION SUPPORTS THE POSITION THAT COSTS OF COLLECTING ARE NOT PART OF THE ASSOCIATION'S LIEN DESCRIBED BY NRS 116.3116(1).

The language of NRS 116.3116(1) allows for "charges for late payment of assessments" to be part of the association's lien.[4] "Charges for late payments" is not the same as "costs of collecting." "Costs of collecting" was first defined in NRS 116 by the adoption of NRS 116.310313 in 2009. NRS 116.310313(1) provides for the association's

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[1] Charges for late payment of assessments comes from NRS 116.3102(1)(k) and is incorporated into NRS 116.3116(1).
[2] NRS 116.310313.
[3] "Costs of collecting" includes any fee, charge or cost, by whatever name, including, without limitation, any collection fee, filing fee, recording fee, fee related to the preparation, recording or delivery of a lien or lien rescission, title search lien fee, bankruptcy search fee, referral fee, fee for postage or delivery and any other fee or cost that an association charges a unit's owner for the investigation, enforcement or collection of a past due obligation. The term does not include any costs incurred by an association if a lawsuit is filed to enforce any past due obligation or any costs awarded by a court. NRS 116.310313(3)(a).
[4] NRS 116.3102(1)(k) (incorporated into NRS 116.3116(1)).

right to charge a unit owner "reasonable fees to cover the costs of collecting any past due obligation." NRS 116.310313 is not referenced in NRS 116.3116 or NRS 116.3102, nor does NRS 116.310313 specifically provide for the association's right to lien the unit for such costs.

In contrast, NRS 116.310312, also adopted in 2009, allows an association to enter the grounds of a unit to maintain the property or abate a nuisance existing on the exterior of the unit. NRS 116.310312 specifically provides for the association's expenses to be a lien on the unit and provides that the lien is prior to the first security interest.[5] NRS 116.3102(1)(j) was amended to allow these expenses to be part of the lien described in NRS 116.3116(1). And NRS 116.3116(2) was amended to allow these expenses to be included in the association's super priority lien.

The Commission's advisory opinion from December 2010 also relies on changes to the Uniform Act from 2008 to support the notion that collection costs should be part of the association's super priority lien. Nevada has not adopted those changes to the Uniform Act. Since the Commission's advisory opinion, the Nevada Legislature had an opportunity to clarify the law in this regard.

In 2011, the Nevada Legislature considered Senate Bill 174, which proposed changes to NRS 116.3116. S.B. 174 originally included changes to NRS 116.3116(1) such that the association's lien would specifically include "costs of collecting" as defined in NRS 116.310313. S.B. 174 proposed changes to NRS 116.3116 (1) and (2) to bring the statute in line with the changes to the same provision in the Uniform Act amended in 2008.

The Uniform Act's amendments were removed from S.B. 174 by the first reprint. As amended, S.B. 174 proposed changes to NRS 116.3116(2) expanding the super priority lien amount to include costs of collecting not to exceed $1,950, in addition to 9 months

[5] See NRS 116.310312(4) and (6).

of assessments. S.B. 174 was discussed in great detail and ultimately died in committee.[6]

Also in 2011, Senate Bill 204 – as originally introduced – included changes to NRS 116.3116(1) to expand the association's lien to include attorney's fees and costs and "any other sums due to the association."[7] The bill's language was taken from the Uniform Act amendments in 2008. All changes to NRS 116.3116(1) were removed from the hill prior to approval.

The Nevada Legislature's actions in the 2009 and 2011 sessions are indicative of its intent not to make costs of collecting part of the lien. The Nevada Legislature could have made the costs of collecting part of the association's lien, like it did for costs under NRS 116.310312. It did not do so. In order for the association to have a right to lien a unit under NRS 116.3116(1), the charge or expense must fall within a category listed in the plain language of the statute. Costs of collecting do not fall within that language. Based on the foregoing, the Division concludes that the association's lien does not include "costs of collecting" as defined by NRS 116.310313.

A possible concern regarding this outcome could be that an association may not be able to recover their collection costs relating to a foreclosure of an assessment lien. While that may seem like an unreasonable outcome, a look at the bigger picture must be considered to put it in perspective. NRS 116.31162 through NRS 116.31168, inclusive, outlines the association's ability to enforce its lien through foreclosure. Associations have a lien for assessments that is enforced through foreclosure. The association's expenses are reimbursed to the association from the proceeds of the sale. NRS 116.31164(3)(c) allows the proceeds of the foreclosure sale to be distributed in the following order:

(1) The reasonable expenses of sale;

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[6] See http://leg.state.nv.us/Session/76th2011/Reports/history.cfm?ID=423.
[7] Senate Bill No. 204 – Senator Copening, Sec. 49, ln. 1-16, February 28, 2011.

(2) The reasonable expenses of securing possession before sale, holding, maintaining, and preparing the unit for sale, including payment of taxes and other governmental charges, premiums on hazard and liability insurance, and, to the extent provided for by the declaration, reasonable attorney's fees and other legal expenses incurred by the association;
(3) Satisfaction of the association's lien;
(4) Satisfaction in the order of priority of any subordinate claim of record; and
(5) Remittance of any excess to the unit's owner.

Subsections (1) and (2) allow the association to receive its expenses to enforce its lien through foreclosure *before* the association's lien is satisfied. Obviously, if there are no proceeds from a sale or a sale never takes place, the association has no way to collect its expenses other than through a civil action against the unit owner. Associations must consider this consequence when making decisions regarding collection policies understanding that every delinquent assessment may not be treated the same.

II. NRS 116.3116(2) ESTABLISHES THE PRIORITY OF THE ASSOCIATION'S LIEN.

Having established that the association has a lien on the unit as described in subsection (1) of NRS 116.3116, we now turn to subsection (2) to determine the lien's priority in relation to other liens recorded against the unit. The lien described by NRS 116.3116(1) is what is referred to in subsection (2). Understanding the priority of the lien is an important consideration for any board of directors looking to enforce the lien through foreclosure or to preserve the lien in the event of foreclosure by a first security interest.

NRS 116.3116(2) provides that the association's lien is prior to all other liens recorded against the unit *except:* liens recorded against the unit before the declaration; first security interests (first deeds of trust); and real estate taxes or other governmental assessments. There is one exception to the exceptions, so to speak, when it comes to priority of the association's lien. This exception makes a portion of an association's lien prior to the first security interest. The portion of the association's lien given priority status to a first security interest is what is referred to as the "super priority lien" to

distinguish it from the other portion of the association's lien that is subordinate to a first security interest.

The ramifications of the super priority lien are significant in light of the fact that superior liens, when foreclosed, remove all junior liens. An association can foreclose its super priority lien and the first security interest holder will either pay the super priority lien amount or lose its security. NRS 116.3116 is found in the Uniform Act at § 3-116. Nevada adopted the original language from § 3-116 of the Uniform Act in 1991. From its inception, the concept of a super priority lien was a novel approach. The Uniform Act comments to § 3-116 state:

> [A]s to prior first security interests the association's lien does have priority for 6 months' assessments based on the periodic budget. A significant departure from existing practice, the 6 months' priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders. As a practical matter, secured lenders will most likely pay the 6 months' assessments demanded by the association rather than having the association foreclose on the unit. If the lender wishes, an escrow for assessments can be required.

This comment on § 3-116 illustrates the intent to allow for 6 months of assessments to be prior to a first security interest. The reason this was done was to accommodate the association's need to enforce collection of unpaid assessments. The controversy surrounding the super priority lien is in defining its limit. This is an important consideration for an association looking to enforce its lien. There is little benefit to an association if it incurs expenses pursuing unpaid assessments that will be eliminated by an imminent foreclosure of the first security interest. As stated in the comment, it is also likely that the holder of the first security interest will pay the super priority lien amount to avoid foreclosure by the association.

III. THE AMOUNT OF THE SUPER PRIORITY LIEN IS LIMITED BY THE PLAIN LANGUAGE OF NRS 116.3116(2).

NRS 116.3116(2) states:

> A lien under this section is prior to all other liens and encumbrances on a unit except:
> (a) Liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances which the association creates, assumes or takes subject to;
> (b) A first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent or, in a cooperative, the first security interest encumbering only the unit's owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent; and
> (c) Liens for real estate taxes and other governmental assessments or charges against the unit or cooperative.
> ***The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien***, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien. If federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien, the period during which the lien is prior to all security interests described in paragraph (b) must be determined in accordance with those federal regulations, except that notwithstanding the provisions of the federal regulations, the period of priority for the lien must not be less than the 6 months immediately preceding institution of an action to enforce the lien. This subsection does not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association.

(emphasis added)

Having found previously that costs of collecting are not part of the lien means they are not part of the super priority lien. The question then becomes what can be included as part of the super priority lien. Prior to 2009, the super priority lien was limited to 6 months of assessments. In 2009, the Nevada legislature changed the 6 months of

assessments to 9 months and added expenses for abatement under NRS 116.310312 to the super priority lien amount. But to the extent federal law applicable to the first security interest limits the super priority lien, the super priority lien is limited to 6 months of assessments.

The emphasized language in the portion of the statute above identifies the portion of the association's lien that is prior to the first security interest, i.e. what comprises the super priority lien. This language states that there are two components to the super priority lien. The first is "to the extent of any charges" incurred by the association pursuant to NRS 116.310312. NRS 116.310312(4) makes clear that the charges assessed against the unit pursuant to this section are a lien on the unit and subsection (6) makes it clear that such lien is prior to first security interests. These costs are also specifically part of the lien described in NRS 116.3116(1) incorporated through NRS 116.3102(1)(j). This portion of the super priority lien is specific to charges incurred pursuant to NRS 116.310312. Payment of those charges relieves their super priority lien status. There does not seem to be any confusion as to what this part of the super priority lien is. Analysis of the super priority lien will focus on the second portion.

A. THE SUPER PRIORITY LIEN ATTRIBUTABLE TO ASSESSMENTS IS LIMITED TO 9 MONTHS OF ASSESSMENTS AND CONSISTS ONLY OF ASSESSMENTS.

The second portion of the super priority lien is "to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien."

The statute uses the language "to the extent of the assessments" to illustrate that there is a limit on the amount of the super priority lien, just like the language concerning expenses pursuant to NRS 116.310312, but this portion concerns assessments. The limit on the super priority lien is based on the assessments for

common expenses reflected in a budget adopted pursuant to NRS 116.3115 which would have become due in 9 months. The assessment portion of the super priority lien is no different than the portion derived from NRS 116.310312. Each portion of the super priority lien is limited to the specific charge stated and nothing else.

Therefore, while the association's *lien* may include any penalties, fees, charges, late charges, fines and interest charged pursuant to NRS 116.3102 (1) (j) to (n), inclusive, the total amount of the *super priority lien* attributed to assessments is no more than 9 months of the monthly assessment reflected in the association's budget. Association budgets do not reflect late charges or interest attributed to an anticipated delinquent owner, so there is no basis to conclude that such charges could be included in the super priority lien or in addition to the assessments. Such extraneous charges are not included in the association's super priority lien.

NRS 116.3116 originally provided for 6 months of assessments as the super priority lien. Comments to the Uniform Act quoted previously support the conclusion that the original intent was for 6 months of the assessments alone to comprise the super priority lien amount and not the penalties, charges, or interest. It is possible that an argument could be made that the language is so clear in this regard one should not look to legislative intent. But considering the controversy surrounding the meaning of this statute, the better argument is that legislative intent should be used to determine the meaning.

The Commission's advisory opinion of December 2010 concluded that assessments *and* additional costs are part of the super priority lien. The Commission's advisory opinion relies in part on a Wake Forest Law Review[8] article from 1992 discussing the Uniform Act. This article actually concludes that the Uniform Act language limits the

[8] See James Winokur, *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 353, 366-69 (1992).

amount of the super priority lien to 6 months of assessments, but that the super priority lien does not necessarily consist of only delinquent assessments.[9] It can include fines, interest, and late charges.[10] The concept here is that all parts of the lien are prior to a first security interest and that reference to assessments for the super priority lien is only to define a specific dollar amount.

The Division disagrees with this interpretation because of the unreasonable consequences it leaves open. For example, a unit owner may pay the delinquent assessment amount leaving late charges and interest as part of the super priority lien. If the super priority lien can encompass more than just delinquent assessments in this situation, it would give the association the right to foreclose its lien consisting only of late charges and interest prior to the first security interest. It is also unreasonable to expect that fines (which cannot be foreclosed generally) survive a foreclosure of the first security interest. Either the lender or the new buyer would be forced to pay the prior owner's fines. The Division does not find that these consequences are reasonable or intended by the drafters of the Uniform Act or by the Nevada Legislature. Even the 2008 revisions to the Uniform Act do not allow for anything other than assessments and costs incurred to foreclose the lien to be included in the super priority lien. Fines, interest, and late charges are not *costs* the association incurs.

In 2009, the Nevada Legislature revised NRS 116.3116 to expand the association's super priority lien. Assembly Bill 204 sought to extend the super priority lien of 6 months of assessments to 2 years of assessments.[11] The Commission's chairman, Michael Buckley, testified on March 6, 2009 before the Assembly Committee on Judiciary on A.B. 204 that the law was unclear as to whether the 6 month priority can

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[9] See id. at 367 (referring to the super priority lien as the "six months assessment ceiling" being computed from the periodic budget).
[10] See id.
[11] See http://leg.state.nv.us/Session/75th2009/Reports/history.cfm?ID=416.

include the association's costs and attorneys' fees.[12] Mr. Buckley explained that the Uniform Act amendments in 2008 allowed for the collection of attorneys' fees and costs incurred by the association in foreclosing the assessment lien as part of the super priority lien. Mr. Buckley requested that the 2008 change to the Uniform Act be included in A.B. 204. Mr. Buckley's requested change to A.B. 204 to expand the super priority lien never made it into A.B. 204. Ultimately, A.B. 204 was adopted to change 6 months to 9 months, but commenting on the intent of the bill, Assemblywoman Ellen Spiegel stated:

> Assessments covered under A.B. 204 are the regular monthly or quarterly dues for their home. *I carefully put this bill together to make sure it did not include any assessments for penalties, fines or late fees.* The bill covers the basic monies the association uses to build its regular budgets.

(emphasis added).[13]

It is significant that the legislative intent in changing 6 months to 9 months was with the understanding that no portion of that amount would be for penalties, fines, or late fees and that it only covers the basic monies associations use to build their regular budgets. It does make sense that a lien superior to a first security interest would not include penalties, fines, and interest. To say that the super priority lien includes more than just 9 months of assessments allows several undesirable and unreasonable consequences.

B. NEVADA HAS NOT ADOPTED AMENDMENTS TO THE UNIFORM ACT TO ALTER THE ORIGINAL INTENT OF THE SUPER PRIORITY LIEN.

The changes to the Uniform Act support the contention that only what is referenced as the super priority lien in NRS 116.3116(2) is what comprises the super priority lien. In 2008, § 3-116 of the Uniform Act was revised as follows:

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[12] See Minutes of the Meeting of the Assembly Committee on Judiciary, Seventy-fifth Session, March 6, 2009 at 44-45.

[13] See Minutes of the Senate Committee on Judiciary, Seventy-fifth Session, May 8, 2009 at 27.

SECTION 3-116. LIEN FOR ~~ASSESSMENTS~~; SUMS DUE ASSOCIATION; ENFORCEMENT.

(a) The association has a statutory lien on a unit for any assessment ~~levied against~~ attributable to that unit or fines imposed against its unit owner. Unless the declaration otherwise provides, reasonable attorney's fees and costs, other fees, charges, late charges, fines, and interest charged pursuant to Section 3-102(a)(10), (11), and (12), and any other sums due to the association under the declaration, this [act], or as a result of an administrative, arbitration, mediation, or judicial decision are enforceable in the same manner as unpaid assessments under this section. If an assessment is payable in installments, the lien is for the full amount of the assessment from the time the first installment thereof becomes due.

(b) A lien under this section is prior to all other liens and encumbrances on a unit except:

~~(i)~~(1) liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances ~~which~~ that the association creates, assumes, or takes subject to~~,~~ ;

~~(ii)~~(2) except as otherwise provided in subsection (c), a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent, or, in a cooperative, the first security interest encumbering only the unit owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent~~,~~; and

~~(iii)~~(3) liens for real estate taxes and other governmental assessments or charges against the unit or cooperative.

(c) A ~~The~~ lien under this section is also prior to all security interests described in subsection (b)(2) ~~clause (ii) above~~ to the extent of both the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien and reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien. ~~This subsection~~ Subsection (b) and this subsection ~~does~~ do not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association. [~~The~~ A lien under this section is not subject to ~~the provisions of~~ [insert appropriate reference to state homestead, dower and curtesy, or other exemptions].]

Explaining the reason for the changes to these sections, the Uniform Act includes the following comments:

> Associations must be legitimately concerned, as fiduciaries of the unit owners, that the association be able to collect periodic common charges from recalcitrant unit owners in a timely way. To address those concerns, the section contains these 2008 amendments:
>
> First, subsection (a) is amended to add the cost of the association's reasonable attorneys fees and court costs to the total value of the association's existing 'super lien' – currently, 6 months of regular common assessments. This amendment is identical to the amendment adopted by Connecticut in 1991; see C.G.S. Section 47-258(b). The increased amount of the association's lien has been approved by Fannie Mae and local lenders and has become a significant tool in the successful collection efforts enjoyed by associations in that state.

The Uniform Act's amendment in 2008 is very telling about § 3-116's original intent. The comments state reasonable attorneys' fees and court costs are *added* to the super priority lien stating that it is currently 6 months of regular common assessments. The Uniform Act adds attorneys' fees and costs to subsection (a) which defines the association's lien. Those attorneys' fees and costs attributable to foreclosure efforts are also added to subsection (c) which defines the super priority lien amount.

If the association's lien ever included attorneys' fees and court costs as "charges for late payment of assessments" or if such sum was part of the super priority lien, there would be no reason to add this language to subsection (a) and (c). Or at a minimum, the comments would assert the amendment was simply to make the language more clear. It is also clear by the language that only what is specified as part of the super priority lien can comprise the super priority lien. The additional language defining the super priority lien provides for costs that are *incurred* by the association foreclosing the lien. This is further evidence that the super priority lien does not and never did consist of interest, fines, penalties or late charges. These charges are not incurred by the association and they should not be part of any super priority lien.

The Nevada Legislature had the opportunity to change NRS 116.3116 in 2009 and 2011 to conform to the Uniform Act. It chose not to. While the revisions under the

Uniform Act may make sense to some and they may be adopted in other jurisdictions, the fact of the matter is, Nevada has not adopted those changes. The changes to the Uniform Act cannot be insinuated into the language of NRS 116.3116. Based on the plain language of NRS 116.3116, legislative intent, and the comments to the Uniform Act, the Division concludes that the super priority lien is limited to expenses stemming from NRS 116.310312 and assessments as reflected in the association's budget for the immediately preceding 9 months from institution of an action to enforce the association's lien.

IV. "ACTION" AS USED IN NRS 116.3116 DOES NOT REQUIRE A CIVIL ACTION ON THE PART OF THE ASSOCIATION.

NRS 116.3116(2) provides that the super priority lien pertaining to assessments consists of those assessments "which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien." NRS 116.3116 requires that the association take action to enforce its lien in order to determine the immediately preceding 9 months of assessments. The question presented is whether this action must be a civil action.

During the Senate Committee on Judiciary hearing on May 8, 2009, the Chair of the Committee, Terry Care, stated with reference to AB 204:

> One thing that bothers me about section 2 is the duty of the association to enforce the liens, but I understand the argument with the economy and the high rate of delinquencies not only to mortgage payments but monthly assessments. Bill Uffelman, speaking for the Nevada Bankers Association, broke it down to a 210-day scheme that went into the current law of six months. Even though you asked for two years, I looked at nine months, thinking the association has a duty to move on these delinquencies.

NRS 116 does not require an association to take any particular action to enforce its lien, but that it institutes "an action." NRS 116.31162 provides the first steps to foreclose the association's lien. This process is started by the mailing of a notice of delinquent

assessment as provided in NRS 116.31162(1)(a). At that point, the immediately preceding 9 months of assessments based on the association's budget determine the amount of the super priority lien. The Division concludes that this action by the association to begin the foreclosure of its lien is "action to enforce the lien" as provided in NRS 116.3116(2). The association is not required to institute a civil action in court to trigger the 9 month look back provided in NRS 116.3116(2). Associations should make the delinquent assessment known to the first security holder in an effort to receive the super priority lien amount from them as timely as possible.

ADVISORY CONCLUSION:

An association's lien consists of assessments, construction penalties, and fines. Unless the association's declaration provides otherwise, the association's lien also includes all penalties, fees, charges, late charges, fines and interest pursuant to NRS 116.3102(1)(j) through (n). While charges for late payment of assessments are part of the association's lien, "costs of collecting" as defined by NRS 116.310313, are not. "Costs of collecting" defined by NRS 116.310313 includes costs of collecting any *obligation*, not just assessments. Costs of collecting are not merely a charge for a late payment of assessments. Since costs of collecting are not part of the association's lien in NRS 116.3116(1), they cannot be part of the super priority lien detailed in subsection (2).

The super priority lien consists of two components. By virtue of the detail provided by the statute, the super priority lien applies to the charges incurred under NRS 116.310312 and up to 9 months of assessments as reflected in the association's regular budget. The Nevada Legislature has not adopted changes to NRS 116.3116 that were made to the Uniform Act in 2008 despite multiple opportunities to do so. In fact, the Legislative intent seems rather clear with Assemblywoman Spiegel's comments to A.B. 204 that changed 6 months of assessments to 9 months. Assemblywoman Spiegel stated that she "carefully put this bill together to make sure it did not include any

assessments for penalties, fines or late fees." This is consistent with the comments to the Uniform Act stating the priority is for assessments based on the periodic budget. In other words, when the super priority lien language refers to 9 months of assessments, assessments are the only component. Just as when the language refers to charges pursuant to NRS 116.310312, those charges are the only component. Not in either case can you substitute other portions of the entire lien and make it superior to a first security interest.

Associations need to evaluate their collection policies in a manner that makes sense for the recovery of unpaid assessments. Associations need to consider the foreclosure of the first security interest and the chances that they may not be paid back for the costs of collection. Associations may recover costs of collecting unpaid assessments if there are proceeds from the association's foreclosure.[14] But costs of collecting are not a lien under NRS 116.310313 or NRS 116.3116(1); they are the personal liability of the unit owner.

Perhaps an effective approach for an association is to start with foreclosure of the assessment lien after a nine month assessment delinquency or sooner if the association receives a foreclosure notice from the first security interest holder. The association will always want to enforce its lien for assessments to trigger the super priority lien. This can be accomplished by starting the foreclosure process. The association can use the super priority lien to force the first security interest holder to pay that amount. The association should incur only the expense it believes is necessary to receive payment of assessments. If the first security interest holder does not foreclose, the association will maintain its assessment lien consisting of assessments, late charges, and interest. If a loan modification or short sale is worked out with the owner's lender, the association is better off limiting its expenses and more likely to recover the assessments. Adding unnecessary costs of collection – especially after a short period of delinquency – can

[14] NRS 116.31164.

make it all the more impossible for the owner to come current or for a short sale to close. This situation does not benefit the association or its members.

IN THE SUPREME COURT OF THE STATE OF NEVADA

HORIZONS AT SEVEN HILLS HOMEOWNERS ASSOCIATION,

Appellant,

v.

IKON HOLDINGS, LLC, a Nevada limited liability company;

Respondent,

CASE NO. 63178

Dist. Ct. Case No. A-11-647850-B

RESPONDENT'S APPENDIX

VOL. 1

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DATED this 24th day of February, 2014.

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Nevada Administrative Code Currentness
Chapter 232. State Departments
Department of Bnsiness and Industry
Practice Before Department

NAC 232.040

NAC 232.040 Petition for declaratory order or advisory opinion: Authorization; filing; contents. (NRS 233B.120)

1. Except as otherwise provided in subsection 4, an interested person may petition the Director to issue a declaratory order or advisory opinion concerning the applicability of a statute, regulation or decision of the Department or any of its divisions.

2. The original and one copy of the petition must be filed with:

(a) The chief who is authorized to administer or enforce the statute or regulation or to issue the decision; or

(b) The Director, if the statute, regulation or decision is administered or enforced by the Director.

3. The petition must include:

(a) The name and address of the petitioner;

(b) The reason for requesting the order or opinion;

(c) A statement of facts that support the petition; and

(d) A clear and concise statement of the question to be decided by the Director or chief and the relief sought by the petitioner.

4. An interested person may not file a petition for a declaratory order or an advisory opinion concerning a question or matter that is an issue in an administrative, civil or criminal proceeding in which the interested person is a party.

Credits
(Added to NAC by Dep't of Commerce, eff. 12-17-87; A 5-14-92)

Current through July 31, 2013, Supplement 2013-1

NAC 232.040, NV ADC 232.040

RA0001

End of Document

MINUTES OF THE MEETING
OF THE
ASSEMBLY COMMITTEE ON JUDICIARY

Seventy-Fourth Session
April 3, 2007

The Committee on Judiciary was called to order by Chairman Bernie Anderson at 7:43 a.m., on Tuesday, April 3, 2007, in Room 3138 of the Legislative Building, 401 South Carson Street, Carson City, Nevada. The meeting was videoconferenced to Room 4401 of the Grant Sawyer State Office Building, 555 East Washington Avenue, Las Vegas, Nevada. Copies of the minutes, including the Agenda (Exhibit A), the Attendance Roster (Exhibit B), and other substantive exhibits are available and on file in the Research Library of the Legislative Counsel Bureau and on the Nevada Legislature's website at www.leg.state.nv.us/74th/committees/. In addition, copies of the audio record may be purchased through the Legislative Counsel Bureau's Publications Office (email: publications@lcb.state.nv.us; telephone: 775-684-6835).

COMMITTEE MEMBERS PRESENT:

Assemblyman Bernie Anderson, Chairman
Assemblyman William Horne, Vice Chairman
Assemblywoman Francis Allen
Assemblyman Ty Cobb
Assemblyman Marcus Conklin
Assemblywoman Susan Gerhardt
Assemblyman Ed Goedhart
Assemblyman Garn Mabey
Assemblyman Mark Manendo
Assemblyman John Oceguera
Assemblyman James Ohrenschall
Assemblyman Tick Segerblom

COMMITTEE MEMBERS ABSENT:

Assemblyman John C. Carpenter (Excused)
Assemblyman Harry Mortenson (Excused)

STAFF MEMBERS PRESENT:

Jennifer M. Chisel, Committee Policy Analyst
Risa Lang, Committee Counsel
Kaci Kerfeld, Committee Secretary
Matt Mowbray, Committee Assistant

OTHERS PRESENT:

Donna Toussaint, Private Citizen, West Sahara Community, Las Vegas, Nevada
Dan Newburn, Private Citizen, Las Vegas, Nevada
Kevin Janison, Private Citizen, Las Vegas, Nevada
Wallace Riddle, Private Citizen, Las Vegas, Nevada
Sandy Ambrose, Private Citizen, Las Vegas, Nevada
Gary Randall, Private Citizen, Las Vegas, Nevada
Bob Sidell, Representing Value Alliance, Las Vegas, Nevada
Karen Dennison, Representing the American Resort Development Association and Lake at Las Vegas Joint Venture Community, Nevada
Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities
Marilyn Brainard, Commissioner, Nevada Commission for Common-Interest Communities
Gail Anderson, Administrator, Department of Business and Industry, Real Estate Division, Nevada
Shari O'Donnell, Vice President of Government Affairs and Community Relations, Signature Homes, Nevada, Representing Nevada Commission for Common-Interest Communities
Kevin Ruth, Representing Community Association Management Companies through Executive Officers, Nevada
Randy Eckland, Representing the Howard Hughes Corporation and the Summerlin Community Association Management Team, Nevada
David Stone, Owner, Nevada Association Service
David Thomas, Resident, Summerlin Community, Nevada
Judy Farrah, Chairman of the Community Associations Institute of Nevada, and Representing Legislative Action Committee
Michael Trudell, Manager, Caughlin Ranch Homeowners Association, Nevada
Sam McMullen, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada

Mandy Shavinsky, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada
Bruce Arkell, Representing the Nevada Association of Land Surveyors

Chairman Anderson:
[Meeting called to order and roll called.]

I have an email addressed to Assemblyman Goedhart regarding Assembly Bill 371 which needs to be entered into the record (Exhibit C).

Let us open the hearing on Assembly Bill 396.

Assembly Bill 396: Makes various changes to the provisions governing common-interest communities. (BDR 10-1284)

Assemblywoman Francis O. Allen, Assembly District No. 4:
[Read from prepared testimony (Exhibit D). Also submitted proposed amendments (Exhibit E).]

Chairman Anderson:
If a homeowner in a common-interest community wishes to give away their voting rights to a certain person, may they do so?

Assemblywoman Allen:
Yes. This does not prevent proxy voting. They can fill out a form in which a person is named to vote on their behalf. This only prevents the systematic process of delegate voting, where one person represents an entire neighborhood.

Chairman Anderson:
If everyone on the block wants the same person to be their representative, would that be allowed?

Assemblywoman Allen:
The neighbors are allowed to cast ballots. They can acquire a proxy and give it to the person they choose to vote for them. The only thing that this does not allow is the systematic casting of votes, which many people do not even know takes place. For example, in our own races, only 40 or 50 percent of the electorate comes out to vote. What if the incumbent could cast the rest of the balance in their own favor?

Assemblyman Horne:
Is there anything to prevent an association from obtaining proxies that say "you agree that I will be able to cast your vote if at any time should you choose not to cast a ballot?"

Assemblywoman Allen:
No, it would not prohibit that. If a homeowners association (HOA) is determined, they could manipulate their rules to get the incumbents reelected. We can only do a finite amount of things. This would be a strong message from the legislature saying that we believe one man equals one vote.

Assemblyman Horne:
Could there be a provision that uses conspicuous language that states failure to vote in any particular election will allow your vote to be exercised by your delegate and may be cast for themselves? That would give the homeowners a fair warning that should they not vote, their delegate would get it.

Assemblywoman Allen:
That is not afforded to people right now. I am open to any suggestions from the Committee as to how to clarify this portion.

Donna Toussaint, Private Citizen, West Sahara Community, Las Vegas, Nevada:
I believe in the democratic process. Delegate voting disenfranchises everybody in the community. It costs thousands of dollars to hold a delegate election and we have to elect delegates every year. In my community, the homeowners pay $20 per month for assessments. We have seven sub associations, six of whom do not care what the master does. We have 2,208 single units, 60 businesses, and 1,800 apartments. The West Sahara Community Association sends a letter to every unit owner, including businesses, requesting that they submit their name to be a delegate. For each mailing, we have to pay for postage, copies, envelopes, and staff, which is around $800. We need 84 delegates; last year we received twelve, and this year we received eight. We compile the responses we receive with their resumes and send everything back out to the unit owners; another $800. We get the third mailing back and call a special meeting at which we open the ballots in public. After that is done, we have to send all of the information back out to the unit owners; another $800. In our community, for every 50 homes there is one delegate. If everyone in area number one votes in favor of one person, but that area did not have a delegate, those votes cannot be counted. In area number two, if we have one person say they will be a delegate and one person who actually votes, that delegate can cast all 50 votes for all of the homeowners in favor of whoever that delegate wants. I do not know where the equity is in this. It is very expensive for our HOA and the system does not work. Delegates may work when the developer is still

involved, but my community is 22 years old. With seven sub associations, the delegate system has created more apathy than you can imagine. Why would anybody vote for a board of directors when they do not know whether or not their vote will count? The homeowners get very confused as to why there is or is not a delegate. It creates the problem where the homeowners get angry and they feel like they do not have a voice. They do not want someone telling them what they have to say. We do not use proxies in our community because the proxy process was abused so much in the late 80's and early 90's. We need 84 delegates in order to have a complete election. Since 1985, the West Sahara Community Association has not had a legal election because we cannot get 84 delegates. We cannot change our documents because we cannot get enough delegates. We need help from the legislature. Our documents are 22 years old and they are written very poorly. This system is broken, costly, and expensive.

Chairman Anderson:
As I understand it, your community has been divided into districts and the election within each district is determined by the number of people who show up to vote. If you have one person who is nominated in that district and that person is the only one that votes, then they get the seat. Is that correct?

Donna Toussaint:
As far as delegates, that is correct. When you are electing the board of directors, you cannot count someone's vote unless they have a delegate. Once a delegate is elected, they can vote any way they want.

Chairman Anderson:
So a representative is elected because he received the only vote from the district and was the only person willing to take on the responsibility. He then has the responsibility of electing a board of directors, but he is not obligated to vote a particular way.

Donna Toussaint:
We would hope that the delegates would cast the votes the way the members would like them to be cast, but that is not always the situation. We have people who want to vote but we cannot count their votes if they do not have a delegate.

Chairman Anderson:
It is not any different than the election that brought in the 42 of us. We all represent the same number of people, but that does not mean that they are all registered voters. The numbers of registered voters in our districts are

dramatically different. If a representative is elected to make decisions, are they entitled to make decisions whether everybody in the district likes it or not?

Donna Toussaint:
Suppose you were running for election and the state law said that in order for you to be elected, there would have to be a delegate in place to cast the votes. If you received 98 percent of the votes but the delegate just did not like you, he could vote for someone else. If a homeowner decides to cast his vote, the vote should count for the person they want. People do not vote because they know that their vote does not count.

Chairman Anderson:
Representative democracies are difficult to understand because they do not have a direct election.

Donna Toussaint:
I would like the way the state government works to funnel down to HOA and not have a system like the electoral college. I think it would be beneficial to the community and to the homeowners.

Dan Newburn, Private Citizen, Las Vegas, Nevada:
In 1994, the Summerlin Community Baptist Church started with seven people. A few years later, we purchased property in the Summerlin North Association. Shortly after we moved into the building, we were notified that we would need to begin paying a monthly assessment which would be based on the number of houses that could have been built on the four acres we owned. When I purchased my private home in Summerlin, it was made absolutely clear that we were moving into a HOA and there would be a monthly fee. That subject was never brought up when purchasing the church. During the years we owned the property and did not have a building on it, we did not pay any assessments. I inquired among the other churches in the area and found that five of the churches as well as the Hebrew Academy and other nonprofits did not pay a fee, and that only the new churches being built were being assessed. We met with the Board of Directors and felt that they too thought one house of worship should not be treated differently than another house of worship. I felt we were on our way to equality when I discovered that one of the larger churches that had been recently built had approached the association and asked if they could pay $100,000 up front so they would not have to make a monthly payment. The Board of Directors agreed to that, and it was suggested to us that if they exempted the other churches in the community from paying assessments, they would have to rebate that money. It is unfair, and the Board, at different times, also thought it was unfair. If we wanted to minister there, we would have to pay the fee. The only way this could be changed is if the Legislature would

make the change. It would benefit all of the churches. The $6,000 per year that the Summerlin Community Baptist Church pays to the association could be used to do other things to serve the community.

Chairman Anderson:
When purchasing the property, did you tell the HOA of the intended usage?

Dan Newburn:
Yes, they actively solicited that we build a Baptist Church in the Association.

Chairman Anderson:
Did they sell the property to you at a reduced rate as compared to other property in the area?

Dan Newburn:
I suspect they did, but we did not ask them to do that. We paid the price they gave us.

Chairman Anderson:
Discussing this issue on another piece of legislation, the general indication is that the HOA's often want to bring churches in to provide the feeling of community which is not offered in dollars and cents. To attract the churches, they often give an upfront deal on the property as compared to other types of usages.

Dan Newburn:
I know they did that with some of the other places of worship early on because they were very desirous. I do not know what they did with other churches but they gave us a price and we paid that price.

Assemblywoman Allen:
Assemblywoman Marilyn Kirkpatrick and Assemblywoman Sheila Leslie have asked to amend this bill with regard to HOA mailings. I consider it a friendly amendment and agree with what they have to say.

Kevin Janison, Private Citizen, Las Vegas, Nevada:
When you are elected, you represent all of the people in your district, whether they voted for you or not. Representing a constituent on issues is much different then representing a district based upon people who chose not to vote. The Electoral College is determined by the number of votes cast, not the number of votes not cast. If you have a dispute with your HOA, they give you a couple of options. They say that you can move out of your home or you can choose to run for the board. In my HOA where there are 16,000 homes, I can

knock on 7,000 doors and completely convince those people that I am the right man for the job. Even if all of them vote, someone else can be sitting in his living room watching Monday night football and be able to cast 9,000 votes because the turnout is less than 10 percent. It gives the delegates over 90 percent of the votes cast. I do not know of any other place where people get to vote for individual candidates by casting ballots for other people. These people are rewarded if the turnout is low so that they do not have to knock on doors. They can sit back and maintain their seat year after year. It is impossible to get new people that might have a different viewpoint.

There is one other issue that is not part of this bill that my HOA engages in and that is a nominating committee. You cannot decide that you want to run for the board and put your name in; you have to go through a nominating committee. Unfortunately, the members of the nominating committee are already board members, delegates, members of the compliance committee, or members of the design review committee. Every step of the way, the appeal process is the same group of faces. If you are a member of a community, you should have the same rights as everyone else to get your name on the ballot and run for the board without having to pursue acceptance by a nominating committee.

Wallace Riddle, Private Citizen, Las Vegas, Nevada:
I strongly support this bill as submitted by Assemblywoman Allen. There are a few changes I would like to recommend. I would like to use *Nevada Revised Statute* (NRS) 116.31034 as an example for the mailing and return of ballots to the Board. I would also like to see a definition of the mailing of ballots plainly set forth in Section 8(a). I would like there to be a Section 8(d) that states only votes that are returned may be counted. NRS 116.3106 refers to the recall of a board member. I would recommend the usage of the policies stated there. If ballots are counted to elect an individual, the same procedure should be used for recall. Thirty-five percent of the people in my HOA cast a ballot and the majority will either recall or not recall an individual. That does not seem fair to the individual homeowners. If you vote to elect an individual, you should vote to remove them on the same procedures.

Sandy Ambrose, Private Citizen, Las Vegas, Nevada:
I am sure there is concern about the wording "without prior consent." There may need to be language put into the bill that would define what is proper and what is not proper. The *Twin Rivers* appellate decision [*Committee for a Better Twin Rivers v. Twin Rivers Homeowners' Association*, 383 N.J. Super. 22 (App. Div. 2006)] is a very important document with regard to freedom of speech. In that decision, they have mandated that while freedom of speech is an amendment right, it is not absolute. There are limitations that the Board may have of time, place, and manner in which freedom of speech can be provided.

In Section 9 subsection 6, defines "an official publication," but the Board members also provide information on an intermittent basis. If the bill does not expound on the definition of an official publication, it gives the implication that it is a regularly circulated newsletter or publication. When they send out ballots, which are "an official publication", they can send flyers that provide information. These flyers are not "an official publication."

Board members often give oral presentations to explain their position, and their presentation may not be in a written publication or official newsletter. If you do not provide some way of allowing members of an association to give an opposing view, then you are only getting one side of the story. An example can be an executive board meeting. A board member can stand up and provide graphs and documents and provide experts to show their position on it. There is no remedy if you do not provide language in the bill for oral presentation by the opposing side. Inherent with this are problems that come up when you have one Board presenting its opinion when there may be 20 members of an association who have opposing views. How do you relegate whose opposing view gets to be presented? Publication can get rather large if you have to have everybody's position posted. In an oral presentation, whose opinion should be presented? I am happy with the bill, but as I have stated, there are some inherent problems that may come along with it. There needs to be something done with the censorship because you need to limit the language someone can use so that it is not slanderous.

Gary Randall, Private Citizen, Las Vegas, Nevada:
I am very much in favor of this bill. We had a situation in my HOA where the homeowners were required to vote for one issue against another rather than a yes or no vote on each issue. The Board was allowed to set forth their position with that ballot, which resulted in people voting for the position they wanted. There was no opportunity at that time for opposition to be voiced. We feel this should not be limited to an official publication such as a newsletter or website.

Chairman Anderson:
I will now move to those in opposition.

Bob Sidell, Representing Value Alliance, Las Vegas, Nevada:
We have a concern with the portion of the bill that relates to the delegate system. The reality is that the system is not working the way it is supposed to, however going from one extreme to another may not be the best solution. To go from a delegate system to a one person one vote rule may cause more difficulty than we already have. We believe there is a midpoint that will satisfy all HOAs. The idea of a cookie cutter solution does not exist in relation to HOAs; there are some as small as 20 homes and some as large as

20,000 homes. The implementation of their Covenants, Conditions, and Restrictions (CC&Rs) differ because they have different problems. The more complacent a community gets and the better it is being managed, the happier everybody is. Complacency is infectious, and that infection happens at different rates with a small community as opposed to a large one. The idea of going from black to white may not solve the problem, but there are infinite shades of grey. Our suggestion is to have the portion of the bill referring to the elimination of the delegate system be addressed again with the idea in mind of not simply eliminating the system, but fixing it. If there is a delegate, the delegate votes, but if there is no delegate, the individual homeowner's votes would count. That is the direction we believe it should take.

Assemblyman Mabey:
What problem would you foresee if each person had a vote and we did away with the delegate system?

Bob Sidell:
An example would be in a very large association with a very small minority who are always vocal. Because of the complacency of one-on-one voting, a contentious issue does not even bring the voters out. The vocal minority could exercise a lot of effort to push a particular issue. True to form, a 5,000 member association may end up with 300 or 400 total votes. The vote will probably be represented by a majority of the dissidents. Unfortunately, the majority of homeowners are silent, especially when things are good. Presently votes may count in favor toward an issue that only affects a very small percentage of the association and is detrimental to most of it. Unfortunately, that is the reality of what exists. Sociologists have been fighting it for years, and I do not know how we will ever get around it. The major concern is that with one-on-one voting, a very small minority can create problems that are detrimental to the majority of homeowners in that association.

Assemblyman Mabey:
It seems like it could be just the opposite.

Bob Sidell:
It very easily could be. It would be great if a contentious issue would bring out the vast majority. The problem is that HOAs are divided between the homeowners and the Board. People seem to forget that the Board is made up of volunteers that are actually giving their time to guarantee that the CC&Rs are going to be protected. When things are going well, nobody cares. The only people who care are the ones who have an axe to grind and they do not necessarily represent the majority.

Assemblyman Horne:
I have seen where people are quiet and unhappy, so we should not be adopting the position that we should keep things the same because there are just a few malcontents that are making the noise because the others would be making the same noise if they were unhappy. When you said that there should be a middle ground found instead of going from one extreme to the other, you admitted there were some problems with this. Did you contact the sponsor of the bill and propose a middle ground?

Bob Sidell:
Unfortunately, Value Alliance is relatively new. There are so many bills we are involved in that we did not have the chance. We would be delighted to sit down with Assemblywoman Allen and try to work out a compromise. Going from one extreme to another, regardless of what the issue is, there is always the problem of creating a monster worse than what you are getting rid of. There are some alternatives by restricting the use of delegate voting, like only allowing certain things, not being able to abuse the process, and satisfying the end result without creating any upset. It is a lot easier for an association that has 100 people in it to deal with something, where an association with 5,000 or 6,000 has difficulty. The concept of a delegate system is correct. Unfortunately, over the years it has evolved into a system that does not work. It does not work primarily because there are no built-in restrictions for how it should operate. If we could correct that, there would not be a need to do anything else.

Assemblyman Horne:
Many of the emails I received were from board members who do not believe the system is broken at all, which is also why Assemblywoman Allen brought the bill. It was expressed that proxy voting is not going away. Many of the concerns that the board has can still be addressed in that manner. It is not appropriate that if a vote is not cast, a vote is cast by someone else. If you want to give away your vote, you have to get a proxy, which as I suggested, could be conspicuous language saying you have my vote.

Assemblywoman Allen:
With regard to the specific instance where a neighborhood does not have a delegate, you said that their votes are not cast. I believe that in Summerlin North, the board president gets to cast those votes when there is no delegate.

Bob Sidell:
The original CC&R documents say that any district which does not elect a delegate will have the current president represent them. It does not say that he

will cast the vote. The people in the districts without a delegate are not represented by someone on the Board of Directors. There are no restrictions, and it would be simple for this bill to say that where there is no delegate elected, the individual votes of homeowners in that district will be counted. It would only need a one-line sentence stating that they may be represented, which is necessary for being able to disseminate information to the homeowners. If they are not represented by a member on the Board, they can keep their voting rights. Those are simple compromises that will allow the system to continue to work.

Assemblywoman Allen:
The concept of delegate voting for people, whether there is a delegate or not, is an affront to democracy. You said yourself that the CC&Rs in Summerlin allow for the Board President to cast those ballots.

Bob Sidell:
I did not say he could cast their vote for them, I said that he is allowed to represent them.

Karen Dennison, Representing the American Resort Development Association and Lake at Las Vegas Joint Venture Community, Nevada:
I am concerned with the issue of a time-share project in a master association voting through delegates. For example, Lake Las Vegas has a time-share project but does not generally have delegate voting. It has a one-unit, one-vote system for the commercial and residential owners except for time-share projects. With 13,000 time-share owners who own undivided interest in the time-share project, it is unmanageable for that to be a system of a one time-share interval. You would have to have 52 intervals to make one unit vote. We are asking for a narrow exception to say that if a time-share project is part of a master association, it should be allowed to vote through delegates. Proxies do not work for time-share projects because in past sessions, our legislature has narrowly defined who can receive a proxy. *Nevada Revised Statutes* 116.311 states that if you cannot vote through delegates, you are limited as to who can have your proxy. It limits your options to an immediate family member, another unit owner who resides in the community, or your tenant who resides in the common-interest community. The time-share owner would then have to go outside his time-share project and find someone who resides in the community to give a proxy to. This disenfranchises the project itself. There is more to proxies than voting; there is the idea that the delegate would attend a meeting on behalf of the time-share project itself. The delegate would have an opportunity to speak and be heard on issues relative to the time-share project. For this reason, we are hoping that you could make an exception for time-share projects in the delegate voting process. The other

issues that will be brought up are approval of the commission to foreclose, as well as the right of redemption after foreclosure sale and the community manager bond. I would like to say that Lake Las Vegas is in agreement with the common-interest communities' position on those issues.

Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities, Nevada:

Our commission has considered a number of bills, including this one, and has had a number of legislative commission meetings in open hearing. I would like to preface all of our remarks to echo what Mr. Sidell said. The commission is very aware that there are all different kinds of associations throughout the state. For this reason, the commission believes as a general proposition that the changes in NRS 116 need to be very carefully thought out. There are different types of delegate voting systems. The commission opposes the elimination of delegate voting. We do not propose or support any particular type of delegate voting, but we did ask the ombudsman and the Compliance Division of the Real Estate Division whether they have received complaints regarding delegate voting and they did not. There have not been hearings before the commission dealing with problems about delegate voting. The commission is concerned that the prohibition of delegate voting in all cases may have an adverse affect on different types of associations, particularly mixed use projects. *Nevada Revised Statute* 116.311 states that proxies are limited to one specific meeting and they terminate after that meeting. They cannot substitute for delegate voting. There were abuses in proxy voting, so the solution was to limit proxies to only one particular meeting. Subsection four of NRS 116.31034 allows members of the association to get their name on the ballot and has been in effect since the 1990's.

The commission opposes the idea of approving foreclosures. It is not clear if the commission would approve the amount or just the process and if they would be required to review the declaration or the budget in which the assessment is based, and at what point in the foreclosure process would the commission intervene. The commission is also concerned that they would be required to meet much more frequently at greater cost to the state, or that the enforcement of assessment liens would become seriously delayed. Most importantly, the commission does not believe that, since they are a formal body of the State of Nevada, they should be in the business of approving foreclosures as if the state itself were condoning specific foreclosures. We also suggest that activities related to foreclosures or enforcement of liens that violate law be subject to recourse either through the Nevada Real Estate Division which regulates managers who investigate associations, or the Financial Institutions Division which licenses those who conduct foreclosure sales, because they must be approved though the financial institutions.

As far as the equity of redemption, the commission did not take a position for or against. We would like to note that an equity of redemption for mortgage foreclosures is described in NRS Chapter 21 very specifically with lots of rules and procedures. It concerns the commission that none of the details are here.

As far as the official publications, we agree with what Ms. Ambrose said. There are a number of problems with the present wording because there needs to be a limitation on how one's views are shared. You do not want the association to have to mail out 20 pages of what one person thought. The commission recognizes the need for this and supports the proposition of political free speech in associations.

The commission did not take a position on the manager bonding in Section 10 because it needs greater detail. Some of the master associations of high-rise condos could have several millions of dollars and we would need to know how the bonding is going to work.

Lastly, if the houses of worship are no longer paying assessments to which they agreed, that would throw the burden on the homeowners who would have to pick up any deficit. In the interest of time, my testimony has been limited to our specific concerns (Exhibit F).

Assemblyman Mabey:
Is every house of worship treated the same?

Michael Buckley:
I do not know. That was just an observation I made. The commission has voted on some of these things, but we had not really discussed that because it was just heard this morning.

Chairman Anderson:
It seems that there are as many different ways of handling these issues as there are communities in this state.

Marilyn Brainard, Commissioner, Nevada Commission for Common-Interest Communities:
Ms. Ambrose made the comment that she felt people in associations did not have the chance to speak. We have public comment periods mandated for all of our associations, no matter what the size, so that the homeowners can come and speak before the formal board meeting begins. Ms. Ambrose also talked about asking the association to insert any material that was presented by a homeowner in the official publication. Many associations would choose not to publish their newsletter or magazine because of that burden. Lastly,

Ms. Ambrose made reference to the *Twin Rivers* decision. It has been argued to the New Jersey Supreme Court and is under consideration, but the final ruling has not yet been decided.

[Chairman Anderson left room.]

Assemblywoman Gerhardt:
I had a situation where I was at odds with my HOA because I did not believe that they were applying the rules equally to all of the residents. I went to a board meeting and asked if there was any way that I could communicate with the other homeowners about this particular issue, to see if there were other people who were having the same problem that I was. I was told that the only way I could have a voice in the process was to go knock on doors. I believe that people need to have an opportunity to be heard. As a homeowner who pays dues, I think it is absolutely appropriate to have a means of communicating with the other members. I could be brief and concise and it would not be cost prohibitive.

Marilyn Brainard:
In the association I served on, our Committee Manager takes minutes. In the beginning of our minutes, there is a summation of comments that were made. We do not identify the homeowner, but significant comments are recorded. The minutes are posted within 30 days, so the other homeowners can go online and read them. It is not a verbatim transcription, but the general issues are contained in that section. If that did not solve the problem, you always have the redress, which is why we have the ombudsman's office to work with the board to be sure that is included.

[Chairman Anderson returned to room.]

Assemblywoman Gerhardt:
How long does it typically take for ombudsman to resolve an issue?

Gail Anderson, Administrator, Department of Business and Industry, Real Estate Division, Nevada:
The ombudsman started the intervention conference program on July 31, 2006. A letter goes out six weeks before the conference, inviting homeowners to come in and attempt to resolve their issues. This is a new procedure we started last summer.

Shari O'Donnell, Vice President of Government Affairs and Community Relations, Signature Homes, Nevada, Representing Nevada Commission for Common-Interest Communities:
The right to use proxies in the election or removal of board members was done away with in past Legislative sessions. Elections and removals can only be conducted through secret ballot. In response to Assemblywoman Gerhardt's comment, we did require community managers to keep a thorough log of all violations so that you could request those records and see how many notices went out on a particular violation. It takes six weeks to have a matter reviewed by the ombudsman because of the due process involved. That timeframe could be shortened if we shortened the due process.

Assemblywoman Gerhardt:
Anecdotally, I have heard that a year to a year and a half is the norm.

Kevin Ruth, Representing Community Association Management Companies through Executive Officers, Nevada:
We represent over 340,000 homes in hundreds of communities. Everything that has been put forth by the commission in opposing the bill, CAMEO supports. We have also provided the Committee proposed amendments (Exhibit G).

Chairman Anderson:
Have you shared this with Assemblywoman Allen?

Kevin Ruth:
No, sir. It was just put together this morning. Our lobbyist did approach Assemblywoman Allen yesterday to indicate that we would be testifying in opposition.

Randy Eckland, Representing the Howard Hughes Corporation and the Summerlin Community Association Management Team, Nevada:
I believe in the delegate system of the government, therefore I must respectfully oppose A.B. 396. Since arriving in Summerlin in 1992, our delegate system has served our community very well. We have completed successful day to day operations, a major amendment process, and the smooth transition of 15,000 homes to resident control. Before residents were entitled to begin serving on the board, they were naturally eager to engage in the community government system, and the neighborhood delegate system gave them the opportunity to do that. They met regularly and it was an immediate and effective resource that engaged them in government in a positive manner. I have found that neighborhood delegates typically attend more community meetings to help familiarize themselves with the many sides of an issue. They

also tend to vest themselves more in the community government processes, and as a result they demonstrate a higher level of stewardship and responsibility. The neighborhood delegate involvement also broadens their knowledge and perspective as they discuss issues with fellow delegates and residents. The delegate system has also been instrumental in the growth of an expanded and well rounded volunteer governmental base, which is vital to any community association striving for harmony and effectiveness. Many of our early delegates eventually assumed leadership roles on the respected boards of the compliance advisory, design review, and finance committees. Not all communities have had the success that our delegate system has, and I can certainly see what the benefits would be of retooling or change. I am committed to work over the next two years to develop workable solutions. If we are given an opportunity to fix what is not working in this environment, it would be a better approach than simply doing away with it to the detriment of those areas that have used it in a good manner.

There were also misperceptions as relating to the Summerlin North Community association and the proxy to the president of the board. In my experience, the neighborhoods which did not have the ability to elect their own delegate were still returning ballots whenever an issue was brought to vote. To make sure the neighborhood was heard, the president would cast ballots for anybody who took the time to return them. There was no casting of any ballots that were not returned or any votes that were unheard.

David Stone, Owner, Nevada Association Service:
I would like to briefly address Section 7 and Section 8. Section 7 deals with getting permission from the commission. The ombudsmen's office already has a process in place regarding foreclosures and I do not think an extra step to the commission will provide any additional level of assurance. Last year, my office started thousands of collection accounts and foreclosed on only two homes. One of the homes was already in foreclosure by the lender and the other home had been abandoned by the homeowner. This is not a problem that truly exists. Section 8 is vague and does not give any timeline for the right of redemption, who is responsible for paying the mortgage, property taxes, or ongoing assessments. It does not say who needs to pay money in order to redeem the property or how to address the issue if the lender is already in foreclosure. What happens if the lender forecloses during the right of redemption period? Are any of the rights lost by any of the individuals? It needs to be cleaned up and answered those questions.

Chairman Anderson:
I have a letter from Judy Farrah in opposition of Section 7 through Section 10 that needs to be inserted into the record (Exhibit H).

Let me close the hearing on A.B. 396.

Let us open the hearing on A.B. 399.

Assembly Bill 399: Revises the provisions relating to the Office of the Ombudsman for Owners in Common-Interest Communities. (BDR 10-026)

Assemblywoman Francis O. Allen, Assembly District No. 4:
[Read from prepared testimony (Exhibit I).]

Chairman Anderson:
Dispute resolution centers are something that I have supported in the past. Would this be moving it to someone who has the training? What are the qualifications established? It appears the office gets to establish what the criteria is going to be, so is this going to take the legislature out of the process of setting forth the duties and responsibilities of the ombudsman? It is not going to be an immediate solution but a rather prolonged one.

Assemblywoman Allen:
I am open to an interim study on how to best give homeowners this resolution. The Office of the Ombudsman would select at random from a list of licensed private ombudsmen. The legislature would have oversight of it, but in actuality, instead of only having one investigator in Carson City and two in Southern Nevada, this would multiply.

Assemblyman Segerblom:
In law, we use the alternative mediation processes regularly and they are fantastic. I would encourage the concept of using mediation.

David Thomas, Resident of Summerlin Community, Nevada:
I am a resident of Summerlin community and also an attorney. I have practiced for 18 years and have represented more HOAs than I have residents. About eight years ago I got involved with youth sports in Summerlin. It became remarkable to me the number of people who came up to me and had complaints. I heard testimony earlier today that it might be 1 to 2 percent of the community that had complaints about the HOA. I do not profess to be an expert because I do not go to meetings, but I know when I was at the soccer fields and baseball fields, I had complaints from about 10 percent of the kids' parents. The complaints I heard from this HOA are not the normal complaints

about reasonable restrictions. No one has ever come to me and said that the HOA will not allow them to paint their house pink or put a garbage sculpture in their front yard. It seems to be more along the lines of people planting trees without prior approval and having to tear them out. Another example is doing brickwork and yard work and having to tear it out. One person even said their HOA did not like the contractor they used. Most recently, someone put up a Greenbay Packers flag Sunday morning and took it down Sunday night and there were complaints about that. These do not seem to be reasonable complaints from the HOA. When I found out there was talk about changing a law that would give the HOA more power, I was concerned. One of my biggest concerns is that the HOA attorneys feel like they need more power. I do not feel they need more power, they just want more power. I am concerned because of the number of contacts I have made with people. HOA's are necessary, but I am concerned about giving them control and authority over everything in the streets, only because of the people I have dealt with and the stories they have. I have always been concerned that the HOA is taking dues and giving them to an attorney and making some of these people's lives miserable. My personal opinion is that the amount of authority that the HOA has to govern their residents is fine. These are things that need to be handled between neighbors. I am concerned about the number of times people say they have been threatened with an attorney or an attorney has actually been retained.

Chairman Anderson:
Do you perceive that there may be a quicker resolution to HOA's without the use of ombudsmen?

David Thomas:
I believe that is the intent, but I have been involved in two cases where the people have felt like the ombudsman was going to take too long and that it was not going to be resolved. Another common thread with the people who have come to me, is that there was no complaint from the neighbors. Some people even had written documents from neighbors saying that they had no problem with the brickwork or the trees. If the neighbors are not concerned, I do not know why the HOA is.

Chairman Anderson:
The purpose of living in a common-interest community is to make sure people maintain their homes.

David Thomas:
HOA's are absolutely necessary for that, but I have never heard from people that they do not feel like repairing their house or watering their grass.

Assemblywoman Allen:
When the ombudsman's office was originally created by the legislature, it was done to prevent the homeowner from having to retain expensive attorneys and go through a lengthy court battle. We created this ombudsman office where someone can go and get dispute resolution. Now, we as a state are failing in that obligation.

Chairman Anderson:
Let me now move to those in opposition.

Kevin Ruth, Representing Community Association Management Companies through Executive Officers, Nevada:
We are in opposition to A.B. 399. The concept of privatizing what is already in existence may be a good thing down the road. However, we as an organization have seen significant improvement in the system in the past six to nine months. The new ombudsman who has been on the staff for that period of time has instituted a new conferencing concept which we support. Issues should be resolved in a more expeditious way. I am not sure if we are trying to remedy and remove the Alternative Dispute Resolution (ADR) process which is in place right now or if we are trying to deal with the intervention process which is taken care of through the real estate division and not through the ombudsman. We feel that creating a private ombudsman is not in the best interest of HOAs at this time, nor the homeowners. We also have significant issues with the funding. It does not make sense that the aggrieved party would be required to put 10 percent of the estimated fees forth, while the respondent would be required to pay the remaining 90 percent. Once the ombudsman comes up with a determination, that all could be flip-flopped based on whether or not the homeowner was found to be incorrect in their assertions. I am confident that the common-interest community commission and the real estate division have some issues with this also.

Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities, Nevada:
Read from prepared testimony (Exhibit J).

We believe that these changes need to be very carefully thought out and have input from a lot of different people. The ombudsman reports that of the people who participate in her conferences, she believes about 50 percent of them are resolved. She does not keep formal statistics on those because she wants it to be a very informal process.

Assemblywoman Gerhardt:
You said that during the public comment portion they were overwhelmingly in support of the commission's position. How many people are you talking about?

Michael Buckley:
It depends on the meeting.

Assemblywoman Gerhardt:
What is an average?

Michael Buckley:
Only one person showed up for our meeting last week.

Assemblywoman Gerhardt:
Is that an average?

Michael Buckley:
No. It depends on what we are talking about. We had a workshop dealing with reserve study preparers in Carson City last August that had about 20 people. I would say 10-20 people come to regular meetings.

Assemblywoman Gerhardt:
How many people are we talking about in Clark County that are part of common-interest communities.

Michael Buckley:
I do not have that number. I think there are 200,000 to 300,000 units in the state and 2,600 associations, most of them in the south.

Chairman Anderson:
Before adopting regulations, we require information on the number of meetings held and the number of people who attend. It is not unusual to see that there are as few as two people who show up and sometimes as many as 100. It depends on the particular topic being discussed. I was surprised to see how frequently no one shows up, although everybody maintains that it is going to change their lifestyle.

Marilyn Brainard, Commissioner, Nevada Commission for Common-Interest Communities:
Assemblywoman Allen proposes a market-based solution in privatization, which would be a tremendous idea in many aspects of government. However, in looking at the privatization for the ombudsman, I am deeply concerned. By creating multiple people, how would oversight and consistency be

accomplished? Part of the reason we have only one ombudsman is that we like to know that every case is treated equally. I cannot even imagine how creating the oversight for a private ombudsman would be accomplished. Our current ombudsman would be forced into an administrative role when so far her strength has been getting people to resolve their problems amicably. That is what we hope will continue so the private program would be a big concern. I do not know how we could continue to hold these meetings without putting a further strain on the resources of our state government. I would like to point out, in referring to the other side of our legislative process, that Senator Schneider removed the language similar to Assemblywoman Allen's Section 10, realizing that it would be grossly unfair to put the burden on an association. It would be impossible to have the supporting regulations in place by July 1, knowing that the Legislative Counsel Bureau (LCB) must approve all language. Overall, I feel that the parts of this bill that would be considered would have many egregious, unintended, and unfavorable consequences.

Judy Farrah, Chairman of the Community Associations Institute of Nevada, and Representing Legislative Action Committee:
If you brought this bill forward in 2001 or 2003, I probably would have been in support of it because the program was not working. However, we are seeing a significant change in the division and the ombudsman's program. We now have administrative law judges who have been hired by the division to handle these particular types of disputes. We need to give them a chance to do what they have finally been able to put together over the last few months, and hopefully this program will be successful. I have submitted my comments in writing as well (Exhibit K).

Michael Trudell, Manager, Caughlin Ranch Homeowners Association, Nevada:
I am one of the people that attended the commission hearings last week, and I appreciated the opportunity to be able to speak to the commissioners about our concerns. Recently, Caughlin Ranch HOA had an incident where we really needed the ombudsman's office to help with a matter where the reform board that had been elected did not want to conform to the requirements to have a recall election after a recall petition had been submitted to the state. If it was not for the ombudsman's office staff being available and acting quickly, we would have had serious consequences in our HOA. Within two weeks after the meeting on January 10 where the board of directors refused to set a special meeting date for the recall ballot to be counted, the ombudsman's office had assisted me in preparing a removal election plan and approving that plan with other items. We were able to hold that recall election. One of the problems with the process is that there are laws in place which indicate how you are to go about any kind of a complaint. Part of that process is that you must file an intervention affidavit with the ombudsman's office. The gentleman who spoke

earlier indicated that he had spoken to people but they did not want to file with the ombudsman's office because they thought it would be ineffective. If homeowners do not file the affidavit, the ombudsman's office does not have the authority to act. If they do not follow the procedures that are currently in place, the failure of the system is blamed, but it is not because the system does not work; it is because people fail to understand how to use the system properly.

Chairman Anderson:
Oftentimes a group of homeowners is paying for an attorney, so an individual homeowner is at a dramatic disadvantage because he is going to have to engage someone on his own.

Michael Trudell:
At times, that is the issue. We have had very good success with the ombudsman's office and the State's staff.

Chairman Anderson:
Is there anyone else wishing to be on the record for A.B. 399?

Hearing closed on A.B. 399.

It is my intention to give A.B. 396 to Assemblywoman Allen. If you have any suggestions on A.B. 396, please share them with her and Ms. Chisel. Please be cognizant of the concerns that have been raised relative to foreclosures, the placing of foreclosures within the HOA for nonpayment of assessments and how those situations are handled. Also we need to try and find a compromise on the voting process that can be worked out. Assemblywoman Allen, I believe we have offers from Ms. Dennison, Mr. Buckley, Mr. Sidell, and the Hughes Corporation to help work on language.

If there is any amended language that needs to be put forward on A.B. 399, I would also suggest that be done as soon as possible.

Let me open the hearing on Assembly Bill 431.

Assembly Bill 431: Establishes provisions governing condominium hotels. (BDR 10-1056)

William Horne, Assembly District No. 34, Clark County, Nevada:
The purpose of this legislation is to create a new section in statute to deal with the unique situation of common-interest communities, particularly condominium hotels. The law currently rests in NRS Chapter 116, but it does not fit cleanly. The bill you have before you without the amendments is just a skeleton. The

amendments (Exhibit L) are supposed to be part of the bill, but because of time constraints and drafting, they have put out a skeleton bill instead. The bill without the amendments does not make very much sense in what we are trying to do in making a separate Chapter 116B for hotel condominiums. Many of the provisions in Chapter 116 have been placed in Chapter 116B. There are additional provisions that deal with the unique character of hotel condominiums. There are approximately 2,200 hotel condominiums in Clark County alone, and about 6,000 currently under construction in Clark and Washoe Counties. These properties, unlike typical HOAs, are mixed use. They are not designed for single family residences and are not the typical condominiums that we have grown accustom to. These sit on hotel properties. In a typical HOA, a large number of residents are the owners of the condos or single family dwellings. In hotel condominiums, many of the unit owners may not live there. They rent them out to visitors who come and go, but the property is managed by the hotel. The reason this legislation was brought was because many of the common elements in a typical HOA are different in a hotel condominium property. This is going to provide some flexibility and control for hotel operators while also giving the same protections for the unit owners in the property. There is also an executive summary of the amendment (Exhibit M) which should give you a brief overview of what this legislation does. No one has contacted me in opposition or with concerns on this proposal.

Sam McMullen, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada:

As Assemblyman Horne said, this is basically a new animal in terms of common-interest communities. Common-interest communities have multiple interests in certain pieces of property within a parcel or unit. Consequently, they have to interact, which is why we have NRS Chapter 116. In the hotel condo situation, there is a difference in common elements, which are called shared components and owned by the hotel unit. Mandy Shavinsky, who is also with Snell and Wilmer, will be doing most of the speaking to give you a quick summary of the details of the bill and how it changes NRS Chapter 116. Approximately 90 percent of this amendment is exact language from NRS Chapter 116. In respect to proxies, reserves, declarations, construction defects, and the initiation of law suits, this bill reads exactly the same as Chapter 116.

Mandy Shavinsky, Snell and Wilmer, Limited Liability Partnership, Representing the Association of Condominium Hotel Unit Owners, Nevada:

As Assemblyman Horne indicated, condominium hotels are very unique and new products to Nevada. They do not fit squarely within the framework of NRS Chapter 116, which was designed to help govern master planned communities such as Summerlin North and other traditional condominiums. Our thought is

that NRS Chapter 116 does not adequately address situations where you have more than one use, specifically hotel use that is taking place in a condominium hotel. Assembly Bill 431 provides the framework for that. Transient use is permitted in these types of developments, and as result of the hotels, it is really the primary use of these projects. It is possible but extremely unlikely that there will be full-time residents living in these types of projects. Most people live in single family subdivisions, and although we enjoy having the benefits of hotel casinos in our state, we do not want to live in them full-time. As Assemblyman Horne said, we took what worked from NRS Chapter 116 and left many of the same protections in place. We have also built in the concept of a hotel unit which is owned by a hotel operator. The hotel operator manages the hotel on-site. They have to maintain certain quality levels and standards within the condominium hotel in order to make the hotel an attractive destination for the unit owners. Operating and soon to be operating condominium hotels are often associated with hotels such as Hyatt, MGM, and other well known chains. Purchasers and guests in those projects are going to expect a level of quality that may not be possible in a traditional condominium situation where the HOA governs common elements. Essentially, the hotel and residential unit owners are all stake holders, and there is a mutuality of interest that exists in promoting and making the hotel condominium successful that is not present with HOA's.

Assembly Bill 431 has many of the same safeguards as NRS Chapter 116, and the common-interest community commission would continue to have jurisdiction over these types of communities so there would be some avenue of redress for homeowners who do not feel their voice is being heard. The ombudsman would also have jurisdiction over these communities. The same types of consumer protections that are currently in NRS Chapter 116 will also be available here, such as the provision of a public offering statement, which is a statement of statutorily mandated disclosures that homeowners must be provided with. The same five-day rescission right will exist, which is the right of someone who has contracted to purchase one of these units to rescind their purchase within five days of the execution of the purchase agreement. There will also be a reserve requirement for major components as there is in NRS Chapter 116. We believe this legislation will create structure and predictability for, not just the unit owners who have purchased and wish to rent their units out under the structure, but also for the developers that have come in and the hotel operators that are looking to this product as the new wave of hotel and resort development in Nevada.

Michael Buckley, Chairman of the Nevada Commission for Common-Interest Communities, Nevada:

We support the concept of having a separate chapter for hotel condos.

Bruce Arkell, Representing the Nevada Association of Land Surveyors:
We have a couple of minor amendments to Section 71 and Section 77 of the mock-up (Exhibit N). The amendments basically take out language that violates licensure laws, and one provides for a vertical datum so that you can find the units from space. The last one allows for a better definition of the units.

Karen Dennison, Representing the American Resort Development Association and Lake at Las Vegas Joint Venture Community, Nevada:
I would like to put on the record that we are in favor of a separate NRS Chapter for condominium hotels for many of the reasons that Mandy Shavinsky pointed out to you. We have not yet had an opportunity to review the amendment, but we will do so and work with the others in support.

Sam McMullen:
I would also be happy to work on this bill. If there are any questions or concerns, please direct them to me.

Chairman Anderson:
Is there anyone else who needs to get on the record? [There were none.]

Let me close the hearing on A.B. 431.

It is the intent of the Chairman to assign A.B. 431 to Assemblyman Horne.

[Meeting adjourned at 10:48 a.m.]

RESPECTFULLY SUBMITTED:

_____
Kaci Kerfeld
Committee Secretary

APPROVED BY:

_____
Assemblyman Bernie Anderson, Chair

DATE: _____

EXHIBITS

Committee Name: Committee on Judiciary

Date: April 3, 2007 **Time of Meeting: 7:43 a.m.**

Bill	Exhibit	Witness / Agency	Description
	A		Agenda
	B		Attendance Roster
A.B. 371	C	Nevada Legal Press	Email to Assemblyman Goedhart
A.B. 396	D	Francis Allen, Assemblywoman District 4	Prepared testimony
A.B. 396	E	Francis Allen, Assemblywoman District 4	Proposed amendment mock-up
A.B. 396	F	Michael E. Buckley, Nevada Commission for Common Interest Communities	Prepared testimony
A.B. 396	G	Kevin Ruth, Cameo, Inc.	Proposed amendments
A.B. 396	H	Judy Farrah, Capital Consultants Management Corporation	Comments on A. B. 396
A.B. 399	I	Francis Allen, Assemblywoman District 4	Prepared testimony
A.B. 399	J	Michael E. Buckley, Nevada Commission for Common Interest Communities	Prepared testimony
A.B. 399	K	Judy Farrah, Capital Consultants Management Corporation	Comments on A. B. 399.
A.B. 431	L	William Horne ,Assemblyman District 34	Proposed amendment
A.B. 431	M	William Horne ,Assemblyman District 34	Executive summary of proposed condominium hotel legislation from Snell & Wilmer
A.B. 431	N	Bruce Arkell, Nevada Association of Land Surveyors	Proposed amendments to A. B. 431

AMENDMENTS TO
UNIFORM COMMON INTEREST OWNERSHIP ACT

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-SEVENTEENTH YEAR
IN BIG SKY, MONTANA
JULY 18 – 25, 2008

WITH PREFATORY NOTE AND COMMENTS

December 8, 2008

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DRAFTING COMMITTEE ON AMENDMENTS TO UNIFORM COMMON INTEREST OWNERSHIP ACT

The Committee appointed by and representing the National Conference of Commissioners on Uniform State Laws in amending this Act consists of the following individuals:

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AMENDMENTS TO UNIFORM COMMON INTEREST OWNERSHIP ACT

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a minimum heat in their units of 55 degrees. The teenage son of the Owner of Unit C turns off all the heat after his last run on Sunday, and on Monday night, the pipes in Unit C burst. A finder of fact might properly conclude that the son of the owner of Unit C was grossly negligent.

SECTION 3-116. LIEN FOR ~~ASSESSMENTS~~; SUMS DUE ASSOCIATION; ENFORCEMENT.

(a) The association has a statutory lien on a unit for any assessment ~~levied against~~ attributable to that unit or fines imposed against its unit owner. Unless the declaration otherwise provides, reasonable attorney's fees and costs, other fees, charges, late charges, fines, and interest charged pursuant to Section 3-102(a)(10), (11), and (12), and any other sums due to the association under the declaration, this [act], or as a result of an administrative, arbitration, mediation, or judicial decision are enforceable in the same manner as unpaid assessments under this section. If an assessment is payable in installments, the lien is for the full amount of the assessment from the time the first installment thereof becomes due.

(b) A lien under this section is prior to all other liens and encumbrances on a unit except:

~~(i)~~(1) liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances ~~which~~ that the association creates, assumes, or takes subject to~~;~~;

~~(ii)~~(2) except as otherwise provided in subsection (c), a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent~~;~~ or, in a cooperative, the first security interest encumbering only the unit owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent~~;~~; and

~~(iii)~~(3) liens for real estate taxes and other governmental assessments or charges against the unit or cooperative.

(c) A ~~The~~ lien under this section is also prior to all security interests described in

subsection (b)(2) ~~clause (ii) above~~ to the extent of both the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien and reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien. ~~This subsection~~ Subsection (b) and this subsection ~~does~~ do not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association. [~~The~~ A lien under this section is not subject to ~~the provisions of~~ [insert appropriate reference to state homestead, dower and curtesy, or other exemptions].]

~~(c)~~(d) Unless the declaration otherwise provides, if two or more associations have liens for assessments created at any time on the same property, those liens have equal priority.

~~(d)~~(e) Recording of the declaration constitutes record notice and perfection of the lien. No further recordation of any claim of lien for assessment under this section is required.

~~(e)~~(f) A lien for unpaid assessments is extinguished unless proceedings to enforce the lien are instituted within ~~[3]~~ [three] years after the full amount of the assessments becomes due.

~~(f)~~(g) This section does not prohibit actions against unit owners to recover sums for which subsection (a) creates a lien or prohibit an association from taking a deed in lieu of foreclosure.

~~(g)~~(h) A judgment or decree in any action brought under this section must include costs and reasonable attorney's fees for the prevailing party.

~~(h)~~(i) The association upon ~~written~~ request made in a record shall furnish to a unit owner a statement setting forth the amount of unpaid assessments against the unit. If the unit owner's interest is real estate, the statement must be in recordable form. The statement must be furnished within [10] business days after receipt of the request and is binding on the association, the

executive board, and every unit owner.

~~(i)~~(j) In a cooperative, upon nonpayment of an assessment on a unit, the unit owner may be evicted in the same manner as provided by law in the case of an unlawful holdover by a commercial tenant, and the lien may be foreclosed as provided by this section.

~~(j)~~(k) The association's lien may be foreclosed as provided in this subsection and subsection (p):

(1) ~~In~~ in a condominium or planned community, the association's lien must be foreclosed in like manner as a mortgage on real estate [or by power of sale under [insert appropriate state statute]];

(2) ~~In~~ in a cooperative whose unit owners' interests in the units are real estate ~~(Section 1-105)~~, the association's lien must be foreclosed in like manner as a mortgage on real estate [or by power of sale under [insert appropriate state statute]] [or by power of sale under subsection ~~(k)~~(l)]; [or and]

(3) ~~In~~ in a cooperative whose unit owners' interests in the units are personal property ~~(Section 1-105)~~, the association's lien must be foreclosed in like manner as a security interest under [insert reference to Article 9, Uniform Commercial Code][;and]

[(4) ~~In the case of~~ in a foreclosure under [insert reference to state power of sale statute], the association shall give the notice required by statute or, if there is no such requirement, reasonable notice of its action to all lien holders of the unit whose interest would be affected].]

[(l)~~(k)~~ ~~In a cooperative, if~~ If the unit owner's interest in a unit in a cooperative is real estate, the following requirements apply ~~(Section 1-105)~~:

(1) The association, upon ~~non-payment~~ nonpayment of assessments and compliance with this subsection, may sell that unit at a public sale or by private negotiation; and

at any time, date, and place. ~~Every aspect of the sale, including the method, advertising, time, place, and terms must be reasonable.~~ The association shall give to the unit owner and any ~~lessees~~ lessee of the unit owner reasonable ~~written~~ notice in a record of the time, date, and place of any public sale or, if a private sale is intended, or of the intention of entering into a contract to sell and of the time and date after which a private disposition may be made. The same notice must also be sent to any other person ~~who~~ that has a recorded interest in the unit which would be cut off by the sale, but only if the recorded interest was on record seven weeks before the date specified in the notice as the date of any public sale or seven weeks before the date specified in the notice as the date after which a private sale may be made. The notices required by this subsection may be sent to any address reasonable in the circumstances. ~~Sale~~ A sale may not be held until five weeks after the sending of the notice. The association may buy at any public sale and, if the sale is conducted by a fiduciary or other person not related to the association, at a private sale.

(2) Unless otherwise agreed, the ~~debtor~~ unit owner is liable for any deficiency in a foreclosure sale.

(3) The proceeds of a foreclosure sale must be applied in the following order:

~~(i)~~(A) the reasonable expenses of sale;

~~(ii)~~(B) the reasonable expenses of securing possession before sale; the reasonable expenses of holding, maintaining, and preparing the unit for sale~~;~~, including payment of taxes and other governmental charges; and premiums on ~~hazard and liability~~ insurance;; and, to the extent provided for by agreement between the association and the unit owner, reasonable attorney's fees, costs, and other legal expenses incurred by the association;

~~(iii)~~(C) satisfaction of the association's lien;

~~(iv)~~(D) satisfaction in the order of priority of any subordinate claim of

record; and

~~(v)~~(E) remittance of any excess to the unit owner.

(4) A good faith purchaser for value acquires the unit free of the association's debt that gave rise to the lien under which the foreclosure sale occurred and any subordinate interest, even though the association or other person conducting the sale failed to comply with ~~the requirements of~~ this section. The person conducting the sale shall execute a conveyance to the purchaser sufficient to convey the unit and stating that it is executed by ~~him~~ the person after a foreclosure of the association's lien by power of sale and that ~~he~~ the person was empowered to make the sale. Signature and title or authority of the person signing the conveyance as grantor and a recital of the facts of ~~non-payment~~ nonpayment of the assessment and of the giving of the notices required by this subsection are sufficient proof of the facts recited and of ~~his~~ the authority to sign. Further proof of authority is not required even though the association is named as grantee in the conveyance.

(5) At any time before the association has disposed of a unit in a cooperative or entered into a contract for its disposition under the power of sale, the unit owners or the holder of any subordinate security interest may cure the unit owner's default and prevent sale or other disposition by tendering the performance due under the security agreement, including any amounts due because of exercise of a right to accelerate, plus the reasonable expenses of proceeding to foreclosure incurred to the time of tender, including reasonable attorney's fees and costs of the creditor.]

~~(f)~~(m) In an action by an association to collect assessments or to foreclose a lien for ~~unpaid assessments~~ on a unit under this section, the court may appoint a receiver to collect all sums alleged to be due and owing to a unit owner before commencement or during pendency of the action. The receivership is governed by [insert state law generally applicable to

receiverships]. The court may order the receiver to pay any sums held by the receiver to the association during pendency of the action to the extent of the association's common expense assessments based on a periodic budget adopted by the association pursuant to Section 3-115.]

(n) An association may not commence an action to foreclose a lien on a unit under this section unless:

(1) the unit owner, at the time the action is commenced, owes a sum equal to at least [three] months of common expense assessments based on the periodic budget last adopted by the association pursuant to Section 3-115(a) and the unit owner has failed to accept or comply with a payment plan offered by the association; and

(2) the executive board votes to commence a foreclosure action specifically against that unit.

(o) Unless the parties otherwise agree, the association shall apply any sums paid by unit owners that are delinquent in paying assessments in the following order:

(1) unpaid assessments;

(2) late charges;

(3) reasonable attorney's fees and costs and other reasonable collection charges; and

(4) all other unpaid fees, charges, fines, penalties, interest, and late charges.

(p) If the only sums due with respect to a unit are fines and related sums imposed against the unit, a foreclosure action may not be commenced against the unit unless the association has a judgment against the unit owner for the fines and related sums and has perfected a judgment lien against the unit under [insert reference to state statute on perfection of judgments].

(q) Every aspect of a foreclosure, sale, or other disposition under this section, including the method, advertising, time, date, place, and terms, must be commercially reasonable.

Comment

1. Section 3-116(a) was amended in 1994 to delete the language "from the time the assessment or fine becomes due." The deleted clause was intended to make clear that the lien was enforceable at the time the assessment became due. Commentators have observed, however, that the language caused confusion with respect to priority issues. The intention of the statute, as demonstrated by the Comments, was that the inchoate statutory lien was the functional equivalent of real estate taxes except with respect to the special priorities identified in subsection (b) of the section. The deletion of the language as suggested makes clear that the lien arises immediately upon the effective date of the statute for old common interest communities and upon recording of the declaration for new common interest communities.

As a result of this deletion, it is clear that in the absence of an exception in a title insurance policy for common charges, a title insurer would be liable for post-insurance obligations which have a priority established prior to the time the policy was issued. This, however, is no different than in other inchoate liens such as real estate taxes and mechanics liens, all of which have become standard exceptions in the title industry.

2. To ensure prompt and efficient enforcement of the association's lien for unpaid assessments, such liens should enjoy statutory priority over most other liens. Accordingly, subsection (b) provides that the association's lien takes priority over all other liens and encumbrances except those recorded prior to the recordation of the declaration, those imposed for real estate taxes or other governmental assessments or charges against the unit, and first security interests recorded before the date the assessment became delinquent. However, as to prior first security interests the association's lien does have priority for six months' assessments based on the periodic budget. A significant departure from existing practice, the six months' priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders. As a practical matter, secured lenders will most likely pay the six months' assessments demanded by the association rather than having the association foreclose on the unit. If the lender wishes, an escrow for assessments can be required. Since this provision may conflict with the provisions of some state statutes which forbid some lending institutions from making loans not secured by first priority liens, the law of each State should be reviewed and amended when necessary.

In cooperatives, the association has legal title to the units and depending on the election made in the declaration pursuant to Section 2-118(i) may have power to create, assume, or take subject to security interests in the units which have priority over the interest of unit owners. Obviously, the cooperative association's lien should not have priority over an interest which the association itself has given, assumed, or taken subject to and subsection (b) expressly so provides.

The special reference to cooperatives in subsection (b)~~(ii)~~(2) merely recognizes that in a cooperative both the association and the unit owner have an interest in a unit.

3. Units may be part of two common interest communities. For example, a large real estate development may consist of one or more condominiums which are also part of a larger planned community. In that case, the planned community association might assess the

condominium units for the general maintenance expenses of the planned community and the condominium association would assess for the direct maintenance expenses of the building itself. In such a situation, subsection ~~(c)~~(d) provides that unpaid liens of the two associations have equal priority regardless of the relative time of creation of the two regimes and regardless of the time the assessments were made or became delinquent.

4. Subsection ~~(f)~~(g) makes clear that the association may have remedies short of foreclosure of its lien that can be used to collect unpaid assessments. The association, for example, might bring an action in debt or breach of contract against a recalcitrant unit owner rather than resorting to foreclosure.

5. The rights of the association against a unit upon nonpayment of an assessment on that unit depends on whether the common interest community is a condominium or planned community on the one hand, or a cooperative on the other.

In the typical cooperative the association will have a substantial underlying mortgage on all or a substantial portion of the real estate in the cooperative and a large part of each unit owner's periodic assessment will go toward payment of that particular unit's proportionate share of the mortgage. If the unit owner fails to pay his assessment on time, the association may be forced into default on its own mortgage payments with consequent possible foreclosure of the underlying mortgage and loss by all unit owners of their interests in the cooperative. Therefore, in the cooperative context it is essential that the cooperative association have a fast and effective remedy for failure of a unit owner to pay his assessment. The act provides in subsection (i) that upon nonpayment the cooperative unit owner may be evicted in the same manner as an unlawfully holding over commercial tenant. Those rules will ordinarily be the most rapid and efficient rules in the State as to eviction of tenants.

If the unit owner's interest is real estate, subsection ~~(j)~~(k)(2) then offers the State two alternatives as to nonjudicial foreclosure of a cooperative association's lien. The first alternative is power of sale under any existing state statute authorizing power of sale under mortgages. If there is no power of sale statute or if the legislature chooses to adopt a special power of sale provision for foreclosure of the lien on cooperative units, the State can choose the 2d alternative: power of sale under subsection ~~(k)~~(l) of this section.

Subsection ~~(k)~~(l), which is patterned after the power of sale foreclosure provisions of the Uniform Land Transactions Act, is a modern power of sale provision which frees private power of sale foreclosure from many of the costly, time consuming, and inefficiency producing strictures of most existing private power of sale statutes. At the same time, it provides reasonable protection to the unit owner and junior interests.

If the unit owners' interest in a cooperative is personal property, the association's lien is foreclosed as if it were a security interest under Article 9 of the Uniform Commercial Code. Article 9 foreclosure is generally less expensive and faster than either judicial or power of sale real estate foreclosure. This difference in cost and speed of foreclosure, both for association liens and security interests, is one of the major factors to be considered in choosing whether, under Section 1-105, the unit owner's interest in a cooperative will be real property or personal property. Article 9 foreclosure is currently used in foreclosing security interests in mobile homes, and has been accepted in the various States as a permissible method of foreclosure in that

housing area without serious challenge.

In a condominium or planned community, there is not likely to be a substantial underlying mortgage for which unit owners are assessed. Therefore, failure to pay assessments on time will have less serious consequences for the association than in the case of cooperatives. The section provides that the association lien in a condominium or planned community is to be foreclosed according to the rules generally applicable to real estate mortgages in the State rather than setting out a special faster method of foreclosure in the statute.

6. New subsection ~~(f)~~(m) makes clear that the courts have authority to appoint receivers upon request by associations to aid in collection of common charges.

7. Few issues are more contentious in common interest communities than the prospect of unit owners losing their homes as a consequence of non payment of common charges – and the loss of all or most of their equity – when the association forecloses. The reaction in state legislatures in recent years has been widespread.

At the same time, it is crucial that the association be able to secure timely payment of common charges in order to provide services to all the residents of the common interest community.

In an effort to balance these competing interests, the 2008 amendments provide additional safeguards governing foreclosure of liens for unpaid common charges. These new procedures may be summarized as follows:

First, Section 3–116(n) bars foreclosure for sums that are less than 3 months of common charges;

Second, Section 3–116(n) also requires the association board, to first, offer the delinquent owner a payment plan which the owner rejects, and second, expressly approve each foreclosure action;

Third, Section 3–116(o) requires that payments of delinquent assessments be applied first to principal rather than to interest and fees, in order to avoid the usual practice of accruing additional interest and late charges as the monthly fees remain unsatisfied while the attorneys fees and interest are paid first.

Fourth, Section 3–116(p) bars any foreclosure for fines alone unless the association first secures a personal judgment against the unit owner.

Finally, Section 3–116(q) requires that if a foreclosure does go forward, any sale of a unit must be commercially reasonable. In the first reported case of foreclosure arising in a state that has adopted this Act, the court required that the sale be reasonable. See *Will v. Mill Condominium Owners Association et al*, 176 VT 380, 848 A2d 336 [2004].

These special procedures would comprise an overlay on existing state foreclosure procedures, whether judicial or non-judicial. Taken together, they respond in a concise but responsible way to the widespread reports of abuses in this field. Hopefully, they will also be

viewed by the various States as a responsible and balanced response to the issues confronting elected officials, defaulting unit owners and homeowners association directors with a fiduciary responsibility to maintain the property.

8. Associations must be legitimately concerned, as fiduciaries of the unit owners, that the association be able to collect periodic common charges from recalcitrant unit owners in a timely way. To address those concerns, the section contains these 2008 amendments:

First, subsection (a) is amended to add the cost of the association's reasonable attorneys fees and court costs to the total value of the association's existing 'super lien' -- currently, 6 months of regular common assessments. This amendment is identical to the amendment adopted by Connecticut in 1991; see C.G.S. Section 47-258(b). The increased amount of the association's lien has been approved by Fannie Mae and local lenders and has become a significant tool in the successful collection efforts enjoyed by associations in that state.

Second, subsection (f) has been amended to emphasize that the association has a variety of other remedies available against a unit owner in addition to the foreclosure remedy. In many cases, an action for sums due may be less costly, less disruptive and more efficient than a foreclosure action in collecting the funds properly due the association.

9. Section 3-116 rejects more extreme provisions favoring defaulting unit owners espoused in various forums. For example, extensive provisions were adopted by North Carolina regarding fines enforcement and collection which may pose significant impediments to the financial well being of unit owner associations. See, e.g., 2205 North Carolina Session Act No. 422). Similarly, the section does not adopt the extensive borrower protections contained in the Uniform Non-Judicial Foreclosure Act. That act contains provisions dealing with repetitive and detailed default notices, mandated meetings before foreclosure, a period of limitation on foreclosures, mandated judicial supervision of foreclosures, extensive redemption rights after foreclosure, and the like. In those cases where foreclosure is supervised by a judge, those procedures are not likely to be of significant benefit to defaulting to unit owners, but will impose significant transaction costs on associations in non-judicial foreclosure states; there is no reason to distinguish common interest community foreclosures from every other procedure.

10. The issue of how the association protects itself from non-payment of assessments may be of concern in a state with a homestead exemption. Either direct foreclosure of the association's statutory lien for unpaid assessments, or foreclosure of a perfected judgment lien which the association might have secured in lieu of foreclosure, may conflict with existing homestead statutes. Further consideration of this issue in those states, in order to reconcile conflicting statutes, would then be appropriate.

11. In requiring a delay for 3 months in commencement of a foreclosure proceeding, subsection 3-116(n)(1) imposes some risk on the association. Since the association's lien has only a limited priority over that of a first mortgage, anything which delays the commencement and completion of a foreclosure by the association, but does not result in the unit owner bringing his or her account current, may be seen as simply raising the cost to the association, and, therefore, to all of the other unit owners who are paying their common charges on time.

12. It may be that the reaction of some legislators to this Section will depend on the

extent to which foreclosure actions in the respective states are subject to judicial supervision. In states where non-judicial foreclosure is either not available or not used in association lien foreclosures, the active role played by the court may minimize the need for certain of the borrower protections in this section.

SECTION 3-117. OTHER LIENS.

(a) In a condominium or planned community:

(1) Except as otherwise provided in paragraph (2), a judgment for money against the association [if recorded] [if docketed] [if [insert other procedures required under state law to perfect a lien on real estate as a result of a judgment]], is not a lien on the common elements, but is a lien in favor of the judgment lien holder against all of the other real estate of the association and all of the units in the common interest community at the time the judgment was entered. No other property of a unit owner is subject to the claims of creditors of the association.

(2) If the association has granted a security interest in the common elements to a creditor of the association pursuant to Section 3-112, the holder of that security interest shall exercise its right against the common elements before its judgment lien on any unit may be enforced.

(3) Whether perfected before or after the creation of the common interest community, if a lien, other than a deed of trust or mortgage~~(~~, including a judgment lien or lien attributable to work performed or materials supplied before creation of the common interest community~~)~~, becomes effective against two or more units, the unit owner of an affected unit may pay to the lien holder the amount of the lien attributable to ~~his~~ the unit, and the lien holder, upon receipt of payment, promptly shall deliver a release of the lien covering that unit. The amount of the payment must be proportionate to the ratio ~~which~~ that the unit owner's common expense liability bears to the common expense liabilities of all unit owners ~~whose~~ the units of which are subject to the lien. After payment, the association may not assess or have a lien against that unit owner's unit for any portion of the common expenses incurred in connection with that lien.

West's Nevada Revised Statutes Annotated
Title 10. Property Rights and Transactions (Chapters 111-120A)
Chapter 116. Common-Interest Ownership (Uniform Act) (Refs & Annos)
Administration and Enforcement of Chapter
General Provisions

N.R.S. 116.623

116.623. Petitions for declaratory orders or advisory opinions: Regulations; scope; contents of petition; filing; period for response

Effective: October 1, 2009
Currentness

1. The Division shall provide by regulation for the filing and prompt disposition of petitions for declaratory orders and advisory opinions as to the applicability or interpretation of:

(a) Any provision of this chapter or chapter 116A or 116B of NRS;

(b) Any regulation adopted by the Commission, the Administrator or the Division; or

(c) Any decision of the Commission, the Administrator or the Division or any of its sections.

2. Declaratory orders disposing of petitions filed pursuant to this section have the same status as agency decisions.

3. A petition filed pursuant to this section must:

(a) Set forth the name and address of the petitioner; and

(b) Contain a clear and concise statement of the issues to be decided by the Division in its declaratory order or advisory opinion.

4. A petition filed pursuant to this section is submitted for consideration by the Division when it is filed with the Administrator.

5. The Division shall:

(a) Respond to a petition filed pursuant to this section within 60 days after the date on which the petition is submitted for consideration; and

(b) Upon issuing its declaratory order or advisory opinion, mail a copy of the declaratory order or advisory opinion to the petitioner.

Credits

Added by Laws 2009, c. 491, § 5.

N. R. S. 116.623, NV ST 116.623

Current through the 2011 76th Regular Session of the Nevada Legislature, and technical corrections received from the Legislative Counsel Bureau (2012).

End of Document

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STATE OF NEVADA

DEPARTMENT OF BUSINESS AND INDUSTRY

IN THE MATTER of the Petition of Prem Investments, LLC., a Nevada limited liability company, Rutt Premsrirut, Manager, for an application for Advisory Opinion and Declaratory Order pursuant to NAC §232.040 Petition for declaratory order or advisory opinion	Docket No.

COMES NOW, Petitioner Prem Investments, LLC., a Nevada limited liability company, Rutt Premsrirut, Manager ("Petitioner" or "Prem Investments") and hereby applies by Petition to the Nevada Department of Business and Industry for an Advisory Opinion and Declaratory Order concerning the applicability of a statute. This application for Petition for Advisory Opinion and Declaratory Order is made pursuant to NAC §232.040, Petition for declaratory order or advisory opinion; Authorization; filing; contents. This Petition is made to the Director of the Nevada Department of Business and Industry pursuant to NAC §232.040(2)(b). In support of this Petition, Prem Investments, by and through its counsel, states as follows:

I

PETITIONER

Prem Investments is not a party in any administrative, civil or criminal action concerning the matters contained in this Petition. Prem Investments is in the business of purchasing single family residences ("Real Property") through foreclosure auctions held by the first mortgage lender of said Real Property. Prem Investments has been the recipient of demands by Nevada collection agencies

licensed under NRS §649 and purporting to represent Nevada common interest communities ("homeowners' associations") in the collection of homeowners' associations' liens placed upon the Real Property. Said liens comprise debts which were incurred by the prior owner of the Real Property but which have been extinguished pursuant to NRS §116.3116 by the first mortgage lender's foreclosure auction. Regardless that the liens have been legally extinguished and the debt is not owed by Petitioner, Nevada collection agencies are demanding and collecting said lien amounts from Petitioner and refusing to clear title of the Real Property unless payment is made.

All correspondence can be mailed to Prem Investments at: 520 S. Fourth Street, Second Floor, Las Vegas, NV 89101, with copy to Adams Law Group, Ltd., at 8681 W. Sahara Ave., Suite 280, Las Vegas, NV 89117.

II.

THE FACTS

Homeowners' associations and their collection agents are enforcing and collecting extinguished association liens and instituting wrongful foreclosure proceedings against the Real Property of Petitioner, and other owners of real property including lenders, government mortgage insurers and investors who take title to single family residences through foreclosure auctions. In Nevada, pursuant to NRS §116.3116, once a first mortgage lender forecloses on a unit located within a homeowners' association, an association's lien is extinguished but for a limited and finite portion of the lien called the "super priority lien amount." However, the practice of homeowners' associations and their collection agents is to regularly violate Nevada law and charge to the new owner (who acquires title at the auction) the entire lien amount, not just the limited, super priority lien amount.

The scheme, which has purported to net Nevada homeowners' associations and collection agencies tens of millions of dollars over the last few years, generally unfolds as follows:

- A homeowner, owning property within an association, becomes delinquent in the payment of his mortgage. Simultaneously, the homeowner stops paying his association assessments.

- The association assesses fines, late fees, and penalties against the homeowner and, most notably, employs a collection agency to collect the past due amounts. Even though the association assessments are often less than $100 per month, the associations and collection agencies add thousands of dollars of "collection" fees onto the homeowner's bill.

- Knowing that these fees constitute a statutory lien on the homeowner's property, the associations and collection agencies are secure in knowing that their many thousands of dollars in "collection" fees will get paid, or else the homeowner's title will remain clouded.

- Then, due to the homeowner's inability to pay his mortgage, the homeowner's lender ultimately forecloses on the property. At the foreclosure auction, the lender, lenders' mortgage insurer or an investor will take title to the property.

- Once this happens, under Nevada law, the association's lien is extinguished by the foreclosure auction, but for the limited, "super priority lien amount" which equals a maximum of 9 times the association's monthly assessments.

- However, instead of informing the new owner that the association's lien has been extinguished but for the super priority lien amount, the associations through their collection agencies represent that they have the legal right to collect from the new owner all monies owed by the original homeowner, including the thousands of dollars of "collection" fees added onto the original homeowner's bill.

- Knowing that title is clouded by the maintaining of the lien and also knowing that the new owner cannot sell the property without clear title, the associations and collection agencies demand vastly more amounts of money than Nevada law requires the new owner to pay.

- Ultimately, in order to clear title and to prevent the association from foreclosing its unlawful lien amount, the new owner pays the improperly demanded amounts and gets the dubious distinction of having paid to Nevada collection agencies thousands of dollars which he did not owe.

This alleged scheme is purported to have been conducted thousands of times resulting in the overpayment by lenders, government mortgage insurers and investors of tens of millions of dollars.

III.

THE ISSUES

The reason for requesting this order and opinion is to determine whether the foreclosure by a first mortgage lender on a property located within a Nevada common interest community extinguishes an existing homeowners' association lien against said property. More particularly, the issues upon which the advisory opinion and declaratory order are sought are the following:

1. Under NRS §116.3116, a homeowners' association has a lien on a unit for any assessment levied against that unit or any fines imposed against the unit's owner from the time the assessment or fine becomes due. Pursuant to NRS §116.3116, what portion of the lien, if any, is superior to the unit's first mortgage lender's security interest ("super priority lien") and may the sum total of the super priority lien amount, whether it be comprised of assessments, fees, costs of collection, or other charges, ever exceed 9 times the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS §116.3115, plus any charges incurred by the association on a unit pursuant to NRS §116.310312 (unit repair expenses)?
2. Pursuant to NRS §116.3116, does a "super priority lien" exist in the absence of a homeowners' association's failure to file a complaint with a court to enforce the lien, i.e., the failure to institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3?

IV.

RELEVANT LAW AND HISTORY

A. Introduction of the Uniform Common Interest Ownership Act

The Uniform Common Interest Ownership Act ("UCIOA") was originally promulgated in 1982 by the National Conference of Commissioners on Uniform State Laws ("Uniform Law

Commissioners" or "ULC"). In 1991, Nevada passed the UCIOA which is embodied in Nevada Revised Statutes §116. As of October 31, 2009, there were 2,961 registered Nevada common interest communities ("homeowners' associations") subject to NRS §116 having a total of 472,777 units within them.[1] UCIOA is a comprehensive act that governs the formation, management, and termination of a common interest community, whether that community is a condominium, planned community, or real estate cooperative. It also provides for disclosure of important facts about common interest property at sale to a buyer, including resale disclosure for any sale after the initial sale by the developer of the property; for warranties of sale; for a buyer's recision rights in a sale contract; and for escrow of deposits made to secure a sale contract. Importantly, it also governs the creation, treatment, foreclosure and extinguishment of homeowners' associations' liens on units within their communities.

B. The Legislative History & the Super Priority Lien

The UCIOA governs liens against properties located within homeowners' associations and, regarding association liens against units, generally states as follows:

a. Homeowners associations have a statutory lien on any unit of real property located within their associations for any assessment imposed against a unit or fine imposed against the unit's owner from the time the assessment or fine becomes due;

b. However, the associations' liens are junior to the first security interest of the unit's first mortgage lender except for a certain, limited and specified portion of the lien as defined in §3-116 which remains senior to the first security interest of the unit's first mortgage lender, provided that the associations had instituted an "action" to enforce their liens (the "Super Priority Lien Amount").

[1] Executive Summary of the Ombudsman, Reporting Period: July 1, 2009 through October 31, 2009

Thus, in a break with traditional lien priority law, the UCIOA granted the association a lien priority over first mortgages recorded before any assessment delinquency. However, as shall be noted below, the associations' lien priority is only available to a certain and limited extent.

The original language of the 1982 UCIOA regarding §3-116 and super priority liens is as follows:

> (a) The association has a lien on a unit for any assessment levied against that unit or fines imposed against its unit owner from the time the assessment or fine becomes due. Unless the declaration otherwise provides, fees, charges, late charges, fines, and interest charged pursuant to Section 3-102(a)(10), (11), and (12) are enforceable as assessments under this section. If an assessment is payable in instalments, the full amount of the assessment is a lien from the time the first instalment thereof becomes due.
>
> (b) A lien under this section is prior to all other liens and encumbrances on a unit except (i) liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances which the association creates, assumes, or takes subject to, (ii) a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent, or, in a cooperative, the first security interest encumbering only the unit owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent, and
>
> (iii) liens for real estate taxes and other governmental assessments or charges against the unit or cooperative. The lien is also prior to all security interests described in clause (ii) above to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien. This subsection does not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association. [The lien under this section is not subject to the provisions of [insert appropriate reference to state homestead, dower and curtesy, or other exemptions]. *(See Exhibit "1")*

Thus, the "super priority" portion of the homeowners' associations' liens were capped "to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding an action to enforce the lien." While an underlying association lien may have been for a higher amount, the only amount which could achieve "super priority" status over the first mortgage lender was an amount equaling 6 times the monthly assessments.

Interestingly, the Super Priority Lien Amount was intended to be a fixed amount, i.e., one that a lender could approximate prior to lending funds to a borrower who was purchasing within a common interest community. This was so that the lender could escrow, from the borrower funds, the predetermined Super Priority Lien Amount in case the borrower failed to pay the assessments. As noted in the comments section of the 1994 draft of the UCIOA:

> To ensure prompt and efficient enforcement of the association's lien for unpaid assessments, such liens should enjoy statutory priority over most other liens. Accordingly, subsection (b) provides that the association's lien takes priority over all other liens and encumbrances except those recorded prior to the recordation of the declaration, those imposed for real estate taxes or other governmental assessments or charges against the unit, and first security interests recorded before the date the assessment became delinquent. However, as to prior first security interests the association's lien does have priority for six months' assessments based on the periodic budget. A significant departure from existing practice, the six months' priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders. As a practical matter, secured lenders will most likely pay the six months' assessments demanded by the association rather than having the association foreclose on the unit. **If the lender wishes, an escrow for assessments can be required.** *(See Exhibit "2," Comments, UCIOA 1994, page 159-160.)*

Thus, since the lender would know what the assessments were prior to lending, and since the lender would know, pursuant to §3-116 of the UCIOA, that the Super Priority Lien Amount was limited to 6 months of assessments, it could require the borrower to escrow, prior to closing, exactly that amount of funds for which the lender might be liable, i.e., the Super Priority Lien Amount. The lender, therefore, had protection if it had to pay the Super Priority Lien Amount, and the association was assured of payment of a maximum figure equal to 6 months of assessments if the borrower/homeowner defaulted on his obligations to his association. Thus, the "equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders" was accomplished.

C. Nevada Revised Statutes §116.3116

In 1991, Nevada adopted the 1982 version of the UCIOA. The provisions relating to homeowners' association liens were embodied in NRS §116.3116. On October 1, 2009, NRS §116.3116 was amended by the Nevada legislature in two important ways. First, it increased the

Super Priority Lien Amount to a figure equaling 9 times (formerly 6 times) the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS §116.3115 (see Nevada Assembly Bill 204). In calculating the Super Priority Lien Amount, it also allowed to be added any charges incurred by the association on a unit pursuant to NRS §116.310312 (repair expenses of a unit) (see Nevada Assembly Bill 361). The most recent adoption of NRS §116.3116 states in pertinent part:

> 1. The association has a lien on a unit for any construction penalty that is imposed against the unit's owner pursuant to NRS 116.310305, any assessment levied against that unit or any fines imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due.
>
> (2) A lien under this section is prior to all other liens and encumbrances on a unit **except**:
>
> (b) A first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent or, in a cooperative, the first security interest encumbering only the unit's owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent;
>
> The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien.

The figure equaling 9 times the association's monthly assessment amount has been dubbed the "Super Priority Lien Amount" because it is that figure which remains senior or superior to the first security interest holder's trust deed. It is only the Super Priority Lien Amount, not all association lien amounts, which is super to the first mortgage holder's trust deed. Any amounts greater than the Super Priority Lien Amount still remain a lien against the owner's unit, but it is a lien which is junior to the first security interest holder. The "junior" portion of the lien, therefore, is extinguished by a foreclosing first mortgage lender and the "super priority" portion of the lien survives extinguishment by the foreclosing first mortgage lender.

D. Necessity for the Institution of an Action

As a condition precedent to the establishment of a super priority lien, homeowners' associations need to file "an action to enforce the lien...." Nevada and Massachusetts have nearly identical language in their homeowners' association super priority lien statutes regarding the necessity for the institution of an action to enforce the lien:

NRS 116.3116	**MA ST 183A s 6**
The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien....	This lien is also prior to the mortgages described in clause (ii) above to the extent of the common expense assessments based on the budget adopted pursuant to subsection (a) above which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien....

Citing nearly identical language as that of the Nevada statute, the Massachusetts courts have held that the institution of a lawsuit (i.e., a civil action) is a condition precedent for homeowners' associations' achievement of super priority status for any portion of its lien amount. The Massachusetts courts have held:

> The condominium lien achieves "super priority" status over the first mortgage when a condominium association institutes "an action to enforce the lien." Thus, Section 6(c) provides that: [t]his lien is also prior to the mortgages described in clause (ii) above to the extent of the common expense assessments based on the budget adopted pursuant to subsection
>
> (a) above which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien...
>
> ***Accordingly, the institution of an action by a condominium association is a condition precedent to achieving "super-priority" status for the condominium lien. However, even when the association files such an action, the condominium lien is given a "super-priority" status only to the extent of unpaid condominium fees for the preceding six months.***
>
> ***It is uncontested by the parties that a lawsuit is required before a lien for unpaid condominium fees achieves a "super-priority"***

> ***status***. See also In re Stern, 44 B.R. 15, 19 (Bankr.D.Mass.1984). ("the establishment of the lien is not dependent on the commencement of a lawsuit, which is only a step necessary to elevate the status of the lien to a position superior to other encumbrances, other than municipal liens and first mortgages.")...
>
> In this regard, M.G.L. ch. 183A, § 6(c) specifically provides that, without the commencement of an enforcement action by a condominium association, a lien for unpaid condominium fees is "prior" to all other liens and encumbrances "except ... (ii) a first mortgage on the unit recorded before the date on which the assessment sought to be enforced became delinquent ..." (emphasis added). ***That exception makes the lien junior at least until an action is commenced. Indeed, if the lien was anything but junior to the first mortgage, there would be no reason to require that an action be filed in order to grant that lien super-priority status.*** *Trustees of MacIntosh Condominium Association v. F.D.I.C., et.al. 908 F.Supp. 58 at 63 (1995).*

Thus, as a "condition precedent" to elevate a portion of a homeowners' association's lien (in Nevada, an amount equaling 9 times the monthly assessments) from "junior" status to "super priority" status, a homeowners' association must file an "action" to enforce the lien. Nevada Rules of Civil Procedure 2 states, "There shall be one form of action to be known as 'civil action.'" Nevada Rules of Civil Procedure 3 states, "A civil action is commenced by filing a complaint with the court." Therefore, until a homeowners' association files a complaint with the court to enforce its lien, no amount of its lien can achieve "super priority" status. While the lien remains a lien on the owner's unit, it is in "junior" status to the first security holder's deed of trust. Thus, until the filing of a complaint with the court to enforce its lien, upon the first mortgage holder's foreclosure, the association's junior lien is extinguished in its entirety.

So in first addressing question 2 above, "Pursuant to NRS §116.3116, does a "super priority lien" exist in the absence of a homeowners' association's failure to file a complaint with a court to enforce the lien, i.e., the failure to institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3?" the answer must be no. Pursuant to NRS §116.3116, a homeowners' association's filing of a complaint with the court to enforce its lien is a condition precedent for any portion of its lien to achieve "super priority" status.

E. Collection Costs and the Super Priority Lien Amount Limit

Even if a homeowners' association does file a complaint with the court to enforce its lien, the lien is only given a "super-priority" status to the extent of a maximum amount equal to 9 times the monthly assessment amount adopted by the association in its last budget *(see NRS 116.3116(2), "The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien.... ").* All other portions of the lien which exceed that limit are junior to the first mortgage lender *(see NRS 116.3116 (2)(b), "A lien under this section is prior to all other liens and encumbrances on a unit except... A first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent.... ").*

It is important to note, however, that any association penalties, fees, charges, late charges, fines and interest are enforceable as assessments are enforceable *(see NRS 116.3116(1)), "... any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS 116.3102 are enforceable as assessments under this section.... ").* In other words, penalties, late fees, and collection charges may be included within the Super Priority Lien Amount, as long as the total Super Priority Lien Amount does not exceed an amount which equals 9 times the association's monthly assessment amount (plus unit repair expenses under NRS 116.310312). Again, as the statute states, *"The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien.... ") (NRS 116.3116(2).*

Indeed, it is critical to make clear that while assessments, late fees, charges, interest, and costs of collecting, etc., may all be included within the Super Priority Lien Amount, in no instance

may the sum total of the super priority portion of the lien exceed 9 times the monthly assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115, plus any charges incurred by the association on a unit pursuant to NRS 116.310312 (repair expenses). With the exception of the addition of repair expenses pursuant to NRS 116.310312, the Super Priority Lien Amount is a finite number which is not to be exceeded. It is a ceiling. It is a limit. It may, however, contain within it more than just assessments.

In 1991, both Nevada and Colorado adopted the UCIOA with language mirroring UCIOA Section 3-116 (1982 version). As noted by the Colorado Supreme Court, "The Colorado Common Interest Ownership Act was originally adopted in 1991, effective July 1, 1992. Ch. 283, sec. 1, §§ 38-33.3-101 to -319, 1991 Colo. Sess. Laws 1701-57. It was adopted, among other reasons, to provide stability to the finances of common interest communities by granting them a super-lien for unpaid assessments, and to provide uniformity and predictability to lenders in order to promote the availability of financing." *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 450 (Colo.App.,2008).* A comparison of the two statutes is as follows:

NRS 116.3116 - NV Super Priority Language	**CO ST s 38-33.3-316 - CO Super Priority Language**
The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien...	... a lien under this section is also prior to the security interests described in subparagraph (II) of paragraph (a) of this subsection (2) to the extent of: (I) An amount equal to the common expense assessments based on a periodic budget adopted by the association under section 38-33.3-315(1) which would have become due, in the absence of any acceleration, during the six months immediately preceding institution by either the association or any party holding a lien senior to any part of the association lien created under this section of an action or a nonjudicial foreclosure either to enforce or to extinguish the lien.

The Colorado Court of Appeals and the author of a Wake Forest Law Review article quoted by the Colorado courts both concluded that although the assessment portion of the super priority lien is limited to a finite number of months, because the assessment lien itself includes "fees, charges,

late charges, attorney fees, fines, and interest," these charges may be included as part of the Super Priority Lien Amount. The Colorado language is the same as NRS §116.3116, which states that "fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS §116.3102 are enforceable as assessments." Therefore, as NRS §116.3116 states that assessments are enforceable through liens, so are collection charges, late charges, fines, fees, etc., enforceable through liens. However, while such charges may be included in the Super Priority Lien Amount, as noted by the Colorado Supreme Court, the maximum amount of the super priority lien is capped:

> We conclude that the plain language of the statute supports Sunstone's position. Within the meaning of subsection (2)(b), a "lien under this section" may include any of the expenses listed in subsection (1), including "fees, charges, late charges, attorney fees, fines, and interest." Thus, although the maximum amount of a super priority lien is defined solely by reference to monthly assessments, the lien itself may comprise debts other than delinquent monthly assessments.
>
> We note that our view matches that of a commentator who has examined the uniform act on which § 38-33.3-316 was based. This commentator has concluded that, under the uniform act, the super priority lien may comprise debts other than delinquent assessments:
>
> A careful reading of the ... language reveals that the association's Prioritized Lien, like its Less-Prioritized Lien, may consist not merely of defaulted assessments, but also of fines and, where the statute so specifies, enforcement and attorney fees. The reference in section 3-116(b) to priority "to the extent of" assessments which would have been due "during the six months immediately preceding an action to enforce the lien" **merely limits the maximum amount of all fees or charges for common facilities use or for association services, late charges and fines, and interest which can come with the Prioritized Lien.** *First Atlantic Mortg., LLC v. Sunstone North Homeowners Ass'n 121 P.3d 254, 255 -256 (Colo.App.,2005).*

Thus, the words "to the extent of" (found in both Nevada's and Colorado's §3-116) limit the maximum amount of all fees, charges, costs and assessments which can comprise the super priority lien to an amount which does not exceed 9 times (6 times in Colorado) the association's monthly assessment amount. In Nevada and Colorado, collection costs and attorney's fees are not added on top of the 9 month amount, but may be incorporated within that amount, provided the Super Priority Lien Amount does not exceed 9 times the association's monthly assessments.

The Colorado Supreme Court recently punctuated the above point in its 2008 case of *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 450 (Colo.App.,2008).*

> The association then has a super-priority lien over the lender's otherwise senior deed of trust in the event of a foreclosure commenced by the association or the lender, which lien is limited to delinquent assessments accruing within six months of the initiation of foreclosure proceedings. § 38-33.3-316(2)(b)(I). Further, the association's super-priority lien includes interest, charges, late charges, fines, and attorney fees **so long as the total does not exceed the limit**. *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 451 (Colo.App.,2008)*

So long as the total of all assessments, fees, costs and other charges do not exceed the limit of an amount equal to 9 times (6 times in Colorado) of monthly assessments, the super priority lien includes interest, charges, late charges, etc. The Colorado Supreme Court, applying Colorado Code Section 38-33.3-116 (which is nearly identical to Nevada's NRS 116.3116,) made clear that the 6 or 9 month assessment total is a super priority limit which cannot be exceeded. This was "... to provide uniformity and predictability to lenders in order to promote the availability of financing." *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 450 (Colo.App.,2008).*

Nowhere is this distinction made clearer than by the very law review article cited by the Colorado courts. James Winokur, in his treatise, "Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Ownership Act," 27 Wake Forest L. Rev.353, states as follows:

> In its most heralded break with traditional law, UCIOA grants the association a lien priority over first mortgages recorded before any assessment delinquency "to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding an action to enforce the lien." Any excess of total assessment defaults, in addition to other lienable fines or costs over this six-month ceiling remains a lien on the property. The portion of the association lien securing this excess will be junior to the first mortgage on the unit, but senior to other mortgages and encumbrances not recorded before the declaration. Thus, although the association's lien is a single lien, its varying priority effectively separates the association's rights in a given unit into what may be conceived of as two liens, which are hereinafter referred to as the "Prioritized Lien" and the "Less-Prioritized Lien."
>
> A careful reading of the quoted language reveals that the association's Prioritized Lien, like its Less-Prioritized Lien, may consist not merely

> of defaulted assessments, but also of fines and, where the statute so specifies, enforcement and attorney fees. The reference in section 3-116(b) to priority "to the extent of" assessments which would have been due "during the six months immediately preceding an action to enforce the lien" merely limits the maximum amount of all fees or charges for common facilities use or for association services, late charges and fines, and interest which can come within the Prioritized Lien. So, for example, if a unit owner fell three months behind in assessments, the Prioritized Lien might include--in addition to the three months of arrearages--the other fees, charges, costs, etc. enforceable as assessments under UCIOA. However, for any assessments or other charges to be included within the Prioritized Lien, there must have been a properly adopted periodic budget promulgated "at least annually" by the association from which the appropriate six months assessment ceiling can be computed. *(James Winokur, Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Ownership Act, 27 Wake Forest L. Rev.353. See Exhibit "3").*

The following examples may assist:

Case 1: A homeowner's assessments adopted through the association's last budget are $100 per month. He is 4 months delinquent ($400). The association has charged $80 in late fees and $375 in costs of collecting. The association has incurred no repair costs under NRS 116.310312. Thus, the total amount of the homeowner's delinquency is $855. Because the association has a lien for assessments under NRS 116.3116, and because any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS 116.3102 are enforceable as assessments, and because the association lien is prior to all first security interests only to the extent of the assessments for common expenses during the 9 months immediately preceding institution of an action to enforce the lien, assuming the institution of an "action" by the association, the maximum super priority lien amount is $900 (9 x $100 of monthly assessments). Thus, the full $855 is included in the super priority lien. Mathematically, $855 (the association lien) is prior to the first mortgage lien to the extent of $900 (9 times the monthly assessments).

Case 2: A homeowner's assessments adopted through the association's last budget are $100 per month. He is 12 months delinquent ($1,200). The association has charged $240 in late fees and $1,600 in costs of collecting. The association has incurred no repair costs under NRS 116.310312. Thus, the total amount of the homeowner's delinquency is $3,040. Because the association has a lien for assessments under NRS 116.3116, and because any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of

> subsection 1 of NRS 116.3102 are enforceable as assessments, and because the lien is prior to all first security interests only to the extent of the assessments for common expenses during the 9 months immediately preceding institution of an action to enforce the lien, assuming the institution of an "action" by the association, the maximum super priority lien amount is still $900 (9 x $100 of monthly assessments). Mathematically, $3,040 (the association lien) is prior to the first mortgagelien only to the extent of $900 (9 times the monthly assessments). Thus, $900 is the Super Priority Lien Amount and the remaining $2,140, while still a lien against the unit, is junior to the first mortgage. This analysis is consistent with the holdings of the Colorado Supreme Court and James Winokur's *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Ownership Act, 27 Wake Forest L. Rev.353*. Winokur described the $900 portion of the lien as the "Prioritized Lien" (i.e., super priority lien) and the $2,140 portion as the "Less Prioritized Lien" (i.e., junior lien).

Thus, the Super Priority Lien Amount does not change from neighbor to neighbor depending upon costs of collection. It is always an amount equal to 9 times the association's monthly assessment. The only time the Super Priority Lien Amount can change is when the assessments change in the association's budget or when the association incurs repair expenses for a unit pursuant to NRS §116.310312.

F. The Connecticut Amendment

As stated above, in 1991, Nevada and Colorado adopted the UCIOA with language mirroring UCIOA Section 3-116 (1982 version). Connecticut also adopted a version of the UCIOA, but with a significant and fundamental amendment to §3-116. This amendment was adopted by Connecticut in 1991 (see C.G.S. Section 47-258(b) as amended by No. 91-359 of the Public Acts of 1991). A comparison of the three statutes as originally enacted is as follows:

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NV Super Priority Language	CO Super Priority Language	CT Super Priority Language
The lien is also prior to all security interests described in paragraph (b) to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien. This subsection does not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association.	... a lien under this section is also prior to the security interests described in subparagraph (II) of paragraph (a) of this subsection (2) to the extent of: (I) An amount equal to the common expense assessments based on a periodic budget adopted by the association under section 38-33.3-315(1) which would have become due, in the absence of any acceleration, during the six months immediately preceding institution by either the association or any party holding a lien senior to any part of the association lien created under this section of an action or a nonjudicial foreclosure either to enforce or to extinguish the lien.	The lien is also prior to all security interests described in subdivision (2) of this subsection to the extent of (A) an amount equal to the common expense assessments based on the periodic budget adopted by the association pursuant to subsection (a) of section 47-257 which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce either the association's lien or a security interest described in subdivision (2) of this subsection **and (B) the association's costs and attorney's fees in enforcing its lien.**

As can be observed, Connecticut added a new provision to UCIOA's Section 3-116, which Nevada and Colorado did not adopt. While Nevada and Colorado's super priority lien was limited to the extent of an amount equal to just 6 months of assessments only, the Connecticut legislature intentionally permitted adding the association's costs and attorney's fees on top of the 6 month assessment figure. This is a fundamental distinction between Connecticut's law, and the laws of the states of Nevada and Colorado (and other states like Alaska, Minnesota, West Virginia, and New Jersey).

However, unlike in Connecticut, in the states of Nevada and Colorado, consistent with the original language of the 1982 UCIOA, while the Super Priority Lien Amount may include collection costs and charges, the sum total of all assessments, fees, and collection costs may not exceed the figure equaling 6 times (now 9 times in Nevada plus unit repair costs) the monthly assessments. As previously mentioned, any amounts which are over that limit still constitute a lien on the homeowner's unit, but it constitutes a lien which is junior to the first mortgage (i.e., a less prioritized lien which may be extinguished by a first mortgage holder's foreclosure).

In July of 2008, the National Conference of Commissioners on Uniform State Laws held its annual conference where it incorporated Connecticut's costs and fees amendment into the Uniform Law Commissioners' 2008 revised version of the UCIOA. Under the 2008, revised UCIOA (which has not been adopted in Nevada,) the UCIOA super priority lien now consists of both six months of assessments and attorney's fees and costs:

> (c) A The lien under this section is also prior to all security interests described in subsection (b)(2) clause (ii) above to the extent of both the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien and reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien. *2008 Amendments to the UCIOA*

As noted in the comments section on Page 198 of the 2008 Amendments to the UCIOA, "First, subsection (a) is amended to add the cost of the association's reasonable attorneys fees and court costs to the total value of the association's existing 'super lien' – currently, 6 months of regular common assessments. This amendment is identical to the amendment adopted by Connecticut in 1991; see C.G.S. Section 47-258(b). The increased amount of the association's lien has been approved by Fannie Mae and local lenders and has become a significant tool in the successful collection efforts enjoyed by associations ***in that state***." *(See Exhibit "4").*

It is vital to note, however, that in 2009 Nevada had the opportunity to adopt the newly revised UCIOA, but chose not to. The October 1, 2009, revisions to NRS §116.3116 are conspicuously absent of the Connecticut amendment. Instead, the Nevada legislature increased the super priority lien cap to an amount equal to 9 times the association's monthly assessments, up from 6 times, and also added unit repairs costs under NRS §116.310312 to the super priority lien.

Because Nevada and Colorado (and other states like Alaska, Minnesota, West Virginia, and New Jersey) adopted the unaltered super priority language of the original1982 UCIOA, and did not adopt the Connecticut amendment, the current state of the law regarding super priority lien amounts in states which did not adopt the Connecticut amendment is as the Colorado courts have held: "The reference in section 3-116(b) to priority "to the extent of" assessments which would have been due "during the six months immediately preceding an action to enforce the lien" **merely limits the**

maximum amount of all fees or charges for common facilities use or for association services, late charges and fines, and interest which can come with the Prioritized Lien..." *First Atlantic Mortg., LLC v. Sunstone North Homeowners Ass'n 121 P.3d 254, 255 -256 (Colo.App.,2005),* and "... the association's super-priority lien includes interest, charges, late charges, fines, and attorney fees **so long as the total does not exceed the limit**." *BA Mortg., LLC v. Quail Creek Condominium Ass'n, Inc. 192 P.3d 447, 451 (Colo.App.,2008).*

Again, collection costs are not added on top of the 9 month amount (as in Connecticut,) but may be incorporated within that amount (as in Nevada, Colorado, Alaska, Minnesota, West Virginia, and New Jersey). While the Nevada legislature may, at some point in the future, wish to adopt the Connecticut amendment, the current law in Nevada is as stated by the Colorado courts and James Winokur's commentary.

V.

CONCLUSION

This Petition requested action in two areas:

1. Pursuant to NRS §116.3116, what portion of a homeowners' association lien, if any, is superior to the unit's first mortgage lender's security interest ("super priority lien") and may the sum total of the super priority lien amount, whether it be comprised of assessments, fees, costs of collection, or other charges, ever exceed 9 times the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS §116.3115, plus any charges incurred by the association on a unit pursuant to NRS §116.310312 (unit repair expenses)?

2. Pursuant to NRS §116.3116, does a "super priority lien" exist in the absence of a homeowners' association's failure to file a complaint with a court to enforce the lien, i.e., the failure to institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3?

As the existing law makes clear, in Nevada, assessments, late fees, costs of collecting and other charges may be included in the Super Priority Lien Amount. However, as the plain language of NRS §116.3116 states, and as noted by the Colorado courts and James Winokur's commentary, there is a ceiling on the Super Priority Lien Amount of 9 times (6 times in other states) the association's monthly assessment amount for common expenses based on the periodic budget adopted by the association (plus repair expenses pursuant to NRS §116.310312). In addition, the total amount of assessments, late fees, costs of collecting and other charges may not exceed that

ceiling in order to be considered a "super priority lien" rather than a "junior" lien. With the exception of the repair expenses pursuant to NRS §116.310312, the Super Priority Lien Amount is limited to a finite number, i.e., an amount which cannot exceed a figure equaling 9 times the monthly assessments which immediately preceding institution of an action to enforce the lien.

Additionally, as a "condition precedent" to elevate a portion of a homeowners' association's lien from "junior" status to "super priority" status, a homeowners' association must file an "action" to enforce the lien. Nevada Rules of Civil Procedure 2 states, "There shall be one form of action to be known as 'civil action.'" Nevada Rules of Civil Procedure 3 states, "A civil action is commenced by filing a complaint with the court." Thus, until a homeowners' association files a complaint with the court to enforce its lien, no amount of its lien can achieve "super priority" status. Therefore, while the lien remains a lien on the homeowner's unit, it is in "junior" status to the first security holder's deed of trust. Thus, until the filing of a complaint with the court to enforce its lien, upon the first mortgage holder's foreclosure, the association's junior lien is extinguished in its entirety. Pursuant to NRS §116.3116, a homeowners' association's filing of a complaint with the court to enforce its lien is a condition precedent for any portion of its lien to achieve "super priority" status.

Dated this 25 day of June, 2010.

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DISTRICT COURT

CLARK COUNTY, NEVADA

A-10-630298-C
14

NEVADA ASSOCIATION SERVICES, INC.; RMI MANAGEMENT, LLC; ANGIUS & TERRY COLLECTIONS, LLC, Plaintiffs, v. STATE OF NEVADA, DEPARTMENT OF BUSINESS AND INDUSTRY, FINANCIAL INSTITUTIONS DIVISION; GEORGE E. BURNS, individually and in his official capacity as Commissioner of State of Nevada, Department of Business and Industry, Financial Institutions Division, Defendants.	Case No. Dept. No. **EX PARTE APPLICATION FOR TEMPORARY RESTRAINING ORDER AND MOTION FOR PRELIMINARY INJUNCTION**

A-10-630298-C
EPAP
Ex Parte Application
1077804

Plaintiffs Nevada Association Services, Inc. ("NAS"), RMI Management, LLC ("RMI"), and Angius & Terry Collections, LLC ("Angius & Terry"), by and through their attorneys of record, Holland & Hart LLP, hereby submit this Ex Parte Application for Temporary Restraining Order[1] and Motion for Preliminary Injunction.

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[1] In accordance with NRCP 65, Plaintiffs are providing a copy of this Application and Motion to Daniel Ebihara, Esq., Deputy Attorney General and counsel for the FID.

This Application and Motion is made pursuant to NRS 33.010 and NRCP 65, and is based on the attached Memorandum of Points and Authorities and supporting documentation, the papers and pleadings on file in this action, and any oral argument this Court may allow.

DATED this 1st day of December 2010

HOLLAND & HART LLP

By _____
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MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF EX PARTE APPLICATION FOR TEMPORARY RESTRAINING ORDER AND MOTION FOR PRELIMINARY INJUNCTION

I.

INTRODUCTION

In this Application for Temporary Restraining Order and Motion for Preliminary Injunction, Plaintiffs NAS, RMI, and Angius & Terry ask this Court to enjoin enforcement of a Declaratory Order and Advisory Opinion Regarding Collection Agency Fees from Homeowner Association Liens Following Foreclosure (the "Opinion"), unlawfully issued by Defendant State of Nevada, Department of Business and Industry, Financial Institutions Division (the "FID"). A copy of the Opinion is attached hereto as **Exhibit "1"**. ***In short, the Opinion was considered and issued without jurisdiction, in blatant violation of NRS 116.615, NRS 116.620, NRS 116.623, and NAC 232.040.***

Plaintiffs are collection agencies that work on behalf of several homeowners' associations ("HOAs") in the State of Nevada. Among other things, Plaintiffs pursue past due charges from delinquent homeowners on behalf of HOAs. This is a task of particular importance in the foreclosure crisis currently overwhelming the Nevada housing market. Indeed, without such collection agencies and the ability to pursue collection costs from the delinquent homeowners, HOAs would have little or no ability (or financial means) to pursue the never-ending list of delinquent charges from homeowners, thereby significantly increasing the costs to those homeowners who do pay their bills.

The Nevada Legislature appreciated the importance of permitting HOAs to recover from delinquent homeowners and thus granted HOAs a "super-priority" lien under NRS 116.3116(2), which is a lien on real property, senior to even the first position deed of trust. Despite the importance of granting HOAs the ability and the means to recover past due charges, several real estate speculators or "flippers," who have made hefty sums of money by flipping foreclosure properties, have filed storms of litigation in the past year disputing the interpretation of the super-priority lien statute, undoubtedly with the goal of fattening their bottom line.

Indeed, Plaintiffs have been named as defendants in several such lawsuits, including actions by or directly related to the Petitioner requesting the Opinion (Rutt Premsrirut) and by Mr. Premsrirut's attorneys (Puoy Premsrirut and James Adams). These various actions include an arbitration brought by Mr. Adams and Ms. Premsrirut against Plaintiffs that currently is involved in heavy briefing in arbitration before the Nevada Real Estate Division, are focused in large part on obtaining a judicial statutory interpretation of NRS 116.3116(2) to determine whether and to what extent collection costs are included in the super-priority lien.

Despite Mr. Premsrirut's and Mr. Adams' clear knowledge that the interpretation of NRS 116.3116(2) is a hotly-contested issue in any number of lawsuits and arbitrations, they engaged the FID *ex parte* and requested that he issue an advisory opinion on these matters, providing absolutely no notice to any party with a competing viewpoint. Thus, without considering Plaintiffs position or any opposing views, on or about November 18, 2010, George E. Burns, Commissioner (the "Commissioner") of the FID issued the Opinion. Plaintiffs have since been informed that the Commissioner intends to immediately enforce this advisory Opinion and institute disciplinary proceedings—including license revocation proceedings—against any collection agency that does not follow it immediately. However, the following issues are among the many problems with the attached Opinion:

- The Commissioner had and has no jurisdiction to interpret the provisions of NRS Chapter 116. In fact, NRS 116.615, NRS 116.620, and NRS 116.623 specifically states that the Real Estate Division has exclusive jurisdiction to issue advisory opinions concerning applicability or interpretation of NRS Chapter 116.

- The request made to the Commissioner to render an advisory opinion violated NAC 232.040(2). This regulation specifically requires that the original and a copy of the petition be forwarded to the "chief who is authorized to Administer or enforce the statute or regulation or to issue the decision." The Commissioner clearly did not forward the petition to the Real Estate Division, which possesses express jurisdiction over the rendering of advisory opinions involving interpretation sof NRS Chapter 116. ***See*** NRS 116.615, NRS 116.620, and NRS 116.623.

- The request made to the Commissioner to render an advisory opinion violated NAC 232.040(4). Parties with an interest in current legal proceedings may ***not*** file a petition for a declaratory order or an advisory opinion concerning a question or matter involved in those legal proceedings.

- The opinion squarely contradicts the order of District Court Judge Jackie Glass in ***Korbel Family Trust v. Spring Mountain Ranch Master Ass'n***, Eighth Judicial District Court Case No. A-06-523959-C, which has been recognized as the industry standard for several years now.

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- The advisory opinion was sought improperly, in an attempt to influence a pending arbitration before the Nevada Real Estate Division. When presenting its petition to Commissioner Burns, counsel for the petitioner purposefully did not advise the parties to the arbitration that this opinion was being sought. As a result, the Commissioner issued his unlawful advisory opinion based on an incomplete record and a one-sided view of the law presented to him.

- To this day, Plaintiffs have been unable to obtain a copy of the Petition that was submitted to the Commissioner. Both the FID and counsel who submitted said Petition have steadfastly refused to provide a copy, and there is no way at this time to know what kind of *ex parte* communications took place between FID and the Petitioner.

The foregoing issues demonstrate that the Opinion not only fails on substantive grounds but, quite simply, could never have been issued due to the Commissioner's clear lack of jurisdiction. Accordingly, because Plaintiffs demonstrate a likelihood of success on the merits, enforcement of the Opinion will cause irreversible harm to Plaintiffs' businesses, and public policy considerations weigh heavily in favor of injunctive relief, Plaintiffs request the Court grant their Application for Temporary Restraining Order and Motion for Preliminary Injunction.

II.

FACTUAL BACKGROUND

A. The Korbel Case

Some background is necessary in this matter. In 2006, Eighth Judicial District Court Judge Jackie Glass heard and decided ***Korbel Family Living Trust v. Spring Mountain Ranch Master Ass'n***, Eighth Judicial District Court Case No. A-06-523959-C. The principal issue in that case was whether HOA collection fees survived foreclosure based upon the so-called "super priority" lien of NRS 116.3116. Upon a specific request for briefing by Judge Glass, the issue was thoroughly briefed (*see* briefs attached hereto as **Exhibit "2"** and **Exhibit "3"**) and decided by Judge Glass in an Order dated December 22, 2006, a copy of which is attached hereto as **Exhibit "4"**.

While the prevailing counsel who prepared the order did not prepare specific findings, it is clear from the ruling, after specific briefing ordered by Judge Glass (*see* minutes attached

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hereto as **Exhibit "5"**), that Mr. Korbel's challenge under NRS 116.3116 did not prevail. As a result, Judge Glass concluded that the HOA was entitled to recover the following:

- Assessments for common expenses;
- Late fees imposed for non-payment of assessments for common expenses;
- Interest on the principal amount of unpaid assessments for common expenses;
- The HOA's "costs of collection, which may include legal fees and costs, that accrue prior to the date of foreclosure of the first deed of trust"; and
- The transfer fee for conveyance and change of ownership of the property foreclosed upon pursuant to the first deed of trust.

See Exhibit 4. Mr. Korbel did not appeal Judge Glass's decision.

Since then, the ***Korbel*** decision has been relied upon as binding precedent in the industry, including the Federal Home Loan Mortgage Corporation ("Freddie Mac"), arguably one of the largest purchasers of homes through foreclosures in the State of Nevada. For example, attached hereto as **Exhibit "6"** is a request for a super-priority payoff demand from the attorney for Freddie Mac. ***According to Freddie Mac's attorney, Korbel controls the determination of the super-priority lien after a bank foreclosure***:

> Federal Home Loan Mortgage Corporation intends to pay immediately all sums properly due and owing to the Association pursuant to NRS § 116.3116(2), also know as a "super-priority demand." . . . Pursuant to the Clark County District Court's interpretation of the statute (***Korbel vs. Spring Mountain Ranch Master Association***), the amount may include 9 months of pre-foreclosure common area expenses, interest, late fees, and reasonable costs of collection.
>
> . . .
>
> It is the intent of Federal Home Loan Mortgage Corporation to immediately pay all sums which are properly due and owing to the Association at this time, and to arrange for payment of monthly assessments as a new property owner and member of the Association.

Exhibit 6. Indeed, permitting recovery of interest, late fees, and costs of collection (with no numerical cap) is and has been common practice in the industry for years. ***See*** Affidavit of

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Paul P. Terry, Jr., attached hereto as **Exhibit "7"**.

B. The Prem Challenge and Egregious Efforts at Forum Shopping

Earlier this year, the Prem Deferred Trust ("Prem") commenced a civil action against NAS and RMI seeking, among other things, a declaration concerning whether collection fees and costs imposed by HOAs and their collection agents survive as part of the so-called "super priority" lien under NRS 116.3116. The co-trustees of Prem are Rutt Premsrirut and his sister, Attorney Puoy Premsrirut.

The lawsuit was plainly barred by NRS 38.310, which compels arbitration of such claims before the Nevada Real Estate Division. ***See Hamm v. Arrowcreek Homeowners' Ass'n***, 124 Nev. 28, 183 P.3d 895, 902 (2008). Accordingly, NAS and RMI filed a motion to dismiss based upon NRS 38.310 and ***Hamm***. In response, one of the trustees, Rutt Premsrirut (Petitioner seeking the Opinion at issue here), filed an affidavit sworn under penalty of perjury, claiming that Prem was the owner of nine parcels of land. A copy of this Affidavit is attached hereto as **Exhibit "8"**. This sworn attestations were made in attempt by Prem's counsel to persuade the court that foreclosure of these parcels was imminent, which would have allowed the court to hear the matter under NRS 38.310. A review of the pertinent public real estate records, however, demonstrated that Prem ***no longer owned*** eight of the nine properties. In one instance, a parcel was sold the very same day that Mr. Premsrirut signed his affidavit. In other instances, Prem had resold its properties as long as six (6) months prior to execution of the affidavit.

Needless to say, the motion to dismiss was granted. A copy of this Order is attached hereto as **Exhibit "9"**. Prem did not appeal.

In the meantime, James Adams, Esq. commenced a similar lawsuit on behalf of a number of real estate investors entitled ***Higher Ground, LLC, et al. v. Nevada Association Services, Inc., et al.***, Eighth Judicial District Court Case No. A-10-609031-C. That case was dismissed by the Honorable Jennifer P. Togliatti, also under NRS 38.310. A copy of this Order is attached hereto as **Exhibit "10"**. Plaintiffs in that case did not appeal.

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Shortly thereafter, Prem and Mr. Adams joined forces and filed yet another lawsuit, seeking the same relief from a different judge. Even though two similar matters had already been dismissed based upon NRS 38.310 and binding Nevada Supreme Court authority, Mr. Adams and Prem commenced ***Prem Deferred Trust, et al. v. The Signature at MGM Grand, et al.***, Eighth Judicial District Court Case No. A-10-617551-C. This case was dismissed by the Honorable Valerie Adair, also pursuant to NRS 38.310 and ***Hamm***. A copy of the order of dismissal is attached hereto as **Exhibit "11"**. Once again, Prem did not appeal.

Also in the meantime, Prem was fully involved with proceedings before the Nevada Real Estate Division Commission for Common-Interest Communities and Condominium Hotels (the "CIC") concerning collection fees and the "super-priority" lien under NRS Chapter 116. The result of those proceedings was a draft advisory opinion penned by Michael Buckley, Chairman of the CIC. A copy of Mr. Buckley's draft advisory opinion, and proof of Ms. Premsrirut's receipt thereof by email, are attached hereto as **Exhibit "12"**. When Prem saw the draft advisory opinion, the Premsriruts simply sought a different advisory opinion from the FID.

Prem's co-trustee, Ms. Puoy Premsrirut, is now co-counsel with Mr. Adams in Nevada Real Estate Division Case No. 10-87 (the "Higher Ground Arbitration") against Plaintiffs and others. A copy of the Amended Demand for Arbitration is attached hereto as **Exhibit "13"**. That case is currently pending before Arbitrator Persi Mishel. Certain interim rulings were received recently from Mr. Mishel—all but one claim was dismissed, and Plaintiffs are currently in the process of seeking clarification from Mr. Mishel on several issues, including the applicability and scope of NRS 116.3115 to this matter. A final arbitration award has not been issued, and discovery has not even commenced in that matter. ***See*** Exhibit 7.

C. The Advisory Opinion Is Based on Only Prem's Side of the Story.

According to the advisory opinion, Prem Investments, LLC petitioned the Commissioner for an advisory opinion. ***See*** Exhibit 1. Plaintiffs have never seen this petition. Exhibit 7. Mr. Adams, Ms. Premsrirut, and the FID have all refused to provide a copy of this petition to Plaintiffs, and the existence of the petition itself was never disclosed in the ***Higher***

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Ground arbitration. ***Id.*** As such, Plaintiffs were never given an opportunity to be heard in the matter, even though it plainly relates to a pending arbitration before the Real Estate Division. ***Id.***

Plaintiffs are not aware of what was actually argued to the Commissioner. ***See*** Exhibit 7. Plaintiffs are also unaware as to what was presented to the Commissioner and what *ex parte* communications, if any, took place between the parties. ***Id.*** One could only suspect that a very one-sided presentation was made, whatever form it took. Needless to say, as none of the Plaintiffs were made aware of this petition, and had no input during its consideration, Plaintiffs (and likely any collection agency or HOA) were effectively shut out of the process.

D. Prem's Unclean Hands Get Dirtier

In the Higher Ground Arbitration, Mr. Adams and Ms. Premsrirut repeatedly attempted to distance themselves from the ***Korbel*** opinion. However, recently, Plaintiffs became aware of the existence of a joint checking account between Mr. Premsrirut ***and Richard Korbel***. A partially redacted copy of this check is attached hereto as **Exhibit "14"**.

Plaintiffs thus far have been unable to determine the exact nature or length of the relationship between Mr. Korbel and Mr. Premsrirut. However, this relationship was ***not*** disclosed to the parties or the Arbitrator in the Higher Ground Arbitration. Plaintiffs' counsel is currently investigating whether Mr. Korbel's telling absence from the pending litigation and arbitration was essentially an act of plaintiff shopping—based upon a desire by Prem to distance itself from the ***Korbel*** opinion, and to avoid issues of *collateral estoppel*. Notably, in the first Prem lawsuit, Prem's counsel was the Cooper Castle law firm, which also represented the Korbel Family Trust in ***Korbel***. ***See*** Exhibit 8.

E. The FID Plans to Enforce the Opinion

On approximately November 22, 1010, Paul Terry, a managing member of Plaintiff Angius & Terry, was advised by a senior auditor at the FID that FID intended to start enforcing the Opinion immediately. ***See*** Exhibit 7. Moreover, Mr. Terry was informed that any collection agency found in violation of the Opinion will be subject to discipline and potential loss of license. ***Id.*** To protect their businesses, Plaintiffs have filed the Complaint in this

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action, seeking an order declaring the Opinion null and void and enjoining any enforcement thereof.

III.

LEGAL ARGUMENT

A. Legal Standard

In Nevada, Rule 65 of the Nevada Rules of Civil Procedure and NRS 33.010 govern the issuance of injunctions. A temporary restraining order or preliminary injunction therefore should be issued when plaintiffs demonstrate "that the nonmoving party's conduct, if allowed to continue, will cause irreparable harm for which compensatory relief is inadequate and that the moving party has a reasonable likelihood of success on the merits." ***Boulder Oaks Community Ass'n v. B&J Andrews Enterprises, LLC***, — Nev. —, 215 P.3d 27, 31 (2009); ***see also*** NRS 33.010. The court may also consider the balance of hardships between the parties. ***Univ. & Comty College Sys. of Nev. v. Nevadans for Sound Government***, 120 Nev. 712, 721, 100 P.3d 179, 187 (2004). Preliminary injunctive relief may be used to preserve the status quo and undo wrongful conditions. ***Leonard v. Stoebling***, 102 Nev. 543, 550-51, 728 P.2d 1358, 1363 (1986).

B. Plaintiffs Will Succeed on the Merits.

An applicant for an injunction must "show a reasonable likelihood of prevailing on the merits." ***Dixon v. Thatcher***, 103 Nev. 414, 416, 742 P.2d 1029, 1030 (1987). Here, Plaintiffs can demonstrate a reasonable likelihood of success on the merits, i.e., demonstrating the Opinion should be not be enforced and should be rendered null and void, on at least three (3) grounds. First and foremost, the Commissioner exceeded his jurisdiction in rending the Opinion and, in doing so, plainly violated NRS 116.615, NRS 116.620, and NRS 116.623. This alone warrants injunctive relief.

Second, Mr. Adams and Mr. Premsrirut's request to the Commissioner to render an advisory opinion—and the Commissioner's consideration thereof—violated NAC 232.040(2 and 4) and was completely inappropriate. Third, the Opinion is based on only one view of the

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interpretation of a hotly-contested statute, which currently is the subject of litigation and arbitration and which likely will end up being decided by the Nevada Supreme Court.

1. The Commissioner Exceeded His Jurisdiction and Violated Nevada Law.

In this matter, Commissioner Burns unquestionably exceeded his statutory jurisdiction and violated Nevada law, Plaintiffs therefore have a strong likelihood of succeeding on the merits of their Complaint. In the Opinion, the Commissioner asserted only that he had jurisdiction to issue his Advisory Opinion under NRS Chapter 649, which governs collection agencies. However, the Commissioner then proceeded to draft an opinion that offered several legal opinions interpreting NRS Chapter 116, the Nevada Common Interest Ownership Act, over which he has absolutely no jurisdiction.

NRS 116.615 provides in pertinent part as follows:

> 1. The provisions of this chapter ***must be administered by the [Real Estate] Division***, subject to the administrative supervision of the Director of the Department of Business and Industry.
>
> 2. The [CIC] and the [Real Estate] Division may do ***all things necessary and convenient to carry out the provisions of this chapter, including, without limitation, prescribing such forms and adopting such procedures as are necessary to carry out the provisions of this chapter.***
>
> 3. The [CIC], or the Administrator with the approval of the [CIC], may adopt such regulations as are necessary to carry out the provisions of this chapter.

NRS 116.615 (emphasis added). In addition, NRS 116.620 states as follows:

> The Attorney General shall render to the [CIC] and the [Real Estate] Division opinions upon all questions of law relating to the construction or interpretation of [NRS Chapter 116], or arising in the administration thereof, that may be submitted to the Attorney General by the [CIC] or the [Real Estate] Division.

NRS 116.620(3).

Finally, advisory opinions concerning NRS Chapter 116 fall within the ***exclusive*** jurisdiction of the Real Estate Division.

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> The [Real Estate] Division shall provide by regulation for the filing and prompt disposition of petitions for declaratory orders and advisory opinions as to the applicability or interpretation of:
>
> (a) ***Any provision of this chapter*** or chapter 116A or 116B of NRS;
>
> (b) Any regulation adopted by the [CIC], the Administrator or the Division; or
>
> (c) Any decision of the [CIC], the Administrator or the [Real Estate] Division or any of its sections.

NRS 116.623(1) (emphasis added). The foregoing language could not be more clear—the Commissioner stepped far beyond his jurisdiction when he signed the unlawful Advisory Opinion. Such an advisory opinion is only permitted by the Real Estate Division.

Despite this clear lack of jurisdiction, staff at the FID have informed Plaintiffs that the Commissioner intends to immediately begin enforcement of this Advisory Opinion and to impose regulatory discipline—which may include immediate license suspension and revocation proceedings—against Plaintiffs and other similarly situated companies. ***See*** Exhibit 7. Neither the Commissioner nor the FID, however, have such authority, due to the clear lack of jurisdiction. Because the jurisdiction for such an opinion and any subsequent actions rests with the Real Estate Division, not the FID, Plaintiffs will most definitely succeed on the merits in this action, i.e., in obtaining declaratory relief to enjoin enforcement of the Opinion and to declare it null and void.

2. The Request for the Opinion Violated Nevada Law.

The Nevada Administrative Code also makes it clear that a party may ***not*** seek an advisory opinion concerning a question that is at issue in a current legal proceeding:

> 1. Except as otherwise provided in subsection 4, an interested person may petition the Director to issue a declaratory order or advisory opinion concerning the applicability of a statute, regulation or decision of the Department or any of its divisions.
>
> . . .
>
> 4. An interested person ***may not file a petition for a declaratory order or an advisory opinion concerning a question or matter that is an issue in an administrative, civil or criminal proceeding in which the interested person is a party.***

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NAC 232.040 (emphasis added). In addition, NAC 232.040(2) specifically provides that an original and copy of any petition must be filed with the "chief who is authorized to administer or enforce the statute or regulation or to issue the decision" or to the "director" if "the statute, regulation or decision is administered or enforced by the director." That obviously did not occur here, as the Director of the FID was petitioned to provide an advisory opinion that plainly was outside the scope of his authority.

Here, the Commissioner set forth NAC 232.040 as establishing the procedure for filing a petition for a declaratory order. ***See*** Exhibit 1 at 2 (incorrectly citing NAC 232.040 as 323.040). The Opinion, however, does not mention the substance of subsection 4, which clearly prohibits a party with an interest in ongoing litigation from requesting an advisory opinion on an issue in that litigation. The arbitration with the Nevada Real Estate Division currently proceeding against Plaintiffs was brought by Mr. Adams and Ms. Premsrirut, the co-trustee of Prem, on behalf of several real estate speculators. It is not hard to see that theletter and spirit of NAC 232.040 were violated here, and that the parties are engaging in a convoluted scheme to seek their desired result by any and all means necessary. However, they simply had no right to request an advisory opinion when the same issues were and are being litigated in arbitration with the Real Estate Division. And, in making his Opinion, the Commissioner plainly violated Nevada law—and his Department's own rules—concerning advisory opinions.

While it certainly would not shocking to find out that Prem and Mr. Adams concealed their interest in the arbitration proceedings from the Commissioner, the Commissioner simply had no authority to render the Opinion when the requesting parties were currently involved in litigation on the same issue. As such, NAC 232.040(2) and (4) provide yet another ground by which the Opinion should be held unenforceable. Plaintiffs, therefore, will succeed on the merits in this action.

3. The Opinion Is Based on a One-Sided View of a Hotly-Contested Statute and Is Contrary to the Only Known Nevada Precedent.

Notwithstanding the clear lack of jurisdiction for the FID's Opinion, the FID Opinion also should be rendered null and void and unenforceable due to the simple fact that it

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was based on only one side of the story, the self-serving argument of real estate speculators. Although the dispute over interpretation of the super-priority lien of NRS 116.3116 affects, at a minimum, homeowners, buyers of homes, sellers of homes, HOAs, collection agencies, and lenders, only real estate speculators, those who flip real estate for substantial profits, have gotten a say in the matter. Tellingly, the Opinion flies in the face of the only known Nevada District Court authority on point—the ***Korbel*** decision. ***See*** Exhibit 4. Indeed, the Opinion does not even mention ***Korbel***, leading to only one conclusion—the Commissioner never was informed of that important authority. ***See*** Exhibit 1.

Despite all of the ongoing litigation on this very matter, Prem took it upon itself to seek a favorable forum on an *ex parte* basis, without notifying any other interested party, in its never-ending efforts to attain its desired result. Indeed, the foregoing matter has been hounded by blatant and egregious forum shopping of the worst sort. More than three years after ***Korbel*** was decided, the various players in this matter filed a lawsuit and lost, filed another lawsuit and lost, and filed a third lawsuit and lost. When they did not like the draft advisory opinion from CIC, they sought a different one from the FID, shutting out Plaintiffs and all others similarly situated in the process. There is no doubt that Prem and Mr. Adams will now wave their result (uncontested as it was) in front of every arbitrator and every court in every case in which they appear in support of their position.

Setting aside the fact that the Commissioner's Advisory Opinion contradicts the ***Korbel*** decision and the draft CIC advisory opinion, that the advisory opinion was sought for an improper purpose, or whether the Commissioner wittingly or unwittingly decided to inject himself into hotly contested litigation, this matter is going to be decided ultimately by the Nevada Supreme Court, not the FID. Whether he intended to do so or not, it is not the business of the Commissioner to influence pending litigation.

Accordingly, due to the Commissioner's clear lack of jurisdiction and the fact that the Opinion analyzes only one, very small, side of the story by a party that will go to any extreme to achieve its desired results, Plaintiffs have a large likelihood of success in enjoining enforcement of the Opinion and declaring it null and void *ab initio*.

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C. Absent a TRO and Preliminary Injunction, Plaintiffs Will Suffer Irreparable Harm

"[A]cts committed without just cause which unreasonably interfere with a business or destroy its credits or profits, may do an irreparable injury and thus authorize issuance of an injunction." ***Sobol v. Capital Mgmt. Consultants, Inc.***, 102 Nev. 444, 446, 726 P.2d 335, 337 (1986). "The right to carry on a lawful business is a property right" and acts which interfere with that will be restrained. ***Guion v. Terra Mktg. of Nev., Inc.***, 90 Nev. 237, 240, 523 P.2d 847, 848 (1974).

Here, despite the clear lack of jurisdiction for the Opinion, staff at the FID have informed Plaintiffs that the Commissioner intends to immediately begin enforcement of this Advisory Opinion and to impose stiff regulatory discipline. ***See*** Exhibit 7. Such actions may include immediate license suspension and revocation proceedings against Plaintiffs. ***See id.*** Any of such actions will be devastating to Plaintiffs. Plaintiffs, as collection agencies for HOAs, obviously rely on their licenses to conduct business on behalf of the HOAs. ***See id.*** Any question as to Plaintiffs' licenses will not only damage, and possibly destroy, Plaintiffs' businesses, but it would also wreak havoc on HOAs' abilities to collect on past due assessments, an act typically done through utilization of collection agencies such as Plaintiffs. ***Id.***

Moreover, for several years, Plaintiffs and others in the industry have been conducting their businesses pursuant to the ***Korbel*** decision. Indeed, even Freddie Mac agrees that it must pay fees pursuant to the ***Korbel*** holding, as the only Nevada authority on point. ***See*** Exhibit 6. A sudden change in how the players in the industry must conduct themselves will create upheaval in the industry, most likely at the expense of HOAs and the homeowners living within those HOAs. In any event, if such an upheaval is to occur, it should occur after a full and thorough analysis of the relevant issues, not after one party dead set on increasing its speculation profits at the expense of all others involved files a secret request for an advisory opinion with an inappropriate state agency.

Therefore, because Plaintiffs will suffer immediate, irreparable harm if the FID enforces the Opinion, injunctive relief is warranted. In other words, Plaintiffs request a

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temporary restraining order and preliminary injunction to maintain the status quo until a court, likely the Nevada Supreme Court, has made a decision on this hotly-contested issue after a full view of the issues based on input from all interested parties.

D. The Public Interest and Potential Hardships Weigh in Favor of Injunctive Relief

In considering preliminary injunctions, courts also weigh the potential hardships to the relative parties and others, and the public interest. ***Univ. & Comty College Sys. of Nev.***, 120 Nev. at 721, 100 P.3d at 187. Here, the potential hardships clearly weigh in favor of granting injunctive relief. As discussed above, Plaintiffs will endure substantial hardships if injunctive relief is not granted enjoining enforcement of the Opinion. Namely, Plaintiffs' licenses are at stake, as is their entire business model. On the contrary, the State's interest is minimal at most. Although the State certainly has an interest in protecting its citizens, the HOA industry has been operating for years under methods that are contrary to the limitations now set forth in the Opinion, with no negative effects on the State's citizens. However, the change suggested by the Opinion will cause great turmoil in the HOA industry. Indeed, whereas any person who believes they have been damaged by the current state of the industry will be able to recover monetary damages for any purported overpayment, the damage to Plaintiffs, in the form of loss of their licenses and businesses, will be irreversible.

From a public interest standpoint, this Opinion has the potential to seriously damage the citizens of Nevada, particularly those living in neighborhoods governed by HOAs. Because the Opinion severely limits the rights of HOAs to recover collection costs, the practical result of the Opinion will be to shift HOA fees, collection costs, and interest back to the HOAs as opposed to the delinquent homeowner. ***The result is that homeowners who live by the rules, pay their mortgages, and pay their HOA fees, will have to absorb these costs by paying increased HOA fees while real estate speculators like Prem will enjoy a "free ride" by not having to pay those fees.*** Hardly a just or equitable result.

Moreover, this action concerns—and has the potential to significantly impact—the role of HOAs during these difficult economic times. With more foreclosures in Nevada than in any other state, HOAs have stepped in to maintain homes that have fallen into disrepair. Dead or

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overgrown landscaping is a common problem, as is unattended pools ripe with algae. Poorly kept residences can create neighborhood blight that depresses surrounding property values that have already been devastated by the worst housing market downturn in Nevada history. If HOAs are unable to recover outstanding lien amounts, which include late fees, collection costs, and interest, their task of maintaining these communities becomes much more daunting. Because the practical result of the Opinion will be that HOAs will not be able to recover any such collection costs, the Opinion will result in a significant burden on HOAs and homeowners.

Accordingly, the public interest and the balance of hardships weigh heavily in favor of granting the injunctive relief requested by Plaintiffs.

E. Any Bond Should be Nominal.

Finally, any bond required should be nominal. Plaintiffs simply seek to maintain the status quo existing in the industry for years. The temporary restraining order and preliminary injunction would cause no injury to Defendants. Instead, this issue should be permitted to run its course in arbitration and in the district court before ultimately being decided by the Nevada Supreme Court.

IV.

CONCLUSION

For the foregoing reasons, NAS, RMI, and Angius & Terry respectfully request the Court grant their Application for Temporary Restraining Order and enjoin Defendants from enforcing the Opinion until such time as the motion for preliminary injunction is heard. Plaintiffs further request that, following a hearing on Plaintiffs' Motion for Preliminary

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Injunction, the Court enter a preliminary injunction enjoining Defendants from enforcement of the Opinion and declaring the Opinion null and void.

DATED this 1st day of December 2010.

HOLLAND & HART LLP

By _____
Patrick J. Reilly (6103)
Jenny L. Routheaux (11258)
3800 Howard Hughes Parkway, 10th Floor
Las Vegas, NV 89169
Attorneys For Plaintiffs

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CERTIFICATE OF SERVICE

Pursuant to Nev. R. Civ. P. 5(b), I hereby certify that on the 1st day of December 2010, I served a true and correct copy of the foregoing **EX PARTE APPLICATION FOR TEMPORARY RESTRAINING ORDER AND MOTION FOR PRELIMINARY INJUNCTION** via email to the person listed below:

Daniel Ebihara, Esq.
Deputy Attorney General
State of Nevada
555 East Washington Street, #3900
Las Vegas, Nevada 89101
Email: debihara@ag.nv.gov

Susan Thompson
An Employee of Holland & Hart LLP

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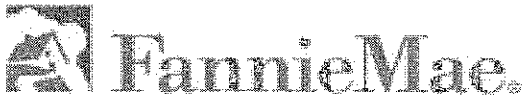

Selling Guide

Fannie Mae Single Family

RA0089

December 1, 2010

Selling Guide: Fannie Mae Single Family

Published December 1, 2010

Fannie Mae Copyright Notice

Table of Contents

All coverages must be in compliance with local, state, and federal insurance laws.

B4-2.1-06, Priority of Common Expense Assessments (04/01/2009)

Introdnction

This topic contains information on priority of common expense assessments.

Priority of Common Expense Assessments

The table below describes the priority of common expense assessments.

If ...	Then ...
the condo or PUD project is located in a jurisdiction that has enacted: • the Uniform Condo Act (UCA), • the Uniform Common Interest Ownership Act (UCIOA), or • other similar statutes that provide for regular common expense assessments, as reflected by the project's operating budget, to have such priority over first mortgage liens.	Fannie Mae allows up to six months of regular common expense assessments for a condo or PUD unit to have limited priority over Fannie Mae's mortgage lien.
Fannie Mae subsequently acquires title to the unit by foreclosure,	Fannie Mae will not be liable for any fees or charges related to the collection of the six months of unpaid assessments that accrued before acquisition of title to the unit.
the condo or PUD project is located in a jurisdiction that allows for more than six months of regular common expense assessments to have priority over Fannie Mae's lien,	Fannie Mae will not purchase a mortgage loan secured by a unit in the project.

Persi J. Mishel, Esq.
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Tel: (702) 255-7029
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Arbitrator

STATE OF NEVADA

DEPARTMENT OF BUSINESS AND INDUSTRY

REAL ESTATE DIVISION

OFFICE OF THE OMBUDSMAN FOR OWNERS IN COMMON-INTEREST COMMUNITIES AND CONDOMINIUM HOTELS

HIGHER GROUND, LLC, A Nevada limited liability company; RRR HOMES, LLC, a Nevada limited liability company; TRIPLE BRANDED CORD, LLC, Nevada limited liability company; EQUISOURCE, LLC, a Nevada limited liability company; EQUISOURCE HOLDING, LLC, a Nevada limited liability company; APPLETON PROPERTIES, LLC, a Nevada limited liability company; CBRIS, LLC, a Nevada limited liability company; MEGA, LLC, a Nevada limited liability company; SOUTHERN Nevada ACQUISITIONS, LLC, a Nevada limited liability company, VESTEDSPEC, INC., a Nevada corporation; CUSTOM ESTATES, LLC, a Nevada limited liability company; KINGFUTT'S PFM LLC, a Nevada limited liability company; THORNTON & ASSOCIATES, LLC, a Nevada limited liability company; WINGBROOK CAPITAL LLC, a Nevada limited liability company; ELSINORE, LLC, a Nevada limited liability company; MONTESA, LLC, a Nevada limited liability company; EKNV, LLC, a a Nevada limited liability company; on behalf of themselves and as representatives of the class herein defined, Claimants,	NRED Control # 10-87

v.

NEVADA ASSOCIATION SERVICES, INC, a Nevada corporation; RMI MANAGEMENT, LLC, dba RED ROCK FINANCIAL SERVICES, a Nevada limited liability company; HOMEOWNER ASSOCIATION SERVICES, INC., a Nevada Corporation; ALESSI & KOENIG, LLC, a Nevada limited liability company; HAMPTON & HAMPTON, a professional corporation; ANGIUS & TERRY COLLECTIONS, LLC, a Nevada limited liability company; SILVER STATE TRUSTEE SERVICES, LLC, a Nevada limited liability company,

Respondents.

INTERIM AWARD REGARDING ORDER GRANTING IN PART AND DENYING IN PART MOTION FOR SUMMARY JUDGMENT ON CLAIM OF DECLARATORY RELIEF

On October 28, 2010, this arbitrator entered an Order Granting in Part and Denying in Part the Claimants' Motion for Summary Judgment on Claim of Declaratory Relief. He interpreted NRS 116.3116 and found:

1. NRS 116.3116(2) provides for a cap of 9 months on assessments for super priority lien purposes. Therefore, costs and fees related to unpaid assessments are subject to the 9-month cap. This arbitrator granted the Claimants' Motion for Summary Judgment on this issue. Thus, they are the prevailing party regarding this issue.
2. Filing a civil action is not a condition precedent for an HOA's super priority lien to exist. This arbitrator denied the Claimants' Motion for

Summary Judgment on this issue. Thus, the Respondents are the prevailing party of this issue.

There is no Nevada Supreme Court decision addressing these two issues. There are substantial properties involved in this case and the attorneys will be spending substantial time to conduct discovery, prepare the case for arbitration, and arbitration hearings. The parties will be incurring significant expenses for attorneys' fees and costs, and this arbitrator's fees. Therefore, this arbitrator is exercising his discretion under NRS 38.231(1) and pursuant to NRS 38.234 incorporates his Order Granting in Part and Denying in Part the Claimants' Motion for Summary Judgment on Claim of Declaratory Relief into an Interim Award, so that the parties may proceed to the District Court pursuant to NRS 38.234.

Dated the 21 day of March 2011.

Persi J. Mishel, Esq., Arbitrator
2340 Flower Spring St.
Las Vegas, NV 89134
(702) 255-7029

NOTICE

NRS 38.234 provides: "If an arbitrator makes a preaward ruling in favor of a party to an arbitral proceeding, the party may request the arbitrator to incorporate the ruling into an award under NRS 38.236. A prevailing party may make a motion to the court for an expedited order to confirm the award under NRS 38.239, in which case the court shall summarily decide the motion. The court shall issue an order to confirm the award unless the court vacates, modifies or corrects the award under NRS 38.241 or 38.242."

CERTIFICATE OF MAILING

I hereby certify that a copy of the forgoing Interim Award Regarding Order Granting in Part and Denying in Part Motion for Summary Judgment on Claim of Declaratory Relief placed in the United States mail, with proper postage affixed thereto, addressed as follows, on this 21 day of March 2011:

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Community Collateral Damage: A Question of Priorities

*Andrea J. Boyack**

Today's soaring mortgage default rate and the uncertainty and delay associated with mortgage foreclosure proceedings threaten to cause financial tragedies of the commons in condominiums and homeowner associations across the country. Assessment defaults in privately governed communities result in an inequitable allocation of upkeep costs—a phenomenon that current law has failed to prevent. But the collateral damage caused by delayed foreclosures and insufficient recoveries can be minimized by increasing the payment priority of the association lien.

In a majority of states, association liens are completely subordinate to the first mortgage lien. At foreclosure of the mortgage lien, the junior priority assessment lien will be extinguished whether or not there are sufficient proceeds to reimburse for community charges. Assessment delinquencies grow over time, so the longer it takes to complete foreclosure, the greater the costs to the neighborhood. Although several states have adopted a limited lien priority for up to six months' worth of unpaid assessments, foreclosures today take far longer than six months, and the amount ultimately owed to a community can be significant and far exceed that cap. Federal housing policy affects the resolution of the issue because the Federal Housing Administration ("FHA"), Fannie Mae and Freddie Mac only permit qualifying mortgages to be subject to a six-month assessment lien priority. The decelerating pace of foreclosure further exacerbates the already unjustifiable financial impact borne by non-defaulting neighbors. The lien priority status quo fails to adequately protect communities in today's context of widespread, delayed foreclosures and

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under-collateralized mortgage loans. Decreasing the first mortgage lien's priority during a foreclosure delay would mitigate the harm.

Lien priority statutory changes could protect association finances in the future, and such provisions might be applied retroactively as well. In other contexts, states have held that changes to a lien priority regime could apply to existing associations and existing mortgages without unconstitutionally impairing contract or property rights. This has been particularly true where the association's lien was deemed to have been created on the date the community's organizational documents were recorded (prior to any unit's mortgage). Historically, bank lobbyists have opposed any enhanced assessment lien priority. However, supporting property upkeep and making assessments more predictable and collectible would actually benefit lenders by shoring up the value of their collateral. Moreover, increased certainty with respect to homeowner payment obligations would enable more responsible credit underwriting and contribute to economic recovery. Shoring up assessment lien priority would not only ensure a fair allocation of community costs, but also would help to contain the current housing market decline.

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INTRODUCTION

Culpable parties in today's housing crisis are legion,[1] but innocent bystanders are directly and tangibly harmed by the fallout. Nonpayment of upkeep charges by financially strapped owners forces guiltless neighbors to fund the community budget revenue gap. The problem is exacerbated by foreclosure delay, since a property conveyance would replace an insolvent owner with a solvent one. Whether a foreclosure delay results from mortgage lenders' strategic behavior[2] or from procedural missteps by servicers,[3] the result is the same—hard-working,

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1. Mortgage brokers pushed unrealistic loans. Steven Krystofiak, President, Mortgage Brokers Ass'n for Responsible Lending, Statement at the Federal Reserve (Aug. 1, 2006), *available at* http://www.federalreserve.gov/secrs/2006/august/20060801/op-1253/op-1253_3_1.pdf. Appraisers validated unrealistic prices. *See* Jonathan R. Laing, *The Bubble's New Home*, BARRON'S ONLINE (June 20, 2005), http://online.barrons.com/article/SB111905372884363176.html (discussing economist Robert Shiller's forecast of the housing market). Homeowners borrowed money they could not repay, and lenders lent funds while ignoring credit and market risks. Ben Steverman & David Bogoslaw, *The Financial Crisis Blame Game*, BLOOMBERG BUSINESSWEEK (Oct. 18, 2008, 12:01 AM), http://www.businessweek.com/investor/content/oct2008/pi20081017_950382.htm. Secondary market purchasers and investors overly relied on securitization, and regulators and credit rating agencies blessed the entire system in error, negligence, or both. *See, e.g.*, Carol Ann Frost, *Credit Rating Agencies in Capital Markets: A Review of Research Evidence on Selected Criticisms of the Agencies*, J. ACCT., AUDITING, & FIN. (forthcoming 2006), *available at* http://ssrn.com/abstract=941861 (analyzing the criticism of the credit rating agencies); John Patrick Hunt, *Credit Rating Agencies and the "Worldwide Credit Crisis": The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement*, 1 COLUM. BUS. L. REV. 109, 114 (2009) ("It is not plausible to argue that rating agencies have a valuable reputation for rating instruments they have never rated before."); Robert T. Miller, *Morals in a Market Bubble*, 35 U. DAYTON L. REV. 113, 136 (2009) ("Alan Greenspan and his colleagues on the Federal Open Market Committee made some mistakes in the early years of this decade by keeping interest rates very low for a very long time."); Randolph C. Thompson, *Mortgage Backed Securities, Wall Street, and the Making of a Global Financial Crisis*, 5 AM. U. BUS. L. BRIEF 51, 53 (2008) (providing an overview of the "misguided confidence in these debt instruments."); Jeff Madrick, *How We Were Ruined & What We Can Do*, N.Y. REV. OF BOOKS, Feb. 12, 2009, *available at* http://www.nybooks.com/articles/archives/2009/feb/12/how-we-were-ruined-what-we-can-do/ (providing an overview of the securitization and the financial crisis); Ronald Colombo, *A Crisis of Character*, HUFFINGTON POST (May 12, 2009, 4:58 PM), www.huffmgtonpost.com/ronald-j-colombo/a-crisis-of-character_b_202562.html (lamenting the erosion of morals in the modern economy).

2. In a normal housing market, pushing foreclosures through quickly is in a lender's best interest. But in a depressed market, lenders have discovered that a foreclosure with a low prospect of a quick resale actually causes them to lose money. In 2009, lenders canceled up to 50% of foreclosure sales in some parts of the country, and many of these delays were inspired by the desire to avoid upkeep costs (maintenance, community assessments, and property taxes) while awaiting a market rebound. Todd Ruger, *Lenders' Latest Foreclosure Strategy: Waiting*, HERALD TRIB., July 12, 2009, at A1.

3. In early October 2010, three of the largest mortgage lenders in the United States—Bank of America, J.P. Morgan Chase, and Ally Financial—announced moratoriums in the twenty-three states that require court-ordered sales to foreclose on mortgages. This was in reaction to

financially responsible homeowners are forced to pay significant, additional amounts of money merely because of their neighbors' payment defaults, and in the many cases where foreclosure sale proceeds do not even cover the loan,[4] such amounts may never be recovered. The additional burden on the non-defaulting neighbors possibly forces such homeowners into their own financial distress. Allocating the cost of a delinquent owner's upkeep share to the paying neighbors is inefficient and unfair.[5] Furthermore, inequitable cost allocation will ultimately lead to additional owner defaults and further impairment of collateral value for every lender.

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increased judicial scrutiny of sloppy—or even fraudulent—servicer foreclosure procedures. *See* Ariana Eunjung Cha & Brady Dennis, *Judges Revisiting Foreclosure Cases May Help Owners but Clog Market*, WASH. POST, Oct. 5, 2010, at A9 (referencing a Florida case). Within a week of the initial announcements of these servicer-initiated moratoriums, Bank of America expanded its freeze on foreclosures nationwide, and attorneys general in all fifty states begun investigative probes into the extent of servicer misconduct in foreclosure procedures. *See* Ariana Eunjung Cha, Steven Mufson & Jia Lynn Yang, *Momentum Builds for Full Moratorium on Foreclosures*, WASH. POST, Oct. 9, 2010, at A11 (reporting that national civil rights groups had called for a government-mandated national moratorium on foreclosures); Jia Lynn Yang & Ariana Eunjung Cha, *Obama Vetoes Foreclosure Bill as Anger Grows*, WASH. POST, Oct. 8, 2010, at A1 (reporting that federal legislation intended to streamline foreclosure proceedings had been vetoed by President Obama, further lengthening the foreclosure process). While moratoriums have now been lifted, the concern that prompted them hangs over foreclosure proceedings, and the increased servicer scrutiny operates to lengthen the foreclosure timeline. *See* Carrie Bay, *Self-Evident Truth in Market Variables: Longer Foreclosure Timelines*, DSNNEWS.COM (Apr. 12, 2011), http://www.dsnews.com/articles/self-evident-truth-in-market-variables-longer-foreclosure-timelines-2011-04-12 (stating that the time period from default to foreclosure continues to increase across the country).

4. According to the Rasmussen Report, 31% of U.S. homeowners with a mortgage owed more on their homes than their homes were worth at the end of 2010. Peter Schroeder, *Poll: Nearly One-Third of Homeowners Underwater on Mortgage*, THE HILL (Mar. 21, 2011, 1:29 PM), http://thehill.com/blogs/on-the-money/801-economy/151039-poll-nearly-one-third-of-homeowners-underwater-on-mortgages. Deutsche Bank predicts that 48% of American homes could have negative equity by the end of 2011. Mortimer B. Zuckerman, *Housing Crisis Represents the Greatest Threat to Recovery*, U.S. NEWS & WORLD REP. (Jan. 27, 2011), http://www.usnews.com/opinion/mzuckerman/articles/2011/01/27/housing-crisis-represents-the-greatest-threat-to-the-recovery.

5. The concept that an unfair enjoyment of benefits by parties not bearing associated costs (free-riding) is inequitable and "wrong" was articulated by H.L.A. Hart in 1955 and was termed the "principle of fairness." H.L.A. Hart, *Are There Any Natural Rights?*, 64 PHIL. REV. 175, 185–86 (1955). This concept has been favorably cited by John Rawls. JOHN RAWLS, A THEORY OF JUSTICE 96 (rev. ed. 1971). Fair allocation of cost demands that all beneficiaries of a cooperative enterprise bear pro rata responsibility for the costs of such enterprise. This formulation of fair allocation is well-suited to the case of upkeep expenses of a common interest community such as a homeowner association or condominium. Unfair cost allocation in communities creates neighborhood contention and lowers quality of life for members of an association. Michelle Conlin & Tamara Lush, *Neighbor vs. Neighbor as Homeowner Fights Get Ugly*, ASSOCIATED PRESS, July 10, 2011, *available at* http://finance.yahoo.com/news/Neighbor-vs-neighbor-as-apf-2524543580.html?x=0.

Today, defaulting neighbors cause millions of blameless homeowners around the country to face such inequitable and unexpected financial burdens.[6] An increasing number of new developments nationwide have adopted a private governance model.[7] Approximately 62,000,000 people in the United States (20% of the country's population) live in one of the 309,600 privately governed common interest communities ("CICs").[8] Nationally, home loan delinquency rates are now between 10% and 13% of all mortgages.[9] Mortgage defaults are concentrated in certain geographic areas, however, so the mortgage delinquency rate in

6. Numerous media accounts have highlighted the stories of suffering by such non-delinquent neighbors. *See, e.g.*, Christine Dunn, *'Nightmare' Condo Fees After Foreclosure*, PROVIDENCE J., July 6, 2008, at G1 (discussing a Rhode Island foreclosure); Christine Haughney, *Collateral Foreclosure Damage*, N.Y. TIMES, May 15, 2008, at C1 (examining the plight of a Miami woman); Sarah Ryley, *New Manhattan Condos See Rise in Foreclosures*, THEREALDEAL.COM (Mar. 8, 2010, 11:00 AM), http://therealdeal.com/newyork/articles/new-manhattan-condos-see-rise-in-foreclosures--2 (reporting on New York foreclosures); David Sutta, *Condos Demanding Foreclosure On Abandoned Units*, MFI-MIAMI (Apr. 28, 2010), http://www.mfi-miami.com/2010/04/condos-demanding-foreclosure-on-abandoned-units/ (discussing the predicament of a Florida woman).

7. More than 80% of newly built homes across the country are in a CIC. Conlin & Lush, *supra* note 5. The prevalence of condominiums increased markedly over the decade ending in 2005. However, since the housing crisis began, the percentage of occupied housing stock within a condominium has notably declined. *See* JENNIFER COMNEY, CERIS NARDUCI & PETER TATIAN, URBAN INST., STATE OF WASHINGTON, D.C.'S NEIGHBORHOOD 2010 26–29 (Nov. 2010) (showing how Washington, D.C.'s housing stock has followed the national trend).

8. "Common interest community" is defined by the Restatement (Third) of Property to be a "development or neighborhood in which individually owned lots or units are burdened by a servitude" that cannot be avoided by nonuse or withdrawal. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 6.2 (2000). Common interest communities include condominiums and homeowner associations—also known as planned unit developments ("P.U.D.s"). Data regarding the number of U.S. common interest communities and their residents is tracked by the Community Associations Institute ("CAI"). *Industry Data*, CMTY. ASS'NS INST., http://www.caionline.org/info/research/Pages/default.aspx (last visited Aug. 16, 2011) [hereinafter CAI Industry Data]. CAI's data indicate that the number of residents of common interest communities has increased from 2.1 million in 1970 to 62.0 million in 2010. This figure represents 20.2% of the population of the United States, estimated by the U.S. Census Bureau to be 307 million in 2009. *Population Finder*, U.S. CENSUS BUREAU, http://factfinder.census.gov/servlet/SAFFPopulation (last visited Aug. 16, 2011).

9. Based on figures provided by Lender Processing Services, as reported at PR Newswire, Press Release, Lending Process Services, Inc., LPS September 'First Look' Mortgage Report: August Month-End Data Shows More Delinquent Loans Entering Foreclosure Process (Sept. 15, 2010), *available at* www.reuters.com/article/idUS224331+15-Sep-2010+PRN20100915. Another article reporting these figures calculates that this rate indicates more than 7.2 million mortgage loans are behind on their payments. Carrie Bay, *Residential Mortgage Delinquency Rate Surpasses 10%: LPS*, DSNEWS.COM (Feb. 4, 2010), http://www.dsnews.com/articles/mortgage-delinquency-rate-surpasses-10-lps-2010-02-04. The foreclosure rate is ten times pre-crisis levels, and the aggregate number of foreclosure sales in one month (around 100,000 nationwide) is now similar to the number of pre-crisis foreclosure sales for an entire year. Alex Viega, *Foreclosure Rate: Americans on Pace for 1 Million Foreclosures in 2010*, HUFFINGTON POST (July 15, 2010, 5:07 PM), http://www.huffingtonpost.com/2010/07/15/foreclosure-rate-american_n_647130.html.

those areas is much higher.[10] The states with recent growth booms are the ones dealing with the steepest mortgage default rate.[11] Notably, these states also have the highest percentage of citizens residing in privately governed CICs.[12] People who have stopped paying their mortgages have, almost invariably, previously stopped paying their community association assessments.[13] The precipitous rise in mortgage

10. *See* Shayna M. Olesiuk & Kathy R. Kalser, *The 2009 Economic Landscape, The Sand States: Anatomy of a Perfect Housing-Market Storm*, 3 FDIC Q., no. 3, 2009 at 26, *available at* http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_1/Quarterly_Vol3No1_entire_issue_FINAL.pdf (discussing the acute nature of the housing downturn in Arizona, California, Nevada, and Florida); *see also* Dina ElBoghdady, *Foreclosure Activity Rises in Most Major Metropolitan Areas*, WASH. POST, July 30, 2010, at A14 ("The 20 regions with the worst foreclosure rates were in the four states—Florida, California, Nevada and Arizona."); Brad Heath, *Most Foreclosures Pack into Few Counties*, USA TODAY (Mar. 6, 2009, 7:13 PM), http://www.usatoday.com/money/economy/housing/2009-03-05-foreclosure_N.htm (explaining that properties concentrated in a mere thirty-five counties accounted for half of the country's foreclosure actions, and eight counties in Arizona, California, Florida, and Nevada were the source of a quarter of the nation's foreclosures in 2008). As of July 2010, 1 in 200 households in California were in foreclosure; 1 in 171 households in Florida were in foreclosure; 1 in 167 households in Arizona were in foreclosure; and 1 in 82 households in Nevada were in foreclosure. *States with Highest Foreclosure Rates*, CNBC.COM, http://www.cnbc.com/id/29655038/States_with_the_Highest_Foreclosure_Rates (last visited Aug. 16, 2011) (citing data from RealtyTrac's U.S. Foreclosure Market Report).

11. In the last decade, many cities in Arizona, California, Florida, and Nevada have experienced both a double-digit rise in prices as well as a double-digit decline in prices. *See House Price Index*, FED. HOUS. FIN. AGENCY, http://www.fhfa.gov/Default.aspx?Page=87 (last visited Aug. 16, 2011) (providing an index of housing transactions by state); S&P/CASE-SHILLER, HOME PRICE INDICES 2009, A YEAR IN REVIEW 5 (Jan. 2010), *available at* http://www.standardandpoors.com/ (follow "S&P/Case-Shiller Home Price Indices" hyperlink; then follow "S&P/Case-Shiller Home Price Indices: 2009 A Year In Review" hyperlink) (reporting on 2009). Conversely, cities such as Boston, Charlotte, Cleveland, Dallas, and Denver never experienced double-digit price rises nor have they experienced double-digit declines. *See* Heath, *supra* note 10 (explaining that in some parts of the country, "the foreclosure wave was barely a ripple").

12. For example, an estimated 25% or more of Californians reside in a condominium or homeowner association. *See* Carol Lloyd, *Condominium Homeowners Face Rising Condo Fees and Special Assessments*, SFGATE.COM (Aug. 3, 2007), http://articles.sfgate.com/2007-08-03/entertainment/17255445_1_affordable-housing-new-homeownership-inclusionary (reporting on increases in special assessments). Tomas Musil, director of the Shenehon Center for Real Estate at the Opus College of Business at the University of St. Thomas in St. Paul, Minnesota, explains that while "the problem is national in scope, it is more pronounced in Florida, California, Texas, and Colorado," where CIC developments were more popular. Tom Bayles, *After Foreclosure, It's Time for Neighbors to Pay*, HERALD TRIB. (Sept. 23, 2008, 1:26 AM), http://www.heraldtribune.com/article/20080923/ARTICLE/809230372/2055/NEWS?Title=When_foreclosure_is_finished__it_s_time_for_neighbors_to_pay (quoting Musil). The Policy Institute of California asserts that 38% of the housing units in California's "Inland Empire" exist in homeowner association communities. Jim Wasserman, *HOAs Struggle with Gotchas*, ASSOCIATED PRESS, http://www.calhomelaw.org/doc.asp?id=463 (last visited Aug. 16, 2011). Wasserman also points out that more than half of the nation's CIC housing is in five states (California, Florida, Texas, Arizona, and Nevada). Jim Wasserman, *California Eyes HOA Changes*, ASSOCIATED PRESS, (July 8, 2004), *available at* http://www.democraticunderground.com/discuss/duboard.php?az=view_all&address=141x2045calhomelaw.org/doc.asp?id=646.

13. Trevor G. Pinkerton, *Escaping the Death Spiral of Dues and Debt: Bankruptcy and*

default rates therefore indicates an even steeper rise in assessment delinquencies, which will continue until solvent owners replace delinquent owners.[14]

All types of CICs, from high-rise residential condominiums to multiple-zip-code single-home developments, share the same essential service and payment structure: homeowner-elected directors manage common upkeep, and all homeowners contribute their pro rata portion of the common costs.[15] The CIC structure enables more community amenities and upkeep, permitting neighborhoods to self-fund and allowing local governments to avoid raising taxes in response to more housing developments.[16]

Owners in condominiums and homeowner associations expect to be financially independent of their neighbors.[17] Architects of CIC-enabling legislation did not intend to create financial co-dependence nor cause significant financial entanglement because default in a well-functioning market would lead expeditiously to foreclosure and title transfer to a successive solvent homeowner. If a credit-worthy party quickly takes over a defaulting owner's share of upkeep obligations and begins to pay allocated assessments, the community would suffer only limited financial loss due to a member's mortgage default. But it often does not work that way in today's market. Now, contrary to original

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Condominium Association Debtors, 26 EMORY BANKR. DEV. J. 125, 142–43 (2009); Monica Hatcher, *Mediators Foresee Gloom, Doom in Condo Industry*, MIAMI HERALD, Jan. 4, 2009, at 1H; Press Release, PR.com, Concerned Homeowners Association Members Coalition Forms (Feb. 18, 2011), *available at* http://www.pr.com/press-release/299084; Donna Gehrke-White, *Homeowner Associations Step Up Foreclosure Filings*, MIAMI HERALD (Feb. 20, 2011), http://www.miamiherald.com/2011/02/20/2062656/homeowner-associations-step-up.html; Daniel Vasquez, *Should Delinquent Condo Owners Lose Internet, TV Service?*, SUN SENTINEL, Mar. 1, 2011, http://articles.sun-sentinel.com/2011-03-01/business/fl-cable-tv-condocol-20110301_1_delinquent-condo-owners-associations-maintenance-fees.

14. *See infra* notes 80–84 and accompanying text (illustrating that because assessments are the primary source of funding for community associations, delinquent payments usually cause increases in the assessments of all other homeowners to offset this financial imbalance).

15. *See* WAYNE S. HYATT & SUSAN F. FRENCH, COMMUNITY ASSOCIATION LAW: CASES AND MATERIALS ON COMMON INTEREST COMMUNITIES 11 (2d ed. 2008) (discussing the power of an elected board of directors); WAYNE S. HYATT, CONDOMINIUM AND HOMEOWNER ASSOCIATION PRACTICE: COMMUNITY ASSOCIATION LAW 105, 121 (3d ed. 2000) (discussing assessments and other collection devices).

16. *See generally* CLIFFORD TREESE, ROBERT DIAMOND & KATHERINE ROSENBERRY, RESEARCH INST. FOR HOUS. AM., CHANGING PERSPECTIVES ON COMMUNITY ASSOCIATION MORTGAGE UNDERWRITING AND CREDIT ANALYSIS 3 (Nov. 2001), *available at* http://www.housingamerica.org/RIHA/RIHA/Publications/48502_ChangingPerspectivesonCommunityAssociationMortgageUnderwriting.pdf (discussing methods that communities utilize to minimize taxes); CAI Industry Data, *supra* note 8 (indicating the number of residents of common interest communities).

17. *See infra* notes 97–100 and accompanying text (discussing the negative aspects of economic entanglement).

intent and expectations, foreclosure is slow in coming and sometimes deliberately or negligently delayed, and community assessments can accrue and remain unpaid for months or years.[18] Furthermore, the sheer number of owners who are currently in default on their payment obligations—some ten times higher than pre-crisis—means that an association could be suffering from widespread assessment delinquency, both increasing its budgetary shortfall and decreasing the number of owners shouldering the burden of bridging that gap.[19] Paying additional upkeep costs harms homeowners. Furthermore, uncertainty in association funding threatens the viability of the community itself.

In the context of today's lengthy mortgage foreclosure timelines, neighbors in CICs have become truly financially interdependent, and the failure of some owners to pay their fair share of common costs requires a greater financial contribution by the others.[20] During the months or years that mortgage foreclosure on a unit is threateued or pending, the association still must pay for upkeep, utilities and necessary repairs; its only source of revenue is increased assessment payments by those owners who are still able to pay.[21] Increased assessments, triggered by chronic non-payments, essentially result in forced inter-neighbor loans. Because foreclosure of the first mortgage wipes away the association's junior lien for assessments,[22] these forced loans typically end up being forced inter-neighbor permaneut subsidies.

Requiring owners to pay their neighbors' debts is wrong, inefficient, and destabilizing for the hundreds of thousands of CICs in the United

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18. Shuang Zhu & R. Kelley Pace, The Influence of Foreclosure Delays on Borrower's Default Behavior 3 (Apr. 19, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=1717127; *see also* Brent Ambrose, Richard Buttimer, Jr. & Charles Capone, *Pricing Mortgage Default and Foreclosure Delay*, 29 J. OF MONEY, CREDIT & BANKING 314, 319–20 (1997) (providing an overview of foreclosure delay).

19. RealtyTrac's Year-End 2010 U.S. Foreclosure Market Report shows a total of 3,825,637 foreclosure filings (including default notices, scheduled auctions, and bank repossessions) reported on a record 2,871,891 U.S. properties in 2010, an increase of nearly 2% from 2009 and an increase of 23% from 2008. Press Release, RealtyTrac, Record 2.9 Million U.S. Properties Receive Foreclosure Filings in 2010 Despite 30-Month Low in December (Jan. 12, 2011), *available at* http://www.realtytrac.com/content/press-releascs/2010-year-end-foreclosure-report-6309. The report also shows that nearly 2.23% of all U.S. housing units (1 in 45) received at least one foreclosure filing during the year, up from 2.21% in 2009, 1.84% in 2008, 1.03% in 2007, and 0.58% in 2006. *Id.* Today, at least 8 million Americans are behind on their mortgage payments, and the threat of further housing price decline (the so-called "double dip") has been called the "greatest strategic threat to the recovery of the economy." Zuckerman, *supra* note 4.

20. *See infra* Part I.B.2 (discussing the communal burden of assessment default in a CIC).

21. *See infra* notes 80–84 and accompanying text (discussing the importance of assessment payments to meet an association's budgetary needs).

22. *See infra* notes 187–97 and accompanying text (explaining the treatment of an assessment lien during first mortgage foreclosure).

States and the millions of homeowners who live in them.[23] The current system forces people who completely lacked the ability to foresee, control, or avoid their neighbors' defaults to bear increasing costs due to irresponsible mortgage lending. These same owners end up effectively subsidizing their neighbors' mortgage lenders whose collateral they pay to maintain, insure, and protect through association expenditures. Current laws fail to protect innocent, non-defaulting owners from being forced to provide their own private mortgage lender and neighbor bailouts. These bailouts are not ultimately reimbursed by the federal government or paid back by the home's foreclosing lender or foreclosure buyer. If neighbors refuse to privately fund deficiencies, lack of association funding for maintenance, insurance, and management of common property will eventually lead to a deterioration of the housing stock.[24]

Several states have responded to the dual problem of under-funded associations and inequitable cost allocation by providing for a capped amount of assessment deficiency (typically six months of unpaid assessments) to be repaid at or after foreclosure of the first mortgage on defaulting homes.[25] Often, this is not enough. Such limited obligations fail to adequately protect associations and their paying members from the costs of neighbor delinquency, in terms of both short-term uncertainty and ultimate association recoveries.[26] Changing the lien priority regime—to allow the first mortgagee's priority to decrease as foreclosure is delayed—is a better solution. Freeing post-foreclosure assessment claims from a dollar-capped limit would permit an association to ultimately recover the lenders' share of upkeep costs.

Decreasing a lender's priority based on the interval between mortgage default and foreclosure would likely incentivize more expeditious foreclosure sales. At first glance, this seems to run against conventional wisdom and current politics. Although lenders could choose to delay foreclosure and pay collateral carrying costs, increased lender costs pre-foreclosure could lead to faster foreclosures and faster home loss for defaulting borrowers. Even so, making lenders bear the costs of maintaining their collateral and encouraging transfer of title to

23. Hart, *supra* note 5, at 185–86; CAI Industry Data, *supra* note 8; *see also infra* Parts I.B & II.B.1 (illustrating how assessement deliquencies can lead to housing devaluation).

24. For example, one Florida CIC was a "dreamy little spot" with affordable amenities before the foreclosure crisis and before "the rats started chewing through the toilet seats in vacant units and sewage started seeping from the ceiling." Conlin & Lush, *supra* note 5; *see also infra* Parts I.B.2–3 (discussing how some states have adopted the Uniform Common Interest Ownership Act, which gives assessment liens a limited priority upon foreclosure).

25. *See infra* Part II.A.1.a (describing the six-month limited priority lien).

26. *See infra* Part II.A.1.d (discussing the inadequacy of limited priority liens).

solvent owners is the only way to contain a community's financial distress.[27] Whether foreclosure delays are caused by default volume, inadequate lender documentation, faulty procedure, predictions regarding resale, or the lender's desire to retain the defaulted loans as performing on the balance sheet, equity demands that the procrastination costs be allocated to the mortgagee rather than to the community as a whole. Lender funding of the upkeep of their own collateral avoids unjust enrichment and places costs on the parties who could have reasonably foreseen and prevented the assessment delinquencies in the first place—the lenders who should have been underwriting their potential borrowers.[28] Creating a legal means for ultimate recovery and reimbursement of neighbor-funded budget deficiencies will shore up the finances of communities and non-defaulting homeowners and help stabilize the housing market.

Part I of this Article explains the negative externalities of foreclosures and defaults in the context of CICs, as well as the limited remedies currently available to community associations under disparate state statutes. Part II.A discusses some attempted and proposed solutions to the problem of assessment nonpayment and foreclosure delay, including judicial attempts to resolve the issue through application of equity and legislative efforts to increase limited lien priority coverage. Finally, Part II.B advocates a more nuanced and targeted approach to solving the problem: capping the community's losses by allowing the first mortgage lien's priority to gradually erode during the assessment default period.

While foreclosure procedure must be closely monitored and stringently followed to protect mortgage borrowers, promoting foreclosure sales within such procedural limits helps combat negative externalities created by defaulting community members. Laws that incentivize prompt, procedurally perfect foreclosures and allow for open-ended assessment lien priority would ultimately benefit homeowners, communities, and mortgage lenders. Systematic erosion

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27. *See infra* Part II.B.2 (explaing how a community stands to benefit from an expedited foreclosure process). Furthermore, foreclosure delays result in a "free ride" for mortgagors and their lenders during the time that assessment obligations are not paid on behalf of the defaulted property. *See* Hart, *supra* note 5, at 182 (articulating the idea of "moral property"). While public policy might justify giving defaulting homeowners reasonable time to relocate, economically and philosophically, there is no justification for substantial foreclosure delays that create "collateral damage" on the surrounding community, due to upkeep costs being allocated inequitably. There is no equitable reason to give either cost-free occupancy to borrowers or cost-free collateral preservation to their lenders. In fact, the very definition of "fair allocation" would demand otherwise. *See* RAWLS, *supra* note 5, at 96 (articulating moral principles).

28. *See infra* notes 378–79 and accompanying text (discussing why shifting the financial burden to the lender would be beneficial to individuals and the economy as a whole).

of mortgage priority during foreclosure delay promotes equitable allocation of upkeep costs and efficient property transfers, and keeps lenders from getting a free ride. Compared to other potential solutions, first mortgage lien priority erosion is the best way to remedy the inequitable and community-destabilizing status quo.

I. THE PROBLEM OF PRIVATE GOVERNANCE AND MEMBER DEFAULTS

A. Negative Externalities of Default

A property owner's failure to meet assessment payment obligations creates significant negative externalities.[29] Widespread payment defaults destabilize communities, depress property values, lower local property tax revenue, and impose additional costs on public agencies that provide municipal services.[30] Although the problem of contagious declines in property values and neighborhood upkeep is often couched in terms of the spillover effect of foreclosures,[31] the most significant external harm arises not from the foreclosure sale itself, but from the default in homeowner payment obligations that preceded it.[32] Below-market foreclosure sales may temporarily reduce real estate market pricing of real estate in the immediate vicinity of the foreclosed parcel.[33] But the adverse neighborhood effect of a property in limbo (foreclosure is pending while upkeep is lacking) is both more tangible and longer-lasting.[34] The true risk of contagion, therefore, comes from default and delay rather than from the ultimate property transfer.

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29. *See, e.g.*, ALLAN MALLACH, BROOKINGS INST., METRO. POL'Y PROGRAM, ADDRESSING OHIO'S FORECLOSURE CRISIS: TAKING THE NEXT STEPS 35 (June 2009), *available at* http://www2.safeguardproperties.com/pub/Alan_Mallach.pdf (reporting on the consequences of Ohio foreclosures).

30. *See* City of Cleveland v. Ameriquest Mortg. Sec., Inc., 621 F. Supp. 2d 513, 536 (N.D. Ohio 2009) (involving a lawsuit brought by the City of Cleveland against several lending institutions), *aff'd en banc*, 615 F.3d 496 (6th Cir. 2010), *cert. denied*, 131 S. Ct. 1685 (2011); *see also* JOINT CTR. FOR HOUS. STUDIES HARV. U., AMERICA'S RENTAL HOUSING: THE KEY TO A BALANCED NATIONAL POLICY 3 (2008), *available at* http://www.jchs.harvard.edu/publications/rental/rh08_americas_rental_housing/rh08_americas_rental_housing.pdf (describing the destabilization of certain communities).

31. In a May 5, 2008 speech, for example, Chairman of the Federal Reserve Ben Bernanke warned that "high rates of delinquency and foreclosure can have substantial spillover effects on the housing market, the financial markets, and the broader economy." Ben S. Bernanke, Chairman, Fed. Reserve, Speech at Columbia Business School 32nd Annual Dinner (May 5, 2008) (transcript available at http://www.federalreserve.gov/newsevents/speech/Bernanke20080505a.htm).

32. *See infra* Part I.A.2 (discussing constructive abandonment).

33. *See infra* notes 38–39 and accompanying text.

34. *See infra* Part II.A.2 (describing the effects of a prolonged foreclosure).

1. Lower Comparable Sales Valuation

In general, property sells at foreclosure for a significant amount below an arm's-length market transaction.[35] Because the market traditionally prices homes based on comparable sales within the same community, any below-market sale creates a drag on neighboring values and sale prices.[36] In addition, mortgage default and foreclosure increases the supply of homes for sale in the given neighborhood, and increasing supply with static demand lowers market prices as well. Research published by Fannie Mae in 2006, focusing on the effect of subprime foreclosures, estimated that 41 million properties in the United States faced declining property values due to foreclosure of nearby parcels, resulting in an aggregate loss of $200 billion in value.[37] The study found that homes within one-eighth of a mile of a foreclosed property experience a 0.9% decline in value after the foreclosure sale.[38] More recent empirical studies have questioned this figure—particularly in terms of the geographic scope and duration of the foreclosure effect—arguing that the depreciation is closer to 0.5%, can quickly rebound, and that the farther away a "good standing" home resides from a foreclosed home, the smaller the psychological and market pricing impact of the foreclosure sale.[39]

Interestingly, while neighboring homeowners may decry falling property values, the downward price pressure of foreclosure sales may actually help rather than hurt the housing market as a whole. Housing prices in this country are likely still inflated above market

35. *See* John Y. Campbell, Stefano Giglio & Parag Pathak, *Forced Sales and House Prices* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 14866, 2009), *available at* http://econ-www.mit.edu/files/3914 (showing that foreclosure sales prices averaged 27% lower than the appraised value for the home). The depressed purchase price at foreclosure, however, is almost never cause to avoid the sale. *See, e.g.*, B.F.P. v. Resolution Trust, 511 U.S. 531, 545 (1994) ("We deem, as the law has always deemed, that a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with.").

36. *See* John Harding, Eric Rosenblatt & Vincent Yao, *The Contagion Effect of Foreclosed Properties*, 66 J. URB. ECON. 164, 172 (2009) (providing statistics). For a description of comparative sales methodology, see James Kimmons, *The Sales Comparison Method of Real Estate Appraisal and Valuation*, ABOUT.COM, http://realestate.about.com/od/appraisaland valuation/p/compare_method.htm (last visited Aug. 16, 2011) (discussing factors to consider in comparing properties).

37. Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single Family Mortgage Foreclosures on Property Values*, 17 HOUS. POL'Y DEBATE 57, 57 (2006).

38. *Id.*; *see also Chart of the Day: Foreclosure Contagion*, PORTFOLIO.COM (Jul. 18, 2008, 12:00 AM), http://www.portfolio.com/views/blogs/odd-numbers/2008/07/18/chart-of-the-day-foreclosure-contagion/#ixzz10I33 (discussing the effects of foreclosure on neighboring property values).

39. Harding et al., *supra* note 36, at 164–65.

"equilibrium"—meaning that the ratio of a home's value based on rental income is well below the comparable sale value of a given home.[40] Even though rents have gone up and prices have gone down, in many cases rents still cannot cover purchase-money mortgage payments, suggesting that real property prices have not yet decreased sufficiently to reach a stable, rent-neutral level.[41] There is, therefore, a systemic (market stability-based) upside to this particular aspect of foreclosure "contagion."

2. Constructive Abandonment

Comparable sales values of homes are notoriously finicky and fragile, and the foreclosure-related value losses likely represent unsustainable prior gains due to housing speculation.[42] Far more long-lasting and tangible costs arise from homeowners defaulting on their property upkeep obligations. Our system of homeownership involves both rights and responsibilities of homeowners,[43] and when owners abandon their homes, either literally, by ceasing to reside there, or figuratively, by ceasing to maintain the property, the community suffers tangible and permanent losses in value,[44] homes and neighborhoods deteriorate, and

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40. *See* Suzanne Stewart & Ike Brannon, *A Collapsing Housing Bubble?*, 29 REG. 15, 16 (2006) ("A reading well below or above 100 indicates a market that is out of equilibrium: if the reading is below 100, renting is a bargain."). In 2005, the average rental value of homes was only 70% of the purchase price nationwide and was the lowest since the Office of Federal Housing Enterprise Oversight ("OFHEO") began the index in 1985—with the next-lowest annual ratio (1989) being roughly 91%. *Id.* The rental-sale price disequilibrium was far more pronounced in certain areas of the country, such as California, Nevada, Arizona, and Florida, where home prices in the prior decade had increased by over 99%. *See* OLESIUK & KALSER, *supra* note 10 (providing statistics); *see also* Anthony Sanders, *The Subprime Crisis and its Role in the Financial Crisis*, 17 J. HOUS. ECON. 254, 254 (2008) (providing statistics).

41. *See, e.g.*, Emma L. Carew, *To Woo A Renter: Homeowners Who Punt on Selling Face Challenge as Tenants Get Choosier*, WASH. POST, Aug. 15, 2009, at E1 (providing an example from the Washington, D.C. area); *see also* Stewart & Brannon, *supra* note 40, at 16.

42. *See* Andrea J. Boyack, *Lessons in Price Stability from the U.S. Real Estate Market Collapse*, 2010 MICH. ST. L. REV. 925, 933–34 (2010) (discussing speculation and overpricing).

43. Owners of real property are obligated to pay property taxes, are required to protect against hazards and nuisance on their properties, and face liabilities related to environmental hazards thereon. Real property cannot be abandoned. *See* RESTATEMENT (FIRST) OF PROP. § 504 cmt. a (1944) (explaining why easements may be abandoned more easily than other land interests); *see also, e.g.*, Pocono Springs Civic Ass'n v. MacKenzie, 667 A.2d 233, 235 (Pa. Super. Ct. 1995) (discussing the law of abandonment in Pennsylvania). Property law requires that some entity always hold seisin, because the holder of seisin is the gatekeeper, or responsible party, with respect to that parcel of realty. *See* THOMAS W. MERRILL & HENRY E. SMITH, PROPERTY: PRINCIPLES AND POLICIES 201 (2007) (discussing the role of gatekeeper as it relates to adverse possession).

44. *See* Ivana Kottasova, *A House Dies and a Block Sinks*, BROOK. INK (Mar. 9, 2011), http://thebrooklynink.com/2011/03/09/23899-a-house-dies-and-a-block-sinks/ ("Vacant properties are often not maintained properly and show signs of physical distress . . . . That itself causes property values to go down—and then the area becomes less attractive for residents." (quoting Josiah

the absence of a vigilant gatekeeper for the property allows vandalism and other crime to increase.[45] A defaulting homeowner facing imminent or even eventual mortgage foreclosure has little incentive to invest anything in the home and, thus, will forego many socially desirable activities: painting shutters, cleaning gutters, mowing the lawn, or fixing broken appliances or cabinets.[46]

The mere drop in home value itself can start the trend toward owner constructive abandonment because once a property is "upside-down" or "underwater" (more is owed on a mortgage loan than the property is worth), any improvements or maintenance made on a home effectively becomes "sweat debt" (value created for the lender) rather than "sweat equity" (value created for the owner). Some commentators have suggested that a typical borrower will consider walking away from a mortgage when the home value falls below 75% of the amount owed on the mortgage.[47] More than 5 million homeowners in the United States

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Madar)). The negative externalities caused by failure of an owner to exercise adequate property oversight are among the many justifications for the doctrine of adverse possession. *See* John G. Sprankling, *An Environmental Critique of Adverse Possession*, 79 CORNELL L. REV. 816, 816 (1994) (advocating an environmental reform of the adverse possession doctrine).

45. *See, e.g.*, John Cutts, *Neighborhood Cleanup Might Improve Cheap Houses for Sale Numbers*, REAL ESTATE PRO ARTICLES (July 7, 2010, 10:15 AM), http://www.realestateproarticles.com/Art/19024/278/Neighborhood-Cleanup-Might-Improve-Cheap-Houses-for-Sale-Numbers.html (discussing foreclosures in San Antonio); Seth Slabaugh, *High Vacancy Rates in Inner-City Muncie*, STAR PRESS (Feb. 26, 2011), http://pqasb.pqarchiver.com/thestarpress/access/2276988201.html?FMT=ABS&FMTS=ABS:FT&date=Feb+26%2C+2011 (reporting on the numerous vacancies in Muncie, Indiana); Yepoka Yeebo, *Coping With Chicago's Foreclosure 'War Zones,'* HUFFINGTONPOST.COM (Mar. 2, 2011, 9:49 AM), http://www.huffingtonpost.com/2011/03/02/chicago-vacant-reo-property_n_829343.html (lamenting vacancies in Chicago).

46. *See* Steve Vitali, *HOA's are Important to Our Valley Communities*, LAS VEGAS REV. J. (Mar. 12, 2011), http://www.lvrj.com/real_estate/hoas-are-important-to-our-valley-communities-117848853.html?ref=853 (describing efforts by the Nevada legislature); Tammy Leonard, Home Appreciation, Default Risk and Neighborhood Upkeep 3 (June 10, 2009) (unpublished manuscript), *available at* http://www.utdallas.edu/~muurdoch/NeighborhoodChange/Tammy/Appreciation_Default_Upkeep_v11.pdf (examining the relationship between houshold maintenance expenditures and default risk). Some homeowners who have defaulted on their mortgages and know that they will ultimately lose their home in foreclosure affirmatively and permissively create waste—some homeowners rip out fixtures and actively destroy improvements on the real property. *See Report: Owners of Foreclosed Homes Steal Appliances, Leave Houses in Disarray*, FOXNEWS.COM (Feb. 4, 2009), http://www.foxnews.com/story/0,2933,487884,00.html (reporting that some homeowners retaliate against lenders by damaging and looting their homes prior to foreclosure sales); James Thorner, *In home foreclosure, if it's not nailed down...*, ST. PETERSBURG TIMES (Feb. 19, 2008), http://www.sptimes.com/2008/02/19/Business/hi_home_foreclosure__.shtml (reporting that, in Florida, 20% of owners strip their houses prior to foreclosure); James Walsh, *Monsey, NY—House Demolished Just Before Auction for Mortgage Default*, VOS IZ NEIAS? (Feb. 4, 2009, 8:41 AM), http://www.vosizneias.com/26875/2009/02/04/monsey-ny-house-demolished-just-before-auction-for-mortgage-default/ (reporting a situation where homeowners destroyed their entire house before a foreclosure sale).

47. David Streitfeld, *No Aid or Rebound in Sight: More Homeowners Just Walk Away*, N.Y.

reached this "tipping point" of underwater valuation by the third quarter of 2009.[48]

According to the Rassmussen Report, 31% of U.S. homeowners with a mortgage owed more on their homes than their homes were worth as of the end of 2010.[49] Deutsche Bank predicted that 48% of American homes could have negative equity by the end of 2011.[50] Along with the numerous defaults on home mortgages caused by the inability to pay, more and more borrowers who are financially able to pay are strategically defaulting on their mortgages.[51] When the lender holds 100% (or more) of the current value of a home, many homeowners feel that there is no financial incentive to continue to pay the mortgage or, for that matter, the community association assessments.[52]

3. Government Rescue Efforts

The negative externalities of homeowner constructive abandonment have been cited to justify policies and programs aimed at helping homeowners facing foreclosure.[53] Many of these programs create additional incentives for lenders to pursue loan modifications or permit

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TIMES, Feb. 3, 2010, at A1.

48. *Id.*; *see also* Thompson, *supra* note 1, at 55 ("Housing prices peaked in the United States in early 2005 and began declining in 2007. Foreclosures then increased in the United States at record levels throughout 2006, continuing throughout 2008."); *Negative Equity Report for Q3*, CALCULATED RISK (Nov. 24, 2009, 4:00 PM), http://www.calculatedriskblog.com/2009/11/negative-equity-report-for-q3.html ("Nearly 10.7 million, or 23 percent, of all residential properties with mortgages were in negative equity as of September, 2009.").

49. Peter Schroeder, *Poll: Nearly One-Third of Homeowners Underwater on Mortgage*, THE HILL (Mar. 21, 2011, 1:29 PM), http://thehill.com/blogs/on-the-money/801-economy/151039-poll-nearly-one-third-of-homeowners-underwater-on-mortgages. Previously, in the first quarter of 2010, Zillow.com had estimated that 23% of homes in the United States were worth less than mortgage loan amounts secured by the property. Brian Louis, *U.S. Mortgage Holders Owing More Than Homes Are Worth Rise to 23% of Total*, BLOOMBERG (May 10, 2010, 3:31 AM), http://www.bloomberg.com/news/2010-05-10/u-s-mortgage-holders-owing-more-than-homes-are-worth-rise-to-23-of-total.html.

50. Zuckerman, *supra* note 4.

51. *See* Gail Marks-Jarvis, *Ethics of Strategic Default are Really Hitting Home*, CHI. TRIB., Oct. 7, 2010, at 7.1 ("Morgan Stanley recently estimated that about 18 percent of defaults will be strategic.").

52. Underwater homeowners have no incentive to pay property taxes either, but counties are always first in line to collect unpaid tax amounts from foreclosure proceeds. There is no cap on the amount of unpaid property taxes that a county can collect from the purchase price at a foreclosure sale.

53. *See* CONGRESSIONAL OVERSIGHT PANEL, EVALUATING PROGRESS ON TARP FORECLOSURE MITIGATION PROGRAMS, APRIL OVERSIGHT REPORT (2010) [hereinafter APRIL OVERSIGHT REPORT] (discussing the Home Affordable Modification Program ("HAMP") and its successes and failures over the first year); *see also* David Streitfeld, *Program to Pay Homeowners to Sell at a Loss*, N.Y. TIMES, Mar. 7, 2010, at A1 (stating that the Obama Administration's latest program "will allow owners to sell for less than they owe and will give them a little cash to speed them on their way").

short sales in lieu of foreclosure.[54] To the extent that loan modifications create true incentives for owners to remain invested in their property by reassuming the gatekeeper role and paying upkeep costs and the like, such modifications would help eliminate the property value losses discussed above and should be promoted as sound policy. To the extent that short sales would streamline the process of replacing insolvent owners with financially capable "gatekeepers," short sale incentives would also benefit the community and deserve to be encouraged.[55] Unfortunately, however, these government efforts have mostly failed to create viable mortgages and ensure homes are held by owners able to meet their assessment obligations. Even with payment reductions and government assistance, more than three-quarters of the mortgage loans that were modified under the Home Affordable Modification Program ("HAMP") remained underwater in April 2010.[56] The initiative for expedited short sales likewise has been mostly unsuccessful.[57]

One obstacle to greater success through loan modifications and/or short sales is the problem of junior liens.[58] Not only do many financially imperiled homes today have subordinate liens from second mortgages and home equity lines, but the community association in any CIC will have a lien securing its rights to recover unpaid assessments.[59] Junior lienors, including community associations, can stymie modification plans by withholding consent to proposed changes to the senior loan.[60] A community association's board might lack the

54. Short sales are tri-party agreements amongst a defaulting mortgage borrower, the mortgage lender, and a third-party purchaser, whereby the purchaser agrees to buy the property for less than the outstanding loan amount, and the lender agrees to accept payment of the buyer's purchase price in full satisfaction of the borrower's mortgage loan.

55. Streitfeld, *supra* note 53, at A1.

56. APRIL OVERSIGHT REPORT, *supra* note 53, at 39.

57. Andrew Jeffrey, *Housing Market: Foreclosure Relief Programs Under Fire*, MINYANVILLE (Mar. 14, 2011, 10:00 AM), http://www.minyanville.com/businessmarkets/articles/foreclosure-forelcosure-relief-program-homeowners-loan/3/14/2011/id/33322.

58. Loan modifications without junior lienor consent can result in a complete loss of priority for the senior lienholder. Short sales are made subject to all junior liens, if these are not paid off or voluntarily released, as part of the sale. *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 871–76 (5th ed. 2007) (discussing the relationship between junior and senior liens); *see also* Robert Kratovil & Raymond J. Werner, *Mortgage Extensions & Modifications*, 8 CREIGHTON L. REV. 595, 610 (1975) (stating that an original clause in the record granting the senior lienor the ability to increase the interest rate on the giving of any extension will not be sufficient for priority for that increased interest over junior lienors, due to prejudice).

59. Many properties in default have other junior lienors as well, including second purchase money mortgages or home equity lines of credit. In many, but not all, states, second mortgages are junior in priority to the association's lien.

60. Loan modifications occurring without the consent of junior lienors are vulnerable to priority loss should a court determine that the modification adversely impacts the secured position of the junior lienor. Many loan modifications, however, have been upheld as non-prejudicial to a

authority to engage in debt forgiveness with respect to delinquent assessments, since this effectively imposes more costs on the remainder of the community and violates the payment allocation provisions of the CIC's governing documents.[61] The argument that in a bad mortgage debt situation, both a borrower and a lender should compromise by giving up value (in terms of lost equity and lost loan proceeds) is compelling.[62] But no similar logic supports a claim that non-party neighbors should be forced to bear losses due to other people's poorly conceived loans. This is one reason the "Helping Families Save their Homes Act of 2009" was voted down in the U.S. Senate: the proposed law would have given bankruptcy judges the ability to mandate massive write-downs on unpaid assessment liens, essentially blocking the already limited ability of associations to collect delinquent assessments and continue to perform their essential functions.[63] If the government truly wants to encourage short sales or modifications in privately governed communities, it must ensure that the workout (a) ultimately stabilizes the community and (b) is not forcibly financed by the non-delinquent neighbors.

Government programs that encourage property to be efficiently conveyed to solvent and responsible owners ameliorate the harm caused

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community association. *See, e.g.*, Dime Sav. Bank of N.Y., F.S.B. v. Levy, 615 N.Y.S.2d 218, 220 (Sup. Ct. 1994) (holding that a modification extending the first mortgage loan term remained a first priority lien, and short sales required cooperation of junior lienors (or full repayment of such obligations) to transfer unencumbered title to the proposed buyer).

61. *See* ROBERT G. NATELSON, LAW OF PROPERTY OWNERS ASSOCIATIONS 437 (1989) (discussing the impact of association conduct on the value individual condominium units); *see also* HYATT & FRENCH, *supra* note 15, at 319, 567–68 (stating that homemakers of a community generally rely on uniform enforcement of covenants that are in furtherance of the original developmental scheme).

62. This argument is often used to promote modifications and short sales. *See* David Benoit, *Bank Of America Begins Mortgage Principal Reduction Program in Arizona*, FOX BUS. (Mar. 2, 2011), http://www.foxbusiness.com/industries/2011/03/02/bank-america-begins-mortgage principal-reduction-program-arizona/ (discussing Arizona's program "using federal money to get Bank of America to lower the amount borrowers owe on their mortgages"); Dave Clarke, *U.S. Regulators Strike Deal on Mortgage Risk Rule*, REUTERS, Mar. 1, 2011, *available at* http://www.reuters.com/article/2011/03/01/financial-regulation-qrm-idUSN0113980220110301 (examining banking regulator's provision forcing services to modify loans if it would save the lenders and borrowers money); Abigail Field, *What the Mortgage Mess Settlement Proposal Really Means*, DAILY FIN. (Mar. 9, 2011, 12:20 AM), http://www.dailyfinance.com/story/credit/what-the-mortgage-mess-settlement-proposal-really-means/19872233/ ("Servicers have to show their math when announcing if a modification is denied."); David McLaughlin & Lorraine Woellert, *Attorney Generals Push for Loan Reductions, Seek Bank Accord*, BLOOMBERG (Mar. 8, 2011, 12:01 AM), http://www.bloomberg.com/news/2011-03-07/foreclosure-settlement-said-to-be-sought-by-states-u-s-within-two-months.html (discussing how state attorneys general are pushing for reduced balance settlements between lenders and borrowers).

63. H.R. 1106, 111th Cong. §§ 202–03, 532 (2009) (defeated in a Senate vote on April 30, 2009).

by owner payment defaults.[64] But most government attempts to mitigate the damage caused by mortgage defaults have failed to adequately address the problems caused by upkeep reduction, and, in fact, some have exacerbated the spillover effects of default. For example, although purporting to help homeowners, foreclosure moratoriums can perpetuate the constructive abandonment maintenance problem.[65] Forced loan modifications—to the extent they merely postpone the inevitable and leave a borrower unable (or unwilling) to pay assessments—do the same.[66] Any government interference that slows foreclosure may (at least in the short-run) help an individual defaulting mortgagor and might, in a temporarily "down" market, even help the mortgage holder ultimately recover more on its loan, but in CICs, these benefits are funded by the neighbors. Keeping an ultimately doomed mortgage loan on this sort of life support increases current and carrying costs borne by neighboring owners, increases CIC assessment levels, and drives down property values.

64. Unlike HAMP and the initiative promoting short sales, the Neighborhood Stabilization Program of the Department of Housing and Urban Development ("HUD") has focused on infusing money into communities directly, buying abandoned homes, renovating them, and contributing to the community's upkeep and property values. This HUD program is effectively the antithesis of foreclosure moratoriums: it encourages sales of constructively abandoned properties to prevent communities from hearing the negative externalities such properties cause. HUD provided $6 billion in two rounds of Neighborhood Stabilization Program funding, some of which was supplemented by state funds to create successful and effective localized programs. For example, $5.6 million in federal funds combined with $30 million in resources from the Twin Cities Community Land Bank created an entity able to buy up 250 blighted and defaulting properties in targeted neighborhoods. These properties were rehabilitated (updated to green standards) and sold to "responsible homeowners." Shaun Donovan, *Fighting Foreclosures and Strengthening Neighborhoods*, U.S. DEP'T OF HOUS. AND URBAN DEV. BLOG (Sept. 3, 2010), http://portal.Hud.gov/portal/page/portal/HUD/press/blog/ (discussing the effectiveness of The Neighborhood Stabilization Program as an example of a fairer and more forward-looking approach to the contagion effects of mortgage defaults in communities).

65. Moratoriums can perpetuate the tenure of owners who are unwilling or unable to bear the costs of ownership, including paying community assessments, property taxes, and basic property upkeep costs, delaying the conveyance of property owning responsibilities to an owner willing to assume such responsibilities. *See, e.g.*, Jennifer Slosar, *Chicago Coupe Deals with Toxic Mold, Unresponsive Bank*, CHI. J. (Oct. 6, 2010), http://www.chicagojournal.com/News/10-06-2010/Chicago_couple_deals_with_toxic_mold,_unresponsive_bank ("As the foreclosure process stretches past the two-year mark, they are struggling to maintain the empty unit and stanch the bleeding in their homeowners association fund from lost assessments."); *see also* Zhu & Pace, *supra* note 18, at 12–17 (stating that foreclosure delays encourage mortgage default and lack of owner upkeep and investment in the property, all of which drives down the value of homes and drives up costs of financing and "may impede the recovery of the housing market").

66. This is because the longer a non-payment problem persists in a community, the more costs are inequitably borne by paying neighbors. If a modification merely delays an ultimate, inevitable foreclosure, it is unlikely that a neighbor will bring his or her association assessments current in the interim, and the threat of permissive and affirmative waste remains.

Foreclosure rescue efforts have mostly failed to create viable long-term mortgage loans, and the most worrisome contagious effects of homeowner defaults remain, since true losses arise not from foreclosure sales themselves, but from a chronic reduction in neighborhood upkeep and inequitable upkeep costs.[67] This fact reinforces the main contention of this Article: delaying foreclosure and allowing property to deteriorate is a lose-lose scenario, avoidable only by ensuring that properties are owned by people who are able and willing to maintain the property and pay association assessments. This is particularly true in CICs where there are additional, direct and compelling cost externalities with respect to payment defaults, so the contagion effect is more pronounced.[68]

B. Financial Entanglement

1. The CIC Ownership, Assessment, and Services Model

The CIC structure is a privatized governance solution to the collective action and free-rider problems often termed the "tragedy of the commons."[69] Widespread private property ownership in the United States has minimized the number of publicly maintained "commons,"[70] and until recently, federal, state, or local governments maintained most of those areas that could not be divided and privatized.[71] In the past

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67. Harding et al., *supra* note 36, at 165, 172, 178; *see also supra* Part I.A.2 (discussing the notion of constructive abandonment).

68. *See infra notes* 83–88 and accompanying text (describing why delayed foreclosure is particularly harmful in CICs).

69. Garret Hardin, *The Tragedy of the Commons*, 162 SCI. 1243, 1244–45 (1968); *see also* Thrainn Eggertsson, *Open Access versus Common Property*, in TERRY L. ANDERSON & FRED S. MCCHESNEY, PROPERTY RIGHTS: COOPERATION, CONFLICT AND LAW, 74–82, 84–85 (2003) (discussing the tragedy of subsequent empirical studies as a result of Garret Hardin's *The Tragedy of the Commons*); James E. Krier, *The Tragedy of the Commons, Part II*, 15 HARV. J.L. & PUB. POL'Y 325, 325 (1992) (acknowledging Garret Hardin as having addressed the problem of coordinating human behavior as it affects environmental quality); Mark A. Lemley, *Property, Intellectual Property and Free Riding*, 83 TEX. L. REV. 1031, 1037 (2005) ("The tragedy of the commons is a specific example of the more general preoccupation of the economic literature on real property with the internalization of externalities and with the use of property law to achieve that end.").

70. Throughout U.S. history, the government has aggressively sought to sell land to private owners. This was the impetus behind Thomas Jefferson's Land Ordinance Act, for example. *Land Ordinance of 1785*, *in* DOCUMENTS OF AMERICAN HISTORY 123–24 (Henry S. Commager ed., 1940); *see* Richard P. McCormick, *The "Ordinance" of 1784?*, 50 WM. & MARY Q. 112, 116–17 (1993) (discussing the scheme for selling and disposing of land acquired under the Ordinance as a reason why it was not adopted in its original form).

71. *See, e.g.*, 39 AM. JUR. 2D *Highways, Streets, and Bridges* § 212 (2011) (discussing usage rights for public property adjacent to private property); 59 AM. JUR. 2D *Parks, Squares, and Playgrounds* § 23 (2011) (discussing the proper use of property such as parks and squares); *see also* Lemley, *supra* note 69, at 1038 (discussing government regulation of property rights due to

century, courts began to routinely hold that community covenants creating payment obligations for common area upkeep were servitudes running with the land.[72] This judicial interpretation enabled the rise of private governance and assessment systems across the United States. In privately governed neighborhoods, common space and amenities are maintained by an association, which assesses each owner a share of the upkeep costs.[73] The association provides sufficient governance to solve the tragedy of the commons by controlling overuse and creating a mechanism for maintenance and shared costs,[74] which in turn permits communities to avoid the economic downside of public goods, meaning that a neighborhood can enjoy better amenities at lower prices.[75] The association is essentially a mini-government, performing public functions: upkeep of common areas and amenities, rule-making, and dispute resolution.[76] Association assessments are therefore, to some extent, the equivalent of property taxes, a mechanism to fund common

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negative externalities).

72. Neponsit Prop. Owners Ass'n, Inc. v. Emigrant Indus. Sav. Bank, 15 N.E.2d 793, 797 (N.Y. 1938). Prior to *Neponsit*, covenants to pay money were viewed as personal, not running with the land because they did not adequately "touch and concern" real property. The *Neponsit* characterization of this covenant as creating a real property servitude, however, spurred the growth of suburban communities across the country. Enforcing payment obligations as servitudes on real property is now *de rigueur*. *See, e.g.*, Regency Homes Ass'n v. Egermayer, 498 N.W.2d 783, 788–93 (Neb. 1993) (holding that a covenant to pay dues to a community association to maintain recreational facilities is a real covenant that runs with the land).

73. Most associations' governing documents explicitly provide for assessment funding of association obligations. HYATT, *supra* note 15, at 108 ("Generally, covenants in the declaration provide authority for the association to collect assessments from each owner."). Even in situations where governing documents for community associations have failed to provide for assessments, courts find the power to assess implicit in the structure of a CIC. *See, e.g.*, Fogarty v. Hemlock Farms Cmty. Ass'n, 685 A.2d 241, 244 (Pa. Commw. Ct. 1996) ("[A]bsent language in the deed covenant prohibiting HFCA from levying special assessments for capital improvements, the [property owners] may be assessed their proportionate costs to construct the new improvements."); Meadow Run & Mountain Lane Park Ass'n v. Berkel, 598 A.2d 1024, 1027 (Pa. Super. Ct. 1991) (finding that inherent in the duty to provide maintenance is the power to assess costs to property owners). *But see, e.g.*, Bd. of Dirs. of Carriage Way Prop. Owners Ass'n v. W. Nat'l Bank of Cicero, 487 N.E.2d 974, 978–79 (Ill. App. Ct. 1985) ("[T]he [association] cho[o]s[ing] to continue to maintain the common areas does not render the [property owners] unjustly enriched."); Wendover Road Prop. Owners Ass'n v. Kornicks, 502 N.E.2d 226, 231 (Ohio Ct. App. 1985) (declining to apply quasi-contract or unjust enrichment theories to require a property owner to pay assessments when the deed conveying the property did not provide for such an assessment).

74. *See* HYATT, *supra* note 15, at 29–32 ("The community association allows innovation, provides for responsibility and obligation, and provides the necessary power to meet these responsibilities.").

75. CAI INDUSTRY DATA, *supra* note 7; *see* TREESE ET AL., *supra* note 16, at 6 (noting that common upkeep also allows a community to take advantage of cost savings from economies of scale).

76. *See* TREESE ET AL., *supra* note 16, at 6 (discussing the municipal responsibilities the associations now assume).

costs, and are treated as such by the income tax laws of at least two states.[77]

For condominiums, a private governance and assessment system is not only beneficial, it is essential. Once states passed statutes allowing fee simple ownership of a three-dimensional "box" of space,[78] multiple individuals could become owners of distinct units within one building. But having many owners within one building mandates certain jointly-held property: the roof, lobby, elevators, hallways, laundry rooms and, in some buildings, water, sewer, trash, electricity, and gas, as well as hazard insurance on the building itself. The mechanism of private community governance provides and pays for all such commons equitably and efficiently.[79]

Typically, CIC governing documents explicitly vest the association with broad authority to assess members according to budgetary needs,[80] and courts have found that even when an association's documents lack explicit authorization, assessment power is implied.[81] As long as the assessments are authorized, it is clear that the obligation to pay assessments is both an *in personam* obligation of a homeowner and an *in rem* affirmative covenant that runs with the land and is binding on all successor owners of the property.[82] The obligation to pay assessments is the most vital obligation in a privately governed community because

77. In New Jersey, the correlation of community assessments and property taxes has been acknowledged by the legislature, which now permits a portion of community assessment payments to offset local property tax assessments. N.J. STAT. ANN. §§ 40:67-23.2-23.3 (West 1993); *see also* K. Kennedy & B. Lambert, *New Developments in Municipal Services Equalization*, 3 J. CMTY. ASS'N L. 1 (2000) (illustrating that the New Jersey Municipal Services Act, which requires a municipality to provide certain public services to private communities, provides a framework for the eradication of the double taxation of these communities). Recently, Pennsylvania's legislature followed suit, passing a law that allows a unit owner in a CIC to deduct 75% of association assessments from state income taxes. H.R. 675, 2009 Gen. Assemb. Reg. Sess. (Pa. 2009). On the other hand, many of the community-provided services supplement local governmental functions rather than replace them and instead operate to replace individual upkeep costs. The trend toward municipal services equalization legislation—refunding members of a CIC local government taxes for items paid for by the association—is discussed in TREESE ET AL., *supra* note 16, at 3.

78. Under the common law, real property is owned in a column of space defined with respect to a two-dimensional real property mapping description, indicating a closed figure on the face of the earth.

79. *See* Robert C. Ellickson, *Cities and Homeowner Associations*, 130 U. PA. L. REV. 1519, 1522–23 (1982) (discussing the method of assessments and distribution of costs amongst property owners).

80. Associations meet their budget requirements through a combination of regular assessments, special assessments, and transfer fees.

81. HYATT, *supra* note 15, at 105–09. *See, e.g.*, *supra* note 73 (discussing whether an association has the authority to demand assessments from its members).

82. HYATT, *supra* note 15, at 105–17.

assessments are a community's "lifeblood" and its primary (and sometimes only) funding source.[83] As Wayne Hyatt, author of the seminal treatise on CICs, explains, "when one member of the community chooses not to pay the assessments, everyone in the community pays the price through increased assessments, decreased services, and declining community appearance and quality of living."[84]

Two aspects of association assessments are important for purposes of this discussion: their collectability and their durability. The ability to collect delinquent assessments is of crucial importance in a context—such as today—where increasing mortgage defaults indicate an even steeper increase in assessment delinquency.[85] In addition to the ability to assess charges, associations have the power to place a lien on a member's real property to secure the assessment payment obligation.[86] In some states, such liens arise and are perfected on the date the association's documents are recorded in the land records.[87] In other states, the lien arises and is perfected automatically at the time an assessment comes due.[88] Still, in other states, perfection of an assessment lien requires filing a notice of the lien in the appropriate land records.[89] Whether this lien has payment priority over a first mortgage can determine whether an association will be able to ultimately collect. Assessment liens are generally junior in priority to first mortgage liens on the units,[90] and junior interests are extinguished upon the foreclosure of a senior priority lien.[91]

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83. *Id.* at 105, 121.

84. *Id.* at 121.

85. Association assessment defaults are nsually well in advance of loan payment delinquencies. *See* Pinkerton, *supra* note 12, at 142–43 (discussing how dnes and debts create a "death spiral").

86. HYATT, *supra* note 15, at 120–21.

87. For example, in Colorado, a perfected association lien exists as of the date of filing the declaration. COLO. REV. STAT. § 38-33.3-316 (2009). Although this perfected lien could be essentially an "empty bucket" securing no indebtedness, it has statutory priority relating back to the date the community was created. First mortgages on units in such states, however, enjoy a special statutory super-priority over the pre-existing association lien.

88. Under the Uniform Common Interest Ownership Act § 3-116 (1994) (amended 2008), recording of the declaration creating a common interest community constitutes record notice and perfection of the lien for all future assessments. *See also infra* note 190 and accompanying text (explaining that the Uniform Common Interest Ownership Act takes the position that assessment liens are considered automatically perfected with the date of perfection relating back to the date the association was formed).

89. *See, e.g.*, F.N. Realty Servs., Inc. v. Or. Shores Recreational Club, Inc., 891 P.2d 671, 674 (Or. Ct. App. 1995) (finding that an association lien arises only upon recordation of notice of lien).

90. *See infra* Part I.C.2 (noting that liens on real property enjoy a priority based on the order in which they were perfected).

91. NELSON & WHITMAN, *supra* note 58, at 872–73 ("[I]f a junior lienor is forced to satisfy

CICs are contractually bound to maintain the property and provide other services mandated by the documents creating the servitude regime.[92] State and local laws may mandate the provision of other services and/or a certain level of association reserves, in addition to document-based requirements.[93] The FHA will only insure loans secured by units in communities with sufficient reserve funding.[94] Although reserve requirements support an association's future financial health, increasing the required reserves means that the association must collect additional funds today. Raising the reserve requirement can exacerbate the problem of increasing assessments for paying members in an environment of widespread payment defaults.[95] The upkeep and reserve funding obligations of the association are not contingent on the condition of the economy or the payment participation of all members, and assessments are the association's sole source of income.[96]

2. Tragedy of the Financial Commons

The legal structure of CICs was an attempt to solve the tragedy of the commons by establishing a government that could manage common resources, preventing overuse and under-maintenance.[97] Such a private consortium democracy with governance obligations and powers theoretically can create a better neighborhood for all. But since the homeowners in CICs jointly bear funding responsibilities for essential

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the senior mortgage in order to protect his or her position, the amount required for such satisfaction will be more than could have been contemplated at the time the junior interest was acquired.").

92. HYATT, *supra* note 14, at 43.

93. States require reserve studies by condominiums and homeowner associations to ensure adequate reserves are collected. *See, e.g.*, VA. CODE ANN. § 55-514.1 (2002) and § 55-79.83.1 (1993) (requiring a condominium's executive organ or a homeowner association's board of directors to conduct a study to determine the necessity and amount of reserves required at least once every five years and review the results of that study at least annually).

94. Reserve requirements are 60% of the annual budget for established condominiums and 100% of the budget for new projects. Letter from Brian D. Montgomery, Assistant Sec'y for Hous., Fed. Hous. Comm'r, to All Appr. Mortgagees and All FHA Roster Appraisers (June 12, 2009) (on file with author).

95. *See, e.g.*, Josh Brown, *Condo Assessments are the Breaking Point for Some*, VA. PILOT (Sept. 20, 2009), http://hamptonroads.com/2009/09/condo-assessments-are-breaking-point-some (explaining that a homeowner faced loss of home through association foreclosure because of an inability to pay an assessment increase to fund the increased reserve requirement mandated by statute).

96. Some associations charge user fees, but most association costs are covered exclusively by assessments paid by unit owners. *See* HYATT & FRENCH, *supra* note 14, at 319 (stating that the most common approach to financing the operations of community associations is the assessment of a share of common expense); HYATT, *supra* note 14, at 121 (noting that assessments are generally the primary funding source).

97. MERRILL & SMITH, *supra* note 43, at 772.

commons upkeep, the fiscal fortunes of the members of a community are intertwined. A change in the economic fortunes of one owner can therefore impact the other owners. Defaults of members on payment obligations cause a direct and devastating impact on the other members of the community who must fund the difference. Sam Chandan, chief economist at the real estate research firm Reis, explained the connection between the upside of joint maintenance and the downside of economic entanglement:

> What motivated people to go into the condo market in a way that led to overbuilding was the expectation that it would be easier than owning a home on a maintenance basis. The downside is that your fate is tied to 50 to 100 other people who may stop making their condo payments.[98]

Although the possibility of member assessment default had long been understood, before 2006, no one anticipated that so many highly leveraged mortgages taking so long to foreclose would eventually put a huge strain on community associations.[99] But today's delinquency rate for assessments has caused many of these associations to fail.[100] Their failure leaves the community without its expected amenities and upkeep and leaves the commons to its natural economic "tragedy" because local municipalities need not provide public services that were previously left to private associations to fund and provide.

Most courts have held that CIC associations cannot declare bankruptcy as long as they retain the power to assess for budgetary shortfalls.[101] Thus, solvent owners must fund their delinquent neighbors' deficiencies. Delinquency levels in some parts of the country have seen astronomical increases since 2005. One management firm in the Boston area reported a 150% increase in delinquent assessments from 2006 to 2007.[102] Vulnerability to increased assessments to fund neighbor shortfalls and the inability of an

98. Haughney, *supra* note 6, at C1 (quoting Chandan).

99. The closest precedent is New England in the late 1980s and early 1990s when many associations were left with debilitating budgetary shortfalls as many owners defaulted on their mortgages and other payment obligations. It was this regional crisis among CICs that led Massachusetts to adopt a six-month lien priority for CIC association liens. *See infra* note 213 (explaining that the six-month super priority in UCIOA was meant to solve this same issue, but the authors of that model legislation did not foresee that in today's climate of extensive and long-delayed foreclosure, six months would generally be inadequate).

100. *See* Pinkerton, *supra* note 12, at 125 (discussing the "crushing" nature of association debt).

101. *See infra* Part I.B.4 (explaining why it is unfeasible for condominium associations to file for bankruptcy).

102. Sacha Pfeiffer, *Delinquencies at Condos Can Cost Neighbors*, BOS. GLOBE, Oct. 16, 2007, at C1.

association to perform contractually required maintenance in the face of member default causes a significant adverse impact on the value of properties within a CIC.[103]

Where available, statistics regarding the problem of assessment delinquencies underscore the magnitude of the problem. According to a study cited by *The Miami Herald*, more than 60% of Florida condominiums and homeowner associations reported in March 2010 that at least half of their units were at least two months behind in paying their assessments.[104] Losing half of the required revenue completely hamstrings the operation of these associations. For example, Parkview Point Condominium in Miami Beach suffered a large enough loss of assessment revenue that it was unable to pay water bills for the building, and the unit owners nearly had their water cut off before solvent owners were able to raise funds to pay the arrearage.[105] The lobby ceiling repairs, however, were stopped mid-repair, leaving wiring and ducts exposed.[106] On the nation's other coast, Gas Lamp City Square in downtown San Diego awaits pending foreclosure sales on multiple units in the building while the association struggles with a $115,000 budgetary shortfall because of unpaid dues.[107] In Union City, California, a special assessment for roof repairs in Alvarado Village ended up costing each paying owner $18,494.27.[108] A couple in San Francisco reports that over the past three years, their special assessments have exceeded $100,000.[109]

Pervasive assessment default unfairly impacts the paying neighbors financially and psychologically, and anecdotal evidence underscores the reality behind the troubling statistics of unpaid community dues. Ana Martinez, for example, reported that she no longer felt safe living in her own home—a unit within a South Florida condominium that was deteriorating in the face of the association's inability to pay for

103. *See, e.g.*, Bd. of Dirs v. Wachovia Bank, N.A., 581 S.E.2d 201, 206 (Va. 2003) (Lacy, J., dissenting) ("Part of the value of a condominium unit comes from the ability of the condominium association to maintain the common areas of the development . . . . The ability to maintain these elements is directly related to the association's ability to secure payment of assessments from the individual unit owners.").

104. Rachael Lee Coleman, *Desperate Condos Thrown a Lifeline*, MIAMI HERALD, Mar. 7, 2010, at 1A.

105. Haughney, *supra* note 6, at C8.

106. *Id.*

107. *Id.*

108. James Temple, *Neighborhood Fees Go Through the Roof*, CONTRA COSTA TIMES (May 29, 2006), http://www.calhomelaw.org/doc.asp?id=487. The Alvarado Village association also blamed the large special assessment on the property developer who they claim failed to adequately fund reserves. *Id.*

109. Lloyd, *supra* note 11.

maintenance.[110] Some of Ana's neighbors had literally abandoned their units, leaving behind not only unpaid and underwater mortgage loans, but also months of unpaid condominium assessments.[111] Ana's monthly assessment tripled in response to the condominium's budget shortfall, and her property's value fell and continues to plummet in the face of lower occupancy, higher crime, and substandard common area maintenance.[112]

In a modest, low-income area of Providence, Rhode Island, Debra McGarry was forced to take out a $4800 personal credit card loan to keep water, gas, and electricity from being cut off in the eight-unit condominium building in which she lives.[113] Two of the owners in the building stopped paying dues and abandoned their homes, nearly bankrupting the small condominium.[114] Even doubling the condominium fees that the remaining six paying owners were assessed failed to generate enough capital to keep the building afloat.[115] The "affordable" unit Debra and her husband Bernard, a disabled veteran, bought in 2006 ended up being their financial "nightmare" since Debra and her solvent neighbors were left to personally pick up the tab left by lenders who failed to foreclose on strategically defaulted mortgages.[116]

The problem of assessment delinquencies is not confined to lower income owners. Many owners of ritzy Manhattan condominiums that come with top-flight amenities (gym membership, butler and maid service, billiards room, and library) can no longer afford the cost of such services because of a rash of unit owner assessment defaults.[117] In the past year, foreclosure filings for Manhattan condominiums doubled, and now, one in every thirteen units are in some stage of foreclosure.[118] Foreclosures in New York take longer than in any other state, and at the current pace, it would take lenders sixty-two years to complete foreclosure on the 213,000 homes now in severe default.[119] During the

110. Sutta, *supra* note 6.
111. *Id.*
112. *Id.*
113. Dunn, *supra* note 6, at G1.
114. *Id.*
115. *Id.*
116. *Id.*
117. Ryley, *supra* note 6.
118. *Id.*
119. David Streitfeld, *Backlog of Cases Gives a Reprieve on Foreclosures*, N.Y. TIMES, June 19, 2011, at A1 (citing calculations by LPS Applied Analytics, a real estate data firm). Even before the housing crisis, it took up to two years for property to be sold at a foreclosure sale under New York law. In the first half of 2011, the average time to complete a foreclosure in New York was 966 days, and the average time to foreclose in Florida was 676 days. While the number of foreclosure sales dropped dramatically in the first half of 2011, this does not indicate a market

several years foreclosure is pending in the current market, the non-defaulting owners in these glamorous buildings will see their own assessments increase to close the association's budgetary gap while the building services and amenities simultaneously disappear. In one Manhattan condominium, the nonpayment of just one investor—who held title to a dozen units in the building—caused the remaining members' monthly charges to jump by 15%.[120]

3. Barriers to Market Recovery

The housing market continues to implode in many localities. Sustainable home pricing and the expeditious placement of owners willing and able to meet a property's upkeep obligations are the only way out.[121] But predictable credit costs and upkeep charges are a prerequisite to stable home pricing and residential real estate investment.[122] Volatile CIC assessments stymie economic recovery. Would-be buyers, faced with uncertain future assessment increases due to financial entanglement in a CIC, are unwilling and unable to manage certain risks. Loan modifications for overburdened borrowers do not

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recovery, but is rather further testament to rampant processing delays and lender strategic delays. Les Christie, *Foreclosures Plunge in First Half of 2011*, CNN MONEY (July 14, 2011), http://money.cnn.com/2011/07/14/real_estate/housing_market_foreclosures/index.htm.

120. Ryley, *supra* note 6. The situation is different for cooperative buildings because assessment payments are characterized as rent. Thus, the cooperative can evict a defaulting owner and need not wait for the owner's lender to foreclose. In condominiums, however, the association lien is subordinate to the first mortgage lien, and typically, the association's assessment will not be paid upon foreclosure.

121. *See* BEN BERNANKE, CHAIRMAN, U.S. FED. RESERVE, SEMIANNUAL MONETARY POLICY REPORT TO THE CONGRESS 2 (July 13, 2011), *available at* http://www.federalreserve.gov/newsevents/testimony/bernanke20110713a1.pdf (opining that one key roadblock to economic recovery is "the continuing depressed condition of the housing sector"); Steven Pearlstein, *To Sort this Mess, Both Banks and Borrowers Must Own Their Mistakes*, WASH. POST, Oct. 10, 2010, at A09 (explaining that "the longer the foreclosure process goes on, the longer it will take for the excess supply of houses to be absorbed, for prices to stabilize and for the real estate market to return to something closer to a normal equilibrium"); Alexander Eichler, *Foreclosure Processing Time Has Doubled Since 2007, Backlogging Housing Market*, HUFFINGTON POST (July 1, 2011), http://www.huffingtonpost.com/2011/07/01/home-foreclosure-backlog_n_888655.html (citing *The Atlantic*'s Daniel Indiviglio's opinion that "the more foreclosures pile up, the longer it will take for the housing market to hit bottom and begin recovering").

122. While the costs of real estate investment are usually cited as high transaction costs and illiquidity, predictability of future costs and returns is often cited as one of the benefits of real estate investment. It therefore stands to reason that eroding this benefit will decrease the attractiveness of investment in the real property sector. *See* Christian Rehring, *Real Estate in a Mixed-Asset Portfolio: The Role of the Investment Horizon*, REAL ESTATE ECON., June 30, 2011, at 22 (finding that return predictability is very important to attracting real estate investors); *cf.* JOINT CTR. FOR HOUS. STUDIES HARV. U., THE STATE OF THE NATION'S HOUSING 4–5 (2011) (chronicling the declining confidence and investment in the housing sector of the economy as prices remain uncertain).

work when assessments rise so quickly that borrowers still cannot meet their reduced mortgage debt obligations while also paying association assessments. Lenders resist financing and refinancing in communities where assessment levels and the fiscal health of the association are both uncertain.[123] The possibility (or reality) of steeply rising assessments makes investors hesitant to purchase a unit when rents may not cover additional increases. As one example: the common charge for a 601 square foot studio in one Manhattan CIC is now $1095 per month, and this substantial cost has discouraged investor purchasers and financiers, even when the purchase price for the unit is set at a tremendous discount.[124] When rents will not cover assessments, ownership of a unit generates a monthly financial loss.

Lenders are as wary of the uncertain financial future of CIC properties as are would-be buyers. Mortgage financing or refinancing of a unit in a condominium or a house in a privately governed community has become vastly more difficult as banks seek information not only about the creditworthiness of their borrower, but the credit of the other members of the financially linked community.[125] Lenders have started to scrutinize a community's reserve amounts and assessment delinquency levels in an attempt to quantify the risk of assessments materially increasing.[126] A buyer of a new condominium unit in New York reported that Bank of America denied her application to refinance because the condominium association's reserve account was depleted, and 17% of the owners in her building were delinquent in paying their assessments.[127] Most lenders require that reserves be sufficiently funded and that no more than 15% of homeowners be more than thirty days delinquent on homeowner assessments before they will agree to lend on any property located in the community.[128]

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123. *See* Dina ElBoghdady, *New Condo Loan Rules Put More Scrutiny on Neighbors*, WASH. POST, Apr. 25, 2009, at A01 (noting that financing availability depends on the credit of neighboring owners in a condominium); *infra* Part II.A.1.b (discussing lending policies and risk assessment).

124. Ryley, *supra* note 6. Ryley also gives the example of a Manhattan studio that rents for $3000 a month costing $5750 a month in mortgage payments, taxes, and common charges.

125. *See, e.g.*, Lorraine Ash, *People Facing Foreclosure Should Seek Help Early*, DAILY RECORD (Mar. 19, 2011, 6:35 PM), http://www.dailyrecord.com/article/CN/20110319/NJNEWS/103190343/People-facing-foreclosure-should-seek-help-early (noting that banks look at the association finances); Matt Tomsic, *Homeowners Associations Stepping Up Legal Pressures with Foreclosures*, STARNEWS (Mar. 5, 2011, 5:01 PM), http://www.starnewsonline.com/article/20110305/ARTICLES/110309754 (noting that lenders look at the financial help of associations).

126. Ryley, *supra* note 6.

127. *Id.*

128. *HOA Delinquinces in Condos*, FREE ADVICE (Apr. 14, 2010), http://forum.freeadvice.com/buying-selling-home-40/hoa-delinquencies-condos-512763.html. *See also infra* notes 129–32 and accompanying text.

The two giants of the secondary residential mortgage market—the government-sponsored enterprises ("GSEs") Fannie Mae and Freddie Mac—likewise demand certain thresholds of reserves and non-delinquencies for CICs in which their prospective mortgage loan purchases are located.[129] For example, Freddie Mac's Condominium Unit Mortgages Project Analysis requires a budget and certification of a working capital fund, appropriate assessments levied with a minimum of 10% of the budget designated for replacement reserves and deferred maintenance, a working capital fund in an amount consistent with the remaining life of the common elements, and no more than 15% of assessments delinquent more than thirty days.[130] Freddie Mac also mandates that common elements be consistent with the nature of the project and competitive with the local market, and it requires the community to be in good financial and physical condition.[131]

The lack of financing alternatives and the threat of instability that would result if assessment delinquencies reach 15% have chilled investment in condominium properties.[132] Some investors report that they will pay only cents on the dollar because of the possibility that neighboring owners will default in paying their pro rata share of maintenance costs, rendering all units in the CIC unfinanceable.[133] Before he would agree to buy, one investor from Italy reportedly demanded a "written guarantee" from the association that he would not

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129. Fannie Mae (formerly the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation) were chartered by Congress and regulated by federal agencies. Although technically still owned by private shareholders, in September 2008, the Treasury Department placed Fannie Mae and Freddie Mac into conservatorship, reorganizing the enterprises and infusing them with new capital. At the time, this was the largest state rescue in history, to the tune of $100 billion. *See* Herbert M. Allison, Jr., President and CEO, Fannie Mae, Oversight Hearing to Examine Recent Treasury and FHFA Actions Regarding the GSEs (Sept. 25, 2008) (addressing how Freddie Mac pursued its mission to support the mortgage market, provide liquidity, and prevent foreclosures since the conservatorship began); James Lockhardt, Acting Dir., Office of Fed. Hous. Enter. Oversight (OFHEO), Testimony Before the Financial Crisis Inquiry Commission (Apr. 9, 2010), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0409-Lockhart.pdf (explaining the Freddie Mac remediation process). *See generally* Press Release, Fed. Hous. Fin. Agency, Questions and Answers on Conservatorship, http://www.fhfa.gov/webfiles/35/FHFACONSERVQA.pdf (explaining conservatorship and how it will affect the Federal Housing Finance Agency).

130. FREDDIE MAC, FREDDIE MAC CONDOMINIUM UNIT MORTGAGES 1, 3 (Apr. 2011), *available at* http://www.freddiemac.com/learn/pdfs/uw/condo.pdf.

131. *Id.*

132. Some areas of the country—New England and Manhattan in particular—faced a breakdown in the early 1990s. There is anecdotal evidence of New Yorkers during that crisis "handing over their Fifth Avenue apartments for $1 because they could not afford the maintenance fees." Haughney, *supra* note 6, at C1.

133. *Id.*

have to pay larger fees in the future (although such a guarantee is likely not enforceable against the association).[134] The fact that no one—neither banks nor buyers—willingly takes on this uncontrollable risk is more evidence that the current system is broken.[135]

Some associations have responded to their community's budgetary crisis by in-sourcing all possible costs.[136] For example, homeowners may be required to take turns mowing common area lawns, caring for common area maintenance, or even staying up all night to serve as a doorman or security guard. While these efforts may reduce the dollar contributions associations need to functiou, in-sourced upkeep actually replicates the very same collective action and free-rider problems that community governance was designed to eliminate: some people will contribute more than others, and others will be unjustly enriched by their efforts. In-sourcing just replaces the problem of increased assessments of money with the problem of increased "assessments" made in kind, and it is equally inequitable. Either way, the non-defaulting homeowners pick up the costs of the defaulting owners mortgage lenders' free ride.[137]

As an alternative to increasing assessments, associations may reduce the level of services offered to members of the community by decreasing maintenance, closing amenities, or starting to charge amenity user fees. In 2008, the Community Associations Institute conducted an informal poll and found that nearly 40% of the associations nationwide had delayed capital expenditures, and nearly 35% had raised assessments—in each case because of an increase in delinquent assessments.[138] Three years later, these numbers are likely even higher. The end result of the efforts to cut services and impose

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134. *Id.* Associations cannot guarantee limitations on future assessments unless the documents so permit because any limitation to one unit owner's obligations necessarily burdens other owners with greater costs should the association's revenue requirements increase.

135. Condominiums as a real estate product type have incurred the biggest losses in terms of market value and transactional volume. CLIFFORD TREESE, METRICS FOR THE DEPRESSED (May 2011), *available at* https://spreadsheets.google.com/spreadsheet/pub?hl=en_US&hl=en_US&key=0Apv0sov_B8cSdGpwVTd4TEwybGJFd2J3QUQ2ZnRFbXc&output=html. According to statistics compiled by LM Funding from the Hillsborough Property Appraiser's Office and Zillow.com, average values for condominiums have dropped 34% from the peak in 2005 to 2009. *Id.*

136. *Housing Associations*, DUE NORTH, http://www.due-north.com/Industries/housing-associations.aspx (last visited Mar. 21, 2011); Michelle Rindels, *Nevada Legislators Considering Reform for HOAs*, ASSOCIATED PRESS, Feb. 25, 2011, *available at* http://www.kolotv.com/home/headlines/Nevada_Legislators_Considering_Reform_for_HOAs_116980213.html; Vitali, *supra* note 46.

137. *See* Lemley, *supra* note 69, at 1057 (discussing the consequences of free riding); *infra* Part II.B.1 (discussing how lenders benefit from upkeep pre-foreclosure).

138. Bayles, *supra* note 11.

more costs on owners is the same: significant decline in a community's property values and a community government that ceases to function effectively.[139]

4. Association Bankruptcy

Community associations cannot seek relief from their financial obligations in bankruptcy, even if their obligations outpace their revenues. Condominium associations typically have no assets of their own,[140] and homeowner associations are prohibited by their governing documents from selling their assets or otherwise seeking to raise revenues in ways not foreseen and explicitly authorized in their covenants.[141] These entities perform primarily (or exclusively) governance and maintenance roles. Although it is nearly impossible to file bankruptcy as a pass-through entity, it is also practically impossible for an association to function if a significant amount of the units are in arrears. Once more than 15% of unit owners are delinquent in their assessment payments, FHA insurance and Fannie Mae loan qualification becomes unavailable for purchaser mortgages on units in that community.[142] At that level of delinquency, neither associations nor their member owners can obtain financing.

Bankruptcy law currently offers no good solution.[143] Courts generally disallow bankruptcy filings by community associations

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139. *See* HYATT, *supra* note 14, at 121 (stating that cutting services and charging user fees for amenities may cause disrepair of the common and recreational facilities, resulting in a decline in property values within the community). A similar fate befell Alaskan condominiums when workers abandoned their units and moved away after the completion of the Alaska pipeline. *See* MIN DIXON, WHAT HAPPENED TO FAIRBANKS? THE EFFECTS OF THE TRANS-ALASKA OIL PIPELINE ON THE COMMUNITY OF FAIRBANKS, ALASKA 295–96 (1980) (explaining that a housing shortage resulted from a lack of certainty regarding the housing that an industry was to supply its employees and the disposition of that housing after the construction period had terminated).

140. In condominium ownership, the unit owners hold title to all common areas as tenants-in-common, and the association's role is purely one of governance.

141. HYATT, *supra* note 14, at 109–12.

142. U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-19, CONDOMINIUM APPROVAL PROCESSS—SINGLE FAMILY HOUSING (June 12, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-19ml.doc; U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-46 A, TEMPORARY GUIDANCE FOR CONDOMINIUM POLICY (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46aml.pdf; U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-46 B, CONDOMINIUM APPROVAL PROCESS FOR SINGLE FAMILY HOUSING (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46bml.pdf.

143. Professor Evan McKenzie calls association bankruptcy attempts "disaster[s]" that accomplish nothing. Joseph Dobrian, *Condominium Associations Hard Hit by Foreclosures Consider Bankruptcy*, J. PROP. MGMT., May/June 2010, at 32 (quoting McKenzie). Recently, scholars have called for reformation of the Bankruptcy Code to offer some relief to beleaguered condominium associations. Pinkerton, *supra* note 13, at 142–46 (citing the inescapable "death

because the associations have assessment powers, and courts can force associations to levy assessments on unit owners to pay for association debt.[144] Because an association can theoretically make special assessments to make up any budgetary shortfall, an association's inability to pay its obligations is seen as a revenue problem rather than as a debt or asset problem. Only if all the members of the association are themselves insolvent does the actual ability of an association to meet its debts become imperiled.[145]

There have been very few exceptions to this general rule, and each has presented an atypical case. For example, in the recent bankruptcy case filed in Florida by Maison Grande Condominium, the association entered into a long-term recreation lease with an escalation clause and faced inability to meet this obligation when 25% of its units became delinquent while lease fees rose astronomically.[146] The association filed a petition for Chapter 11 bankruptcy seeking to reject the lease, and the bankruptcy judge in that case permitted the lease rejection.[147] The court noted that the board of directors had concluded that further increases of assessments would be unavailing because unit owners had advised the board that they lacked the ability or willingness to pay.[148]

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spiral" of association unpaid dues and debt).

144. *See* White v. Cox, 95 Cal. Rptr. 259, 263 n.3 (Cal. Ct. App. 1971) (stating that a condomium owner may satisfy his portion of any liability arising from the association by the payment of his proportionate share of the liability); HYATT & FRENCH, *supra* note 14, at 591; NATELSON, *supra* note 61, at 328–31; Donald L. Schreifer, *Judicial Action and Condominium Unit Owner Liability: Public Interest Considerations*, 1986 U. ILL. L. REV. 255, 262–65 (1986) (explaining that at least a share of the debt may be collected from any member who has been named and served in the absence of a statute to the contrary); Jessica Meyers, *HOA Bills Start to Get Spotlight*, DALL. NEWS (Mar. 7, 2011, 10:05 AM), http://trailblazersblog.dallasnews.com/archives/2011/03/hoa-bills-start-to-get-spotlig.html; *cf. In re* Rivera, 256 B.R. 828, 830–36 (Bankr. M.D. Fla. 2000) (denying as moot and unnecessary a homeowner association's "Motion for Reconsideration of Order denying Motion to Compel Debtor to Reaffirm, to Redeem, or to Surrender, and to Withhold Entry of the Discharge Pending Consideration of this Motion or Alternately to Dismiss," because post-petition homeowner association assessments survived a Chapter 7 discharge as a condition of continued ownership of a lot subject to such assessment), *superseded by statute*, 11 U.S.C. § 523(a)(16) (2006).

145. *See* Pinkerton, *supra* note 13, at 147–64 (discussing the insolvency and condominium association debtors).

146. *In re* Maison Grande Condo. Ass'n, 425 B.R. 684, 687–88 (Bankr. S.D. Fla. 2010).

147. *Id.* at 689, 707.

148. *Id.* at 688 ("Some owners advised members of the Board that they lacked the financial resources to pay additional assessments. Others advised the Board that they would refuse to pay additional assessments that were only necessitated by other owners not paying their fair share. The Board also took into consideration the demographics of the unit owners, including the fact that many [were] elderly and on fixed incomes." (citation omitted)). Chapter 11 Bankruptcy offers an association the only hope of bankruptcy relief, but even that avenue is uncertain and perilous. *See* Pinkerton, *supra* note 12, at 155–65 (asserting that Chapter 7 is "not a good option for condominium associations" and that while Chapter 11 "might work," the association faces many problems with that route as well); *see also* Kristen L. Davidson, *Bankruptcy Protection for*

This case, however, is an anomaly and upon closer reading, seems to be predicated on a finding that the subject lease's escalation clause was unenforceable in Florida as against public policy.[149]

More typical is the approach of another Florida bankruptcy case, in which the court adamantly rejected the association's proposed Chapter 7 bankruptcy.[150] In this case, the association sought to dissolve and reform to avoid payment obligations to a roofing vender that it could not meet without significant increases to assessments.[151] The court rejected this plan, calling the association's attempt to avail itself of bankruptcy protection bad faith.[152] Carla Barrow, counsel to the roofing company, noted that at least eight other condominiums had also filed for some sort of bankruptcy protection in South Florida, attempting to avoid paying for roof repairs,[153] but such attempts are unlikely to be successful. In 2010, Florida passed the Distressed Condominium Relief Act, which, among other things, specifically empowers associations to take stronger measures to recover revenues from non-paying owners and permits "bulk assignees" and "bulk buyers" to take over unsold developer condominium inventory, assuming assessment obligations but not other liabilities of the original developer.[154]

Without bankruptcy as a potential escape from financial obligations in excess of collected funds, associations with assessment delinquencies are left with only one alternative: increase assessment amounts and hope the paying members will make up the shortfall. Charging paying members more to make up for neighbor defaults is not only unfair,[155] but it is unlikely to actually save the community from de facto insolvency. As the court in *Maison Grande* noted, increased assessments will likely increase delinquencies.[156] Increased delinquencies lead to increased assessments that can further increase delinquencies, requiring still greater increases of assessments (*ad infinitum*). Barring some ability to actually recover from non-paying

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Community Associations as Debtors, 20 EMORY BANKR. DEV. J. 583, 616–25 (2004) (discussing the difficulty that courts have in applying bankruptcy laws to community associations).

149. *In re Maison Grande*, 425 B.R. at 702.

150. *In re* Boca Village Ass'n, 422 B.R. 318, 327 (Bankr. S.D. Fla. 2009).

151. *Id.* at 325.

152. *Id.* at 321–25.

153. Dobrian, *supra* note 143, at 33.

154. S.B. 1196, 2010 Sess. (Fla. 2010) (adding new Sections 718.701–708 to the Florida Statutes through the "Distressed Condominium Relief Act").

155. *See* Hart, *supra* note 5, at 185 ("[W]hen a number of persons conduct any joint enterprise according to rules and thus restrict their liberty, those who have submitted to these restrictions when required have a right to a similar submission from those who have benefited by their submission.").

156. *In re* Maison Grande Condo. Ass'n, 425 B.R. 684, 688 (Bankr. S.D. Fla. 2010).

owners or properties, the only remaining solution is to have a public (state, local, federal) government step in and bail out communities that are unable to collect sufficient revenues from their members.[157] Private government failure mirrors local government failure (when tax revenues are insufficient to maintain the community), but unlike community associations, municipalities can, in fact, declare bankruptcy.[158]

C. Payment Collection and Lien Priority

1. Association Collection Efforts

Because of the difficulty of enforcing payment obligations in privately governed communities, conventional wisdom holds that an association board should act quickly in response to nonpayment of assessments. An association with delinquent members has the ability to enforce its payment obligation in several ways. Associations may be able to use self-help by denying a delinquent owner the right to use common elements or by suspending the owner's voting rights.[159] For example, a nonpaying unit owner may be barred from using a community amenity such as a swimming pool or health club. The

157. *See* Dobrian, *supra* note 143, at 34 ("The main burden of dealing with troubled condo associations will fall on local governments, which are seldom experienced in such matters.") (quoting Professor Evan McKenzie).

158. 11 U.S.C. § 109(c)(1) (2006). Chapter 9 of the Bankruptcy Code provides for reorganization of municipalities, which includes cities, towns, villages, counties, taxing districts, municipal utilities, and school districts. *E.g.*, *Municipality Bankruptcy*, U.S. COURTS, http://www.uscourts.gov/federalcourts/bankruptcy/bankruptcybasics/chapter9.aspx (last visited Aug. 16, 2011). It does not, however, cover common interest communities. Municipal bankruptcy legislation has a history of constitutional fragility. *See, e.g.*, Ashton v. Cameron Cnty. Water Improvement Dist. No. 1, 298 U.S. 513, 530–32 (1936) (striking down as incompatible with the Tenth Amendment the initial attempt by Congress to craft bankruptcy protection for local governments). According to the federal government, in the more than sixty years since Congress established a constitutionally viable municipal bankruptcy procedure, there have been less than 500 governmental bankruptcy petitions filed. *Municipality Bankruptcy*, *supra*. Those filings that do occur, however, are typically extreme cases in large municipalities (e.g., Orange County, CA) and can involve many millions of dollars in municipal debt. MARK BALDASSARE, WHEN GOVERNMENT FAILS: THE ORANGE COUNTY BANKRUPTCY 7 (1998).

159. HYATT, *supra* note 14, at 121–22; *see also* How v. Mars, 513 N.W.2d 511, 516 (Neb. 1994) (holding that both the association bylaws and Nebraska's nonprofit corporations code permitted the association to deny delinquent owners the right to vote in the community). *But see* Mountain Home Props. v. Pine Mountain Lake Ass'n, 185 Cal. Rptr. 623, 630 (Cal. Ct. App. 1982) (holding that California law bars a community association from denying membership privileges to a new member because of the unpaid association debts of the new member's predecessors in interest). In most cases, private governments are able to suspend voting rights of members due to non-payment of assessments even though public governments may not suspend the right to vote based on non-payment of taxes. For example, a Florida law passed in July 2010 clarifies the availability of this type of self-help in that state. S.B. 1196, 2010 Sess. (Fla. 2010). For further discussion of how assessments in communities are similar to and yet distinct from taxes, see *infra* Part II.A.3.

extent to which services may be denied, however, depends on state law. For example, a Texas court permitted an association to turn off the utilities of a delinquent owner,[160] but few states permit the discontinuance of essential services, such as heat, water or electricity.[161]

If such efforts fail, an association can commence an action to collect a debt against the non-paying owner. Federal case law is split on the issue of whether association assessments are debts for the purposes of the 1966 Fair Debt Collection Practices Act, 15 U.S.C. § 1692 (2006), which would require certain explicit warnings and notices to be served prior to collection efforts.[162] To the extent an association complies with any such applicable laws, it can thereafter bring lawsuits against delinquent owners personally, claiming breach of contract and seeking damages equal to the unpaid assessment amounts.[163] Collection based on a judgment against the owner can proceed like any other debt collection (garnishing wages, seizing assets, enforcing a judgment lien, etc.).[164] Bringing a lawsuit, however, can be costly to the association in terms of time and attorney fees, and the paying owners—those who are already bearing the costs of their neighbors' delinquencies—will have to foot that bill unless the delinquent owner or responsible party can

160. San Antonio Villa Del Sol Homeowners Ass'n v. Miller, 761 S.W.2d 460, 465 (Tex. App. 1988) ("Clearly, a condominium dweller who does not pay his share of the maintenance fee, admits that the other owners are in essence paying his way, and fails to respond to notice of disconnection is in violation of the meaning and intent of the [by-laws]. The Association took appropriate action to abate this condition.").

161. *See, e.g.*, N.Y. GEN. BUS. LAW § 352-eee(4) (McKinney 2011) (prohibiting a property owner who wishes to convert a building to cooperative or condominium ownership from the "interruption or discontinuance of essential services, which substantially interferes with or disturbs the comfort, repose, peace or quiet of any tenant in his use or occupancy of his dwelling unit or the facilities related thereto."). Among property managers, the belief is that the most efficient way to collect unpaid assessments is to turn off community-provided cable or satellite television services where law permits. *See* Polyana da Costa, *Associations Get Creative in Punishing Delinquencies*, MIAMI DAILY BUS. REV., Nov. 23, 2010, at A1 (discussing legal and prohibited methods of encouraging assessment compliance); *see also* Mark Leen, *Condo Utilities May Be At Mercy of Assessments*, KING CNTY. BAR ASS'N BAR BULLETIN, 2009, *available at* http://www.kcba.org/newsevents/barbulletin/archive/2009/09-07/article18.aspx (discussing why cutting services off to a unit is "particularly effective").

162. *Compare, e.g.*, Bryan v. Clayton, 698 So. 2d 1236, 1237 (Fla. Dist. Ct. App. 1997) (assessments are not covered by the Act) *with* Newman v. Boehm, Pearlstein & Bright, Ltd., 119 F.3d 477, 479 (7th Cir. 1997) (finding that a past due assessment is a "debt" under the Act).

163. *See* HYATT, *supra* note 14, at 119 (discussing a typical collection process for an association against a delinquent owner, including filing a lawsuit against the delinquent owner personally, in addition to filing a lien on the delinquent owner's unit).

164. *See infra* Part I.C.1 (discussing association collection efforts). The priority of any such judgment lien, however, will be subordinate to any mortgages or other obligations currently secured by the property, and thus, perfecting the association's assessment lien likely offers a better chance for ultimate recovery.

obtain the costs of collection.[165] Nevertheless, these sorts of collection actions are how the bulk of unpaid assessments are eventually collected.[166]

The lien on the defaulting owner's property that association covenants create for delinquent assessments is another tool for delinquency recovery.[167] The lien guarantees that the association will be paid out the proceeds of any resale, after all senior interests are satisfied. Furthermore, a lien for unpaid assessments clouds the owner's title and can be used as leverage to convince an owner who is seeking clear title (for sale or financing) to pay up. A last resort for associations is to foreclose on the property lien securing the assessment obligation.[168]

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165. *See* HYATT, *supra* note 14, at 121 (discussing the substantial amount of time it takes to foreclose on a lien and collect a judgment, the low price a sheriff's sale may generate, and that the availability of wage garnishment is dependent on the delinquent owner having an income).

166. *See, e.g.*, KATZMAN GARFINKEL & BERGER, COMMUNITY ASSOCIATION ASSESSMENT COLLECTION AND FORECLOSURE 14–15 (2011), *available at* http://www.canfl.com/pdfs/KGBcollFAQs_sm.pdf (explaining the benefits of collection actions).

167. *See* Pinkerton, *supra* note 13, at 143 ("Functionally, condominium associations only possess one remedy to recover their expenses from delinquent unit owners. They can obtain a lien on the unit for the amount owed to the association by that unit owner. The association can then foreclose on its lien if the debt remains unpaid. However, this remedy is not very useful in the face of many states' laws concerning the relative priority of mortgages."). The association lien has always been used as a practical means to induce voluntary compliance with assessment obligations rather than as a means to collect from the asset's value directly via foreclosure (although the viable threat of foreclosure can motivate payment). The problem arises in situations where a homeowner is already facing foreclosure (under the mortgage) and the owner's equity is gone. The association in such cases loses its power to motivate compliance. At this point, the only other interest holder of the property who still has a stake in its value is the first mortgagee, which is why eroding that priority position may incentivize a lender to pay, or cause a borrower to pay, assessments. A lender would be motivated to pay to preserve its own collateral value if its claim on the property would diminish should assessments remain delinquent.

168. *See, e.g.*, UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (amended 2008) (outlining enforcement of lien for sums due the association, including foreclosure); Societe Generale v. Charles & Co. Acquisition, Inc., 597 N.Y.S.2d 1004, 1009 (N.Y. Sup. Ct. 1993) ("[A] condominium's lien for unpaid common charges may be foreclosed in the same manner as a mortgage on real property . . . ."). Some state laws limit recovery for debt repayment from foreclosure of a homestead. Homestead exemptions protect a certain amount of equity from sale to satisfy a debt. In Missouri, for example, the first $15,000 of debt is exempted as the owner's homestead. MO. REV. STAT. § 513.475 (2002). Florida, Texas, Oklahoma and Colorado have virtually unlimited homestead exemptions. *See, e.g.*, TEX. PROP. CODE ANN. § 41.001 (West 2010) (providing that a homestead is "exempt from seizure for the claims of creditors except for encumbrances properly fixed on homestead property," which include: (1) purchase money; (2) taxes on the property; (3) work and material used in constructing improvements on the property; (4) an owelty of partition; (5) the refinance of a lien against the homestead; (6) an extension of credit subject to certain conditions including security by a voluntary lien; and (7) a reverse mortgage which meets certain requirements); *Id.* § 52.001 (attaching judgment liens to real property except that property exempt from seizure or forced sale under Chapter 41, the Texas Constitution, or any other law). Mortgage lenders typically require an explicit waiver of this statutory protection of borrower equity.

How useful association foreclosure is as an enforcement tool depends greatly on the perfection and priority regime of the applicable state.[169] A first mortgage loan on a particular unit in a CIC enjoys senior priority to the association's assessment lien in all states, although the first mortgage priority is subject to a capped payment priority association lien in several states.[170] In those states lacking a six-month super-priority for assessment liens, the association will only be able to recover from the sale if foreclosure proceeds exceed the senior loan amount.[171]

Depending on the jurisdiction, lien foreclosures are effected either by a sale in a court action in equity or by private power of sale granted in the security instrument.[172] Judicial foreclosure is the exclusive method of foreclosure in over one-third of the states,[173] and it is available in

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Similarly, association declarations may purport to waive application of the homestead exemption for foreclosure of the association lien. Many states have passed statutes explicitly carving out CIC associations from the applicability of such limitations. The Colorado statute expressly authorizes an association to ignore the homestead exemption otherwise applicable in that state. BA Mortg., LLC v. Quail Creek Condo. Ass'n, 192 P.3d 447, 451 (Colo. App. 2008). Texas, a state with a very broad homestead exemption, allows association foreclosure to circumvent this limitation. Inwood N. Homeowners' Ass'n v. Harris, 736 S.W.2d 632, 637 (Tex. 1987). In other states, the applicability of the homestead exemption to association lien foreclosure proceedings is less clear. *See, e.g.*, Andres v. Indian Creek Phase III-B Homeowner's Ass'n, 901 So.2d 182, 182–83 (Fla. Dist. Ct. App. 2005) (expressing, in dicta, doubt that covenants purporting to waive the state's homestead exception would he effective); Knolls Condo. Ass'n v. Harms, 781 N.E.2d 261, 267–69 (Ill. 2002) (holding that the homestead exemption did not preclude the association suing for possession of a defaulting unit hut not reaching the question of whether it would preclude foreclosure of the association's lien).

169. *See* HYATT, *supra* note 14, at 120–21 (discussing the practical value of an association's lien rights as dependent upon the state law authority for the lien, procedures for perfection and enforcement, and lien priority). In some states, perfection of the lien is automatic. In other states, a filing is required to perfect the lien. State law may require re-filing to maintain perfection. For example, in New Hampshire, a notice of an association's lien must be re-filed every six months to retain perfection. N.H. REV. STAT. ANN. § 356-B:46, III (LexisNexis 2010). States specifically prescribe the method of foreclosure and the process required in order to legally foreclose on real property. In addition, certain states have attempted to limit the power of associations to foreclose based on unpaid assessment liens. For example, in 2004, a bill in California that would have set a threshold of $2500 of unpaid assessments before an association could pursue foreclosure was vetoed by Governor Arnold Schwarzenegger. *See* Jim Wasserman, *Schwarzenegger Rejects Ban on Foreclosures*, ASSOCIATED PRESS, Oct. 1, 2004, *available at* http://www.calhomelaw.org/doc.asp?id=462 (discussing Governor Schwarzenegger's veto of a bill that would have required associations to use small claims courts, instead of nonjudicial foreclosure, to collect unpaid debts under $2500).

170. *See infra* Part I.C.2 (discussing assessment lien priority).

171. *See, e.g.*, Bd. of Dirs. of Olde Salem Homeowners Ass'n v. Sec'y of Veterans Affairs, 589 N.E.2d 761, 764 (Ill. App. Ct. 1992) (finding that a buyer at a mortgage foreclosure took the property free of assessments accruing prior to recording of the deed, which were extinguished by the foreclosure action); Long Island Sav. Bank, F.S.B. v. Gomez, 568 N.Y.S.2d 536, 537 (N.Y. Sup. Ct. 1991) (finding that an association's junior lien was extinguished by foreclosure of the senior priority mortgage).

172. NELSON & WHITMAN, *supra* note 58, at 600–01, 633.

173. *Id.* at 601 n.1. Judicial foreclosure is the exclusive or generally used method in

every jurisdiction.[174] Judicial foreclosures are complicated, costly, and time-consuming compared with non-judicial foreclosures pursuant to a power of sale.[175] Some states that permit a mortgage containing an explicit power of sale to be non-judicially foreclosed will likewise permit non-judicial foreclosure of association liens. Such states have a separate foreclosure statutory provision dealing solely with association liens.[176]

Most associations, as well as owners and legislatures, view the foreclosure of an assessment lien as "a last resort" for two reasons.[177] First, foreclosure proceedings—even in states permitting non-judicial foreclosure of association liens—involve significant upfront costs such as advertising, auction, and legal fees. These costs would have to be borne by the neighborhood as a whole, unless they can be recovered from the delinquent owner. Second, a buyer who purchases at an association foreclosure would take the property subject to a first priority mortgage lien unless that loan amount is paid off.[178] This vastly

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Arkansas, Delaware, Florida, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Montana, Nebraska, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, South Carolina, and Wisconsin. In two other states, Connecticut and Vermont, foreclosure is judicial but is not a public sale; rather, it is a transfer of ownership to the lienor (called strict foreclosure).

174. In some states, an explicit statutory right to foreclose through the court exists. In others, judicial foreclosure is available as an incident to the jurisdiction of courts of equity. *See* Lansing v. Goelet, 9 Cow. 346, 366, 403 (N.Y. 1827) (holding that the decree for the sale of mortgaged premises was within the inherent powers of a court of equity, in addition to a statutory right to foreclose through the court).

175. STEVEN W. BENDER ET AL., MODERN REAL ESTATE FINANCE AND LAND TRANSFER 419–21 (4th ed. 2008); NELSON & WHITMAN, *supra* note 58, at 601–02.

176. *E.g.*, Property Owners' Association Act, VA. CODE. ANN. tit. 55 § 516 (2007) (titled "Lien for Assessments"); Maryland Condominium Act, MD. CODE ANN., REAL PROP. § 11-110 (West 2003), *amended by* Act of May 10, 2011, ch. 387, H.B. 1246 (effective Oct. 1, 2011).

177. Benny L. Kass, *Condo Board Can Foreclose for Delinquent Fees*, WASH. POST, Feb. 14, 2009, at F4; *see also* Baker v. Monga, 590 N.E.2d 1162, 1164–65 (Mass. App. Ct. 1992) (holding that a unit valued at $350,000 could be foreclosed for the owner's nonpayment of assessments totaling less than $3000). A recent unsuccessful bill in California attempted to place a significant cost threshold on when an association could pursue foreclosure to enforce its lien for unpaid assessments. S.B. 1682, 2003–2004 Reg. Sess. (Cal. 2004).

178. Junior priority liens are wiped out by foreclosure and, after paying amounts owed to the association, are distributed to such lienors in order of priority, but buyers at the foreclosure of a junior lien take subject to senior liens. Most courts have held, and scholars have opined, that this "subject to" means that a junior lien foreclosure transfers the property with the senior liens intact but unpaid. NELSON & WHITMAN, *supra* note 58, at 611–14; *see also, e.g.*, Shaikh v. Burwell, 412 S.E.2d 924, 926 (N.C. Ct. App. 1992) ("If the trustee is only foreclosing on the junior deed of trust, the senior lien continues with the property and the trustee must sell subject to the senior lien."). In a puzzling recent Virginia decision, however, foreclosure of an association's junior lien was misinterpreted to mandate payment of the first mortgage, rather than as a sale of property subject to a first mortgage lien. Bd. of Dirs. of the Colchester Towne Condo. Council of Co-Owners v. Wachovia Bank, N.A., 581 S.E.2d 201, 206 (Va. 2003). The Supreme Court of Virginia, over a vigorous dissent, interpreted the statutory authority to foreclose the unit "subject to prior liens" to mean that proceeds of the association's foreclosure sale must be used first to

decreases the ability of the association to find a third-party buyer at such a sale. In fact, in today's environment of underwater properties, finding an interested third-party buyer at a junior lien foreclosure would be unlikely at best.

In the absence of a third-party buyer, the association in an assessment foreclosure would be forced to take title to the unit itself. While this strategy might allow an association to rent out a unit and pay rental proceeds toward association costs, this approach is risky.[179] Once an association takes title to a unit, it becomes responsible for the assessments on that unit, which means that the unit's assessment obligations will continue to be spread among the paying owners in the community—precisely the unsatisfactory result that collection efforts against the prior owner were trying to avoid in the first place. As the owner, the association also becomes liable for property taxes, meaning that yet another cost is passed on to the community. Although the association could theoretically mitigate these costs by renting out the unit, this would entail the association becoming a landlord, exposing the community to the various risks and liabilities of assuming that role.[180] Even if an association is willing to serve as a landlord, rental properties

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satisfy the lien of the first deed of trust before any delinquent assessments are reimbursed. *Id.* at 203–04. The doctrinal basis of this holding seems misconstrued. The majority cites principles of interpretation—that a statute should be read to be internally consistent—to support its conclusion. *Id.* at 203. But the asserted inconsistency seems to arise from the court's complete misunderstanding of secured transactions law. The court states that by granting first mortgage liens super priority in Virginia Code section 55-79.84(A), the Virginia Legislature implicitly required the judicial reformation of the statutory repayment waterfall in an association foreclosure, as contained in Virginia Code section 55-79.84(I)(5)(c). *Id.* at 203–04. As the dissent noted, this interpretation "is inconsistent with that phrase's well-understood and long accepted meaning." *Id.* at 205 (Lacy, J., dissenting). Justice Lacy also notes that there is nothing ambiguous or inconsistent in the statute that requires judicial re-writing of the language to reach the majority's result, chiding that "we generally do not engage in adding words to a statute." *Id.* While this decision runs contrary to nearly every other interpretation of the term "subject to," the Virginia General Assembly has thus far been unable to pass legislation correcting this judicial precedent. *See* S.B. 411, 2010 Sess. (Va. 2010) (stricken Jan. 27, 2010) (attempting to clarify the statute by adding language that states that the term "subject to" means that liens to which an association's lien is subordinate "shall survive the sale and be binding upon the purchaser at such sale").

179. *See, e.g.*, Daniel Vasquez, *Should Condo Associations Rent Units in Foreclosure?*, SUN SENTINEL (Mar. 18, 2009), http://articles.sun-sentinel.com/2009-03-18/news/0903170451_1_rent-units-condo-associations-foreclosure-action (explaining the various costs and liabilities that an association incurs when it becomes a landlord of units it acquires in assessment foreclosure proceedings).

180. *See, e.g.*, Matt Humphrey, *HOA Foreclosing to Rent Units? First Know the Risks*, HOALEADER.COM (Mar. 25, 2011), http://www.hoaleader.com/public/554.cfm (warning that an association becoming a landlord of a unit acquired in foreclosure is "very dangerous" because it "opens the association up to economic liability"). *But see* Gehrke-White, *supra* note 13 (explaining that in the context of long bank foreclosure delays, condominium association foreclosure and renting of units is the only way to obtain assessment funds from defaulting units).

that are subject to pending mortgage foreclosure—and therefore potentially terminable with little advance notice—would likely fetch rentals that are far below market. The depressed rental revenue may not be enough to pay property taxes and assessment charges on the unit.[181]

Generally, senior lienholders cannot be joined in a foreclosure action involuntarily.[182] Some dated case law supports the contention that a junior lienor may join a senior lienor in a combined foreclosure proceeding when the senior loan is also in default and is due and payable.[183] In the unlikely event that this doctrine would gain new traction, it could permit foreclosing associations to join a lender and potentially safeguard its lien in a sufficient sale or, at least, speed the process of senior lien foreclosure, giving associations the legal ability to self-protect in an environment of lender foreclosure delays. Most courts today, however, agree that a lienor has the right to choose the timing of foreclosure of its lien.[184]

2. Priority Baseline

As a general rule, liens on real property enjoy a priority based on the order in which they were perfected.[185] This first-in-time basic presumption is usually subject to a handful of exceptions under state law, including municipal real property taxes, which always enjoy the highest lien priority.[186] In addition, most states set the priority of a mechanic's lien supporting payment obligations for work done to the

181. *See* Bruce Rogers, *Collecting Delinquent Assessments: Why the Old Ways Won't Work and How to Play the Association's Cards in the Great Recession*, LM FUNDING LLC, 1, http://www.lmfunding.com/assets/Collecting-Delinquent-Assessments-in-Todays-Market.pdf (last visited Oct. 30, 2011) (explaining that current economic reality is why only 4% of associations with delinquent assessments foreclose on their liens).

182. NELSON & WHITMAN, *supra* note 58, at 611; *see also, e.g.*, Osage Oil & Ref. Co. v. Mulber Oil Co., 43 F.2d 306, 308 (10th Cir. 1930) (holding that the junior lienor cannot enforce a sale for more than its own equity of redemption without consent of the senior lienor).

183. *See, e.g.*, Hefner v. Nw. Mut. Life Ins. Co., 123 U.S. 747, 754 (1887) (holding that when a first mortgagee's debt is due and payable, the first mortgagee may be made a party); Hagan v. Walker, 55 U.S. 29, 37 (1852) (holding that a senior lienor may be a "necessary party" to a foreclosure, when the senior lienor is also in default, so that "a sale may be made of the whole title"); Masters v. Templeton, 92 Ind. 447, 451–52 (1883) (allowing a junior mortgagee to join a senior mortgagee so that the "ultimate rights of the parties" may be determined in one action); Peabody v. Roberts, 47 Barb. 91, 102 (N.Y. 1866) (allowing a junior mortgagee to proceed with a foreclosure action despite a prior foreclosure and sale under the senior mortgage). Even as late as 1992, the court in *Shaikh v. Burwell* cited six possible "special circumstances" that would enable a junior lienor to join a senior lienor in a foreclosure action. *Shaikh*, 412 S.E.2d at 927–28.

184. NELSON & WHITMAN, *supra* note 58, at 612. This creative approach is similar to the "mortgage terminator" approach that has recently been used on occasion in Florida. *See infra* Part II.A.2 (discussing creative strategies used by attorneys in seeking recovery for their clients).

185. BENDER ET AL., *supra* note 175, at 123.

186. *Id.* at 271–73.

real property itself as relating back to the date on which such work was commenced.[187] In the absence of a statutory directive to the contrary, assessment liens follow the general first-in-time priority rule, and because mortgage loans are typically funded prior to assessment delinquencies, such first mortgage liens are senior to assessment liens.[188] The California Condominium Act, for example, explicitly follows the first-in-time rule, setting lien priority according to the time a separate "notice of delinquent assessment" is filed in the land records.[189]

In some states, assessment liens are considered automatically perfected with the date of perfection relating back to the date on which the association was formed (when the declaration was filed in the land records).[190] However, statutes defining priority in such states specifically make an exception for first mortgage liens on individual units within the community, permitting the first mortgage to always enjoy a priority senior to the association lien, even though the first-in-time rule would otherwise deem the related-back perfected association lien to be first.[191] For example, the Virginia Condominium Act provides that the assessment lien is subordinate to "sums unpaid on any first mortgages or first deeds of trust recorded prior to the perfection of said lien for assessments and securing institutional lenders."[192]

187. *See, e.g.*, CAL. CIV. CODE §§ 3134, 3137 (West 1993) (providing that liens for site improvements have priority based on the commencement of site improvements); 770 ILL. COMP. STAT. ANN. 60/16 (West 1989) (providing that no encumbrances placed upon land shall operate before a lien in favor of work done or materials furnished has been satisfied).

188. An increasing number of states have statutorily created a limited priority for such liens. *See infra* Part II.A (discussing some attempted and proposed solutions to the problem of assessment nonpayment and foreclosure delay). Some states define the time of perfection for association liens as relating back to the date on which the assessment was due. *See infra* note 190 and accompanying text.

189. CAL. CIV. CODE § 1367.1(b), (d) (West 2011).

190. The UCIOA takes this approach. *See* UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (1994), *available at* http://www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/ucioa94.htm (stating that recording of the declaration constitutes record notice and perfection of the lien); *see also* FLA. STAT. ANN. § 718.116(15)(a) (West 2011) (providing that the lien is effective dating back to the recording of the original declaration); TEX. PROP. CODE ANN. § 82.113 (West 1997) (providing that the association's lien for assessments is created by recordation of the declaration, which constitutes perfection); *see also, e.g.*, American Holidays, Inc. v. Foxtail Owners Ass'n, 821 P.2d 577, 580 (Wyo. 1991) (deeming the date the declaration was recorded as the date of perfection for assessment lien).

191. *See, e.g.*, COLO. REV. STAT. ANN. § 38-33.3-316 (LexisNexis 2010) (providing that any security interest created before the assessment becomes delinquent has priority over the assessment lien). This way of conceptualizing the priority of association liens likely originated with the FHA Model Condominium Act of 1961. In some cases, the priority granted to first mortgage liens is subject to a capped super-priority. *See infra* Part II.A (discussing capped "super priority" liens).

192. VA. CODE ANN. § 55-79.84A (LexisNexis 2007).

Arizona's Condominium Act protects first mortgage priority even further, providing that such liens are always superior to assessment liens regardless of when they arose.[193] Maryland and North Carolina also deem an association lien completely subordinate to first mortgage liens on units within the community.[194] In states where the statute is arguably vague as to the priority position of the first mortgage, courts have clarified that even an assertion of super-priority in the declaration establishing the community will not create a priority superior to a first mortgage lien.[195] Thus, regardless of jurisdiction, first mortgages on units within a community are senior in priority to association liens for unpaid assessments. Legislatures and courts cite a policy of promoting financing availability as the motivation for this priority scheme.[196]

Holders of junior claims on the property (both liens and holders of equity) must be joined in a foreclosure proceeding to terminate their rights.[197] Because the association is a junior lienor, a foreclosing first mortgage loan is required to name the association as a necessary party to the foreclosure proceeding, and any excess sale proceeds beyond the amount owed on the first mortgage will be applied to the association's claim. However, where mortgages are under-collateralized, foreclosure sales typically do not obtain sufficient proceeds to pay off the first mortgage, let alone junior liens. Whether paid off or not, junior liens are wiped out in foreclosure of the senior lien.

Courts and legislatures in some states have attempted to limit the extent of association losses and protect community members against non-payment of assessments, even those lacking any priority protection with respect to first mortgages.[198] In New York, for example, the

193. ARIZ. REV. STAT. ANN. § 33-1256B (West 2007) (effective through Jan. 1, 2012).

194. MD. CODE ANN., REAL PROP. § 11-110 (LexisNexis 2010); N.C. GEN STAT. ANN. § 47C-3-116 (LexisNexis 2009). Maryland recently enacted a three-month capped priority for unpaid assessments. *See infra* notes 290–92 and accompanying text.

195. *See* Holly Lake Ass'n v. Fed. Nat. Mortg. Ass'n, 660 So. 2d 266, 269 (Fla. 1995) (holding that an assessment lien relating back to the date of declaration would expose lenders to unknown risks and therefore cannot have priority); Tally Arms Condo. Ass'n, Inc. v. Breland, 854 So. 2d 28, 30 (Miss. Ct. App. 2003) (holding that a subsequent assessment lien cannot have priority over a mortgage lien); First Fed. Sav. & Loan Ass'n of Charleston v. Bailey, 450 S.E.2d 77, 81 (S.C. Ct. App. 1995) (holding that assessments fixed or determined subsequent to a mortgage lien are subordinate to the assessment lien).

196. *See, e.g*, Bd. of Dirs. of Colchester Towne Condo. Council of Co-Owners v. Wachovia Bank, N.A., et al., 581 S.E.2d 201, 202 (Va. 2003) (explaining that "the realities of the marketplace require that such lenders be encouraged to provide the desired financing for individual condominium units by granting priority to the lien of their first mortgages or first deeds of trust").

197. NELSON & WHITMAN, *supra* note 58, at 570–73, 602–08.

198. A limited priority lien for assessment liens has been proposed multiple times to the New York legislature, but lenders have lobbied against the adoption of the measure. The first year it

statutory lien securing all unpaid condominium assessments is junior in priority to first mortgage liens,[199] and New York case law has confirmed that all sums related to a first mortgage lien (including collection costs, fees, etc.) on a unit within a community take priority over an association lien.[200] If a unit is delinquent on assessments in New York, however, legislation provides that the association may obtain a court-appointed receiver to pay regular assessments to the association *prior to* making any mortgage payments, and collect rents directly from a tenant.[201] Case law clarified that this provision does not apply to special assessments that are payable by a receiver only after mortgage loan payments are made.[202]

Even without appointing a receiver or foreclosing its lien, associations in Florida, like New York, can collect rents directly from any tenants living in units owned by defaulting members.[203] The 2010 amendment to the Florida Common Interest Community Act provides that associations can collect rent payments directly from tenants when the owner of a unit is delinquent and further provides that if tenants do not pay rent to the association, the board can evict them.[204] The revised law also explicitly permits associations to suspend voting privileges for owners who are ninety days delinquent in their assessments and clarifies

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was proposed, the measure was allowed to die in committee. The next year, it was defeated on the floor. *See* Ronald A. Sher, Esq., *Habitat Board Leadership Conference Seminar: Condo Collections*, HIMMELFARB & SHER LLP, http://www.himmelfarb-sher.com/options/condo_collections.htm (last visited Aug. 16, 2011) (discussing a proposed law that would give assessment liens a limited priority for six months).

199. N.Y. REAL PROP. LAW § 339-z (McKinney 2006).

200. Bankers Trust Co. v. Bd. of Managers of Park 900 Condo., 616 N.E.2d 848, 849 (N.Y. 1993).

201. N.Y. REAL PROP. ACTS § 1325(2) (McKinney 2006).

202. *See* First N.Y. Bank for Bus. v. 155 E. 34 Realty Co., 158 Misc. 2d 658, 661 (N.Y. Sup. Ct. 1993) (holding that special assessments are generally for capital improvements well beyond the period of receivership, and thus, obligation for the special assessments cannot be placed on the receiver).

203. *See* S.B. 1196, 2010 Sess. (Fla. 2010) (effective July 1, 2010).

204. S.B. 1196, 2010 Sess. (Fla. 2010) (codified at Fla. Stat. § 718.116 (2011)). The newly amended Florida provision attempts to permit associations to walk the fine line between incurring landlord liability and having the authority to collect rents and evict tenants. Tenants in Florida and New York, however, raise a valid complaint that they have no contractual or property relationship with the association (except indirectly through their landlord) and that even though the statute in question purports to immunize tenants who pay rents to the association against eviction by the landlord, landlords can do much to lower a tenant's quality of life while still acting within the strict "letter of the law" of a lease. *See* Kenric Ward, *Condo Associations Put 'Hammer' Down on Renters*, SUNSHINE STATE NEWS (June 2, 2010), http://www.sunshinestatenews.com/story/condo-associations-put-hammer-down-renters (highlighting the potential pitfalls of the new law for tenants).

that associations can restrict delinquent owners' use of common areas.[205]

Bankruptcy of a delinquent owner may impact an association's ability to collect delinquent assessments, particularly under Chapter 12, which permits junior liens to be "stripped" of their collateral claims when the collateral's value is less than the amount owed on a senior debt.[206] In a November 2010 decision, the U.S. Bankruptcy Court for the Eastern District of Virginia ordered that a community association be stripped of its unpaid assessment lien in the amount of nearly $7000 because the property was subject to a first mortgage debt that exceeded its current county-assessed value, which, the court opined, left no excess security to which the association's lien could attach.[207] Although the association argued that the cited real estate value for the property was "artificially low" because of a depressed housing market,[208] the court refused to preserve the lien "based solely on anticipated future increase in the value of a secured creditor's collateral."[209] The court held that while under-secured creditors' liens are generally valid, in the case of a party whose secured claim has "inconsequential value," a bankruptcy filing should cause the lien to disappear.[210] The operation of the Bankruptcy Code in this case further bolsters the argument that a junior priority for association liens is inequitable, particularly in cases of homes securing under-collateralized mortgages.

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205. S.B. 1196, 2010 Sess. (Fla. 2010).

206. *See In re* Cook, No. 10-10113-SSM, 2010 WL 4687953 at *1–2 (Bankr. E.D. Va. Nov. 10, 2010) (holding that Section 506(d) of the Bankruptcy Code makes any junior lien void upon a prior lien exhausting a creditor's collateral); *see also* 11 U.S.C. § 523(a)(16) (2006). Although Congress has specified that post-petition assessments are non-dischargeable in Chapter 7 bankruptcies, this carve-out specifically does not apply to pre-petition debts including assessments. *Id.*

207. *In re Cook*, 2010 WL 4687953, at *2. Interestingly, county tax assessed value is not how a property's value is typically determined. Market players typically price according to comparable sales or stream-of-income value for a property, and even judicial review of foreclosure sale prices admits that there is no precise benchmark for real property valuation. *See* B.F.P. v. Resolution Trust Corp., 511 U.S. 531, 545 (1994) (mentioning that there are several ways to determine a property's fair market value).

208. The association cites the "economic crisis that was triggered by the sub-prime mortgage loan meltdown" as having caused the drop in property valuation. *In re Cook*, 2010 WL 4687953, at *2.

209. *Id.*

210. The court also noted that "[a]lthough there may well be policy arguments favoring preservation of liens for pre-petition assessments when debtors in reorganization cases propose to retain the property, such arguments are properly addressed to Congress." *Id.*

II. ALTERNATIVES TO FAILED PRIVATE GOVERNANCE

Under current laws, owners in a CIC face financial uncertainty stemming from the ownership structure and assessment model of their community. Linked fiscal fortunes means that owners face the threat of ever-increasing assessments due to their neighbors' delinquencies, and these unpaid assessments may never be recovered because of such neighbors' mortgage defaults. The status quo in most states is not only destabilizing, it is also inequitable. Association maintenance preserves the value of a lender's collateral, and passing the pro rata share of upkeep costs onto non-defaulting owners results in unjust enrichment of the lenders.[211] Courts and legislatures have struggled to resolve such unfairness, particularly now that the current crisis has highlighted this deficiency in the CIC assessment system.

A. Other Attempted and Proposed Solutions

1. Limited Priority Liens

a. UCIOA and Six-Month Limited Priority Lien

The drafters of the Uniform Common Interest Ownership Act ("UCIOA"),[212] recognizing that assessment liens would ordinarily be junior in priority to individual first mortgage liens, crafted an "innovative" solution to the problem of assessment nonpayment during mortgage default: the six-month "limited priority lien."[213] The UCIOA model, which has been adopted by eight states to date,[214] provides that

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211. *See generally* RAWLS, *supra* note 5, at 96 (advocating that beneficiaries of a cooperative venture should bear the costs of such a venture on a *pro rata* basis); Hart, *supra* note 5, at 185–86 (arguing that enjoyment of benefits by parties not bearing associated costs is inequitable).

212. *See generally* UNIF. COMMON INTEREST OWNERSHIP ACT (1994) [hereinafter UCIOA]. In 1977, the National Conference of Commissioners on Uniform State Laws began drafting the Uniform Condominium Act based on the 1974 Virginia model. Subsequently, the Conference prepared three uniform laws governing condominiums, cooperatives, and homeowners associations—the three forms of privately governed communities with different ownership structures. These were the Uniform Condominium Act, the Uniform Planned Community Act, and the Model Real Estate Cooperative Act. The Conference then combined the three acts, resulting in the UCIOA. This Act contains provisions governing condominiums, planned unit development/homeowner associations, as well as cooperatives.

213. Carl Lisman, Chair of UCIOA's Drafting Comm., Presentation to the Maryland Task Force on Common Ownership Communities—Maryland Dep't of Hous. and Cmty. Dev. at the American Homeowners Resource Center: The Uniform Common Interest Ownership Act (June 9, 2006) (transcript available at http://www.epohoa.org/index.php?option=com_content&view=article&id=104:formation-1975-a-birth-of-ucioa&catid=93:news&Itemid=111). Lisman seems to believe that the UCIOA limited priority lien solves the problem of non-payment of assessments, noting that "we are now convinced that we are more brilliant than we thought we were." *Id.*

214. *See infra* notes 221–28 (explaining that these eight states include Nevada, Alaska,

an assessment lien, which is normally subordinate in priority to first mortgages on units, is given limited priority upon foreclosure of the first priority mortgage lien "to the extent the common expense assessments based on the periodic budget adopted by the association . . . would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien."[215] Thus, an association under UCIOA would have a priority position arising at a mortgage foreclosure sale for unpaid assessments up to an amount equal to six months of regular-assessment assessments.[216]

The six-month capped "super priority" portion of the association lien does not have a true priority status under UCIOA since this six-month assessment lien cannot be foreclosed as senior to a mortgage lien. Rather, it either creates a *payment* priority for some portion of unpaid assessments,[217] which would take the first position in the foreclosure repayment "waterfall," or grants *durability* to some portion of unpaid assessments,[218] allowing the security for such debt to survive foreclosure.[219]

The UCIOA priority portion does not include costs incurred by the association to collect delinquent assessments, such as attorney fees. Some states, however, have enacted statutory variations that include such costs.[220] According to Washington, D.C. lawyer Catherine Park,

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Colorado, West Virginia, Connecticut, Vermont, Minnesota, and Delaware). Legislative proposals to adopt UCIOA are pending in six more states: Utah, Indiana, New Jersey, South Carolina, Kentucky, and Ohio.

215. UCIOA § 3-116.

216. *Id.* Under such a capped priority arrangement, the priority position of the association lien is split: a super-priority position is given to up to six months of unpaid assessment amounts, and the remainder of unpaid amounts is accorded the typical priority position of the association lien, namely subordinate to the first mortgage lien. *Id.*

217. *See, e.g.*, MINN. STAT. ANN. § 515A.3-115 (West 2002 & Supp. 2010), *amended by* H.F. 1023, ch. 116, 2011 MINN. SESS. LAW SERV. (West) (providing that the lien does not have priority over a senior mortgage lien, but allows for recovery of assessments for a period of six months). Under this interpretation, six months of unpaid assessments are paid out of foreclosure proceeds prior to repayment of the first mortgage.

218. Under this interpretation, a lien securing six months of unpaid assessments would survive the first mortgage foreclosure. One problem with this second interpretation of the super-priority provision is that post-foreclosure, an association often still has to bring a lawsuit against the buyer or lender to recover the six months of allowable unpaid assessments. This can be onerous for the association. For example, in Georgia, an association cannot recover the costs of bringing an action to recover the six months' worth of assessments against the lender. First Fed. Sav. Bank of Ga. v. Eaglewood Court Condo. Ass'n, Inc., 367 S.E.2d 876, 878 (Ga. Ct. App. 1988) (finding that the statutory language limited recovery from the lender at six months of assessments, not including the costs of collecting such assessments).

219. The effect depends on a state's interpretation of the provision.

220. *See, e.g.*, MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 1996 & Supp. 2002); CONN. GEN. STAT. ANN. § 47-258 (West 2009 & Supp. 2011) (allowing for recovery of attorney's fees within the priority portion).

who specializes in condominium law and litigation, the failure of strict UCIOA states to include attorney costs can be exploited by mortgage lenders, which gamble that an association will not hire an attorney to recover "a mere six months" of unpaid assessments.[221]

The lien priority concept contained in UCIOA has gained traction even in states that have not otherwise enacted these uniform acts. Today, in the eight UCIOA states (Alaska,[222] Colorado,[223] Connecticut,[224] Delaware,[225] Minnesota,[226] Nevada,[227] Vermont,[228] and West Virginia[229]), in ten more states (Alabama,[230] Florida,[231] Illinois,[232] Maryland,[233] Massachusetts,[234] New Jersey,[235] Pennsylvania,[236] Rhode Island,[237] and Washington[238]), and in the

221. Catherine Park, *"Super Lien" Legislation: How Super is it Really? And Why Isn't the Mortgage Industry Complying with the Legislation?*, LAW OFFICE OF CATHERINE PARK (July 10, 2010), http://cparklaw.com/condolaw/2010/07/10/super-lien-legislation-how-super-is-it-really-and-why-isnt-the-mortgage-industry-complying-with-the-legislation. According to Park, the only way for would-be homeowners to protect themselves in such jurisdictions is to "avoid buying in a small community" and thereby hope to minimize the budgetary impact of assessment defaults. *Id.*

222. ALASKA STAT. § 34.08.470 (2010).

223. Colorado Common Interest Ownership Act, COLO. REV. STAT. § 38-33.3-316 (LexisNexis 2010); *see infra* notes 241–46 and accompanying text.

224. CONN. GEN. STAT. ANN. § 47-258.

225. DEL. CODE ANN. tit. 25, § 81-316 (2009).

226. MINN STAT. ANN. § 515B.3-115(a), (e)(1)–(3), (f), (i) (West 2002 & Supp. 2010), *amended by* State Agencies–Courts And Common Interest Ownership Act, ch. 116, sec. 16, § 515B.3-115, 2011 MINN. SESS. LAW SERV. (West).

227. NEV. REV. STAT. ANN. § 116.3116(2)(c) (LexisNexis 2010), *amended by* Uniform Laws–Amendments–Common Interest Communities Act, ch. 389, sec. 49, § 116.3116, 2011 Nev. Legis. Serv. (West); *see infra* notes 273–74 and accompanying text.

228. VT. STAT. ANN. tit. 27, § 1323 (2006).

229. W. VA. CODE ANN. § 36B-3-116 (LexisNexis 2005).

230. ALA. CODE § 35-8A-316 (LexisNexis 1991).

231. FLA. STAT. ANN. (West 2011); *see infra* notes 280–86 and accompanying text.

232. 765 ILL. COMP. STAT. ANN. 605/9 (West 2009). Section 9(g) of the Illinois Condominium Property Act requires the association board to have "taken action" to trigger the requirement that subsequent purchasers of a foreclosed unit pay six months of unpaid assessments. *Id.*

233. MD. CODE ANN., REAL PROP. § 11-110 (LexisNexis 2010), *amended by* Condominiums and Homeowners Associations—Priority of Liens Act, ch. 387, sec. 2, § 11-110, 2011 Md. Legis. Serv. (West) (granting a mere four-month, $1200-capped priority to association assessment liens at mortgage lender foreclosure).

234. MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 1996 & Supp. 2002). The Massachusetts statute includes a provision for attorneys' fees together with a dollar-amount cap. *Id.*

235. N.J. STAT. ANN. § 46:8B-21 (West 2003 & Supp. 2010).

236. 68 PA. CONS. STAT. ANN. § 3314 (West 2004).

237. R.I. GEN. LAWS § 34-36.1-3.16 (1956 & Supp. 2010).

238. WASH. REV. CODE ANN. § 64.34.364 (West 2005).

District of Columbia,[239] community association liens enjoy a limited priority, typically capped at six months or less. Legislatures in five states (Indiana, Kentucky, Ohio, South Carolina, and Utah) have been considering adopting a UCIOA-based statute that would include a six-month lien priority for unpaid assessments.[240] Even with these progressive statutory developments in many states, more than thirty states lack any lien priority for association assessments.

To illustrate the typical UCIOA lien priority approach, consider the Colorado Common Interest Ownership Act ("CCIOA").[241] Under the Act, association liens, which include assessments and all collection costs, are considered automatically perfected as of the date the association was created.[242] This type of lien is subordinate to property tax liens and to a first deed of trust on the property, but it is superior to all other encumbrances of record, regardless of when such other lien is filed.[243] At foreclosure of a first deed of trust on a property,[244] the association lien will be paid according to a limited priority position to the extent of six months of budgeted assessment amounts.[245] Colorado courts have held that the lien may be more than assessments alone, as it also includes "attorney fees, interest & other allowable items."[246] In

239. D.C. CODE § 42-1903.13 (2001).

240. *See* MALLACH, *supra* note 29, at 12 (advising state policymakers to consider allowing borrowers of mortgages in foreclosure a six month forbearance period).

241. COLO. REV. STAT. § 38-33.3-316 (2011). The 1992 version of the Colorado Common Interest Ownership Act ("CCIOA") automatically applies to associations created after 1992, but any pre-1992 association can elect to avail itself of the protections and provisions of the Act. By electing to come under the 1992 CCIOA, an association can effectively change the provisions in its own governing documents, without filing an amendment, since application of the law is deemed to change inconsistent declaration language in order to conform to the Act.

242. *Id.* The automatically perfected lien applies to "any assessment levied against that unit or fines imposed against its unit owner," which includes fees, late charges, attorneys' fees, and interest. *Id.* § 38-33.3-316 (1). There are no limits on late fees and interest, but it is arguably unclear whether the statutory language includes attorney fees.

243. *Id.* § 38-33.3-316 (3). This is because the priority timing for the association lien relates back to the recordation of the declaration. This applies only to liens for deeds of trust recorded after 1992 when CCIOA was created. For all such provisions, the super-priority six-month lien applies, regardless of language in the community documents or the deed of trust to the contrary. *Id.*

244. A deed of trust is essentially a mortgage. The common foreclosure method for mortgage liens in Colorado is non-judicial foreclosure through power of sale in a deed of trust. The only way to foreclose an association lien, however, is through a judicial proceeding. *See, e.g.*, ORTEN CAVANAGH RICHMOND & HOLMES, LLC, COLO. FORECLOSURE LAWS 1–2, 8 (Mar. 2008), *available at* http://www.ocrhlaw.com/library/Colorado_Foreclosure_Laws.pdf (explaining the non-judicial foreclosure procedure in Colorado and contrasting the non-judicial procedure to the mandated judicial foreclosure procedure for association liens).

245. *Id.* at 8.

246. First Atl. Mortg., LLC v. Sunstone N. Homeowners Ass'n, 121 P.3d 254, 255 (Colo. App. 2005) (citing COLO. REV. STAT. § 38-33.3-316 (2)(b) (2010)).

Colorado, the lien is not payable out of foreclosure proceeds, but rather survives the foreclosure of the first deed of trust (a durability interpretation of the UCIOA lien priority provision).[247]

Within non-UCIOA states, some lien priority statutory provisions originated in response to past housing crises imperiling community associations in that jurisdiction. For example, Massachusetts' lien priority law grew out of the state's real estate boom and bust of the late 1980s and early 1990s.[248] Two decades ago, associations in Massachusetts struggled with massive budget shortfalls when homeowners abandoned units they could no longer afford, forcing the communities to increase assessments on the remaining owners to keep the association afloat. The remaining owners often could not afford to make up extra payments to bridge the budgetary gap, which led to a domino effect of assessment and mortgage delinquencies.[249] Today, CIC liens in Massachusetts have a capped super-priority because of judicial and legislative efforts to protect communities during the 1990s.[250]

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247. This follows logically from the limitation on non-judicial foreclosure of association liens. *See supra* notes 201–02 (explaining that New York case law provides that all sums related to a first mortgage lien on a unit within a community, including collection fees and costs, take priority over an association lien). However, New York legislation provides that if a unit is delinquent on assessments, the association is able to obtain a court-approved receiver to pay regular assessments to the association before making any mortgage payments. N.Y. REAL PROP. ACTS. § 1325(2) (McKinney 2006). The association may also collect rents directly from a tenant. *Id.*

248. MICHAEL GOODMAN & JAMES PALMA, OFFICE OF THE PRESIDENT, UMASS DONAHUE INST., WINNERS AND LOSERS IN THE MASSACHUSETTS HOUSING MARKET: A STUDY FOR CITIZENS' HOUSING AND PLANNING ASSOCIATION AND THE MASSACHUSETTS HOUSING PARTNERSHIP 2 (2004), *available at* http://www.massbenchmarks.org/publications/studies/pdf/housingmarket04.pdf.

249. *See* Grahame K. Wells, *The Use of Super-Liens to Promote Cooperation Between Condominium Associations and Lenders*, 13 ANN. REV. BANKING L. 477, 477–78 (1994) (citing Henry L. Judy & Robert A. Wittie, *Uniform Condominium Act: Selected Key Issues*, 13 REAL PROP., PROB., & TR. J. 437, 475 (1978)). The troublesome state of the economy during the late 1980s and early 1990s left many condominium owners with severe financial problems, which in turn, led those owners to stop paying condo fees. Subsequently, the condos could no longer afford to perform proper maintenance or pay utility bills, the utilities were shut off by their providers, and local governments condemned the buildings. *Id.*; *see also* James Winokur, *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 353, 355 (1992) (discussing the real estate economy of the 1990s as a catalyst for creating limited lien priorities in several states).

250. Baker v. Monga, 590 N.E.2d 1162, 1164 (Mass. App. Ct. 1992) (holding that owners had an absolute obligation to pay assessments and that owners lack the right to withhold payments); *see also* Trs. of Prince Condo. Trust v. Prosser, 592 N.E.2d 1301, 1302 (Mass. 1992) (reiterating the *Monga* court's holding, stating that "[f]or the same reason that tax payers 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"). The Massachusetts legislature attempted to further mitigate the harm felt by associations losing their

Rhode Island's lien priority law is one of the newest in the nation, and it passed unanimously in the state's House and Senate in June 2008.[251] This legislation increased the capped foreclosure and collections cost amount to $5000 and $7500, respectively (inclusive of legal fees), and provided for a six-month lien priority for assessment liens upon foreclosure of the first mortgage.[252] Before the measure came to a vote, and when seeking the governor's veto thereafter, the Rhode Island Mortgage Bankers Association strenuously objected to the new law's lien priority provisions, claiming that they would spell the end of residential mortgage finance for community association housing in Rhode Island.[253] Legislative counsel to the Bankers Association bemoaned the measure, claiming that "it's basically picking the lenders' pockets, at the end of the day."[254] Rhode Island disagreed and passed the measure.

By crafting legislation that creates a six-month limited lien priority for assessments, state legislatures hope to motivate first mortgage lenders to help pressure non-paying owners to pay their delinquent obligations. If their borrowers make all their association payments, lenders can avoid paying six months' worth of assessments out of their foreclosure proceeds. If, however, the property is under-collateralized and mortgage foreclosure takes vastly longer than six months, the six-month priority cap actually may (perversely) induce a lender to further delay foreclosure until there is a ready third-party purchaser on hand. This is because a lender purchasing at foreclosure will be liable for all subsequent assessments, and the foreclosure will also trigger the six-month payment obligation, increasing the prospective lender costs of foreclosing. Also, a lender is still likely to recover more in an upside-down loan if a borrower makes payments on the mortgage rather than association deficiencies because the lender will only have to reimburse a six-month capped amount of association deficiencies at some future time.

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entire assessment lien by passing legislation that provides for a six-month lien priority arising at closing. MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 2011).

251. R.I. GEN. LAWS § 34-36.1-3.16 (2010). The previous law not only failed to provide any lien priority for assessment liens, but capped an association's reimbursement for foreclosure costs at $2500, with any additional costs having to be paid by the community as a whole. Patricia Antonelli, *Changes to Rhode Island Law Affect Foreclosures, Priority of Condominium Liens for Assessments, Mortgage Escrow Accounts and Reverse Mortgages*, PARTRIDGE SNOW & HAHN LLP (July 2008), http://www.psh.com/content345.

252. R.I. GEN. LAWS § 34-36.1-3.16 (2010).

253. Dunn, *supra* note 6, at G1 (quoting Terrance Martiesian, a lawyer for the Rhode Island Mortgage Bankers Association, who remarked that "[a] bank is not going to take second place . . . in the chain of liens against the property. . . . They want to be first.").

254. *Id.* (quoting James Hahn).

b. Federal Housing Impacts on Association Fiscal Recovery

Federal agencies and GSEs, such as Fannie Mae and Freddie Mac, insure or guarantee more than nine out of every ten mortgages that have been originated since the meltdown in credit markets in 2008.[255] The FHA now insures nearly 50% of all residential mortgages, up from 1.7% of the market in 2006.[256] As the buyer or insurer of nearly every currently originated mortgage loan, these federal policies regarding lending risk have an enormous impact in terms of capital availability. The policies of the FHA and the GSEs impact the resolution of the community assessment issue in two ways: first, by requiring any super-priority of assessment liens to be limited at six months' worth of assessments and, second, by prohibiting loans secured by units located in condominiums with high rates of neighborhood mortgage defaults.[257]

The GSE secondary market purchasers and the FHA insurers specifically define qualifying mortgages as a mortgage subject to no greater than a six-month capped assessment lien priority.[258] This effectively prevents association recovery beyond that threshold.[259]

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255. DEP'T OF TREASURY & U.S. DEP'T OF HOUS. & URBAN DEV., REFORMING AMERICA'S HOUSING FINANCE MARKET: A REPORT TO CONGRESS 12 (2011), *available at* http://www.treasury.gov/initiatives/Documents/Reforming%20America%27s%20Housing%20Finance%20Market.pdf [hereinafter TREASURY/HUD REPORT]; *see also* CTR. FOR AM. PROGRESS, A RESPONSIBLE MARKET FOR HOUSING FINANCE: A PROGRESSIVE PLAN TO REFORM THE U.S. SECONDARY MARKET FOR RESIDENTIAL MORTGAGES 2 (2011), *available at* http://www.americanprogress.org/issues/2011/01/pdf/responsiblemarketforhousingfinance.pdf (explaining that "Fannie Mae and Freddie Mac also now purchase more than 80 percent of all multifamily mortgages, loans to owners, and developers of rental residential properties").

256. CTR. FOR AM. PROGRESS, *supra* note 255, at 44–45; *see also Government Affairs Update: FHA Condo. Recertification Requirements*, NAT'L ASS'N OF REALTORS, http://www.realtor.org/wps/wcm/connect/15f94c8044f67a04b112f35d6aeab3b5/FHA%2BCondo%2BRecertification%2BRequirements%2B12.8.10.pdf?MOD=AJPERES&CACHEID=15f94c8044f67a04b112f35d6aeab3b5 (last visited Aug. 16, 2011); Rick Newman, *Kill Fannie and Freddie? Not Likely*, U.S. NEWS & WORLD REPORT (Feb. 21, 2011, 12:12 PM), http://money.msn.com/investing/kill-fannie-and-freddie-not-likely-usnews.aspx (explaining that most mortgages issued are currently supported by Fannie Mae, Freddie Mac or the FHA). In contrast, private lenders handled twenty percent of mortgages during "normal" times. *Id.*

257. *See infra* notes 258–59 and accompanying text.

258. *See* FANNIE MAE, FORM 1054 (1208): WARRANTY OF CONDOMINIUM PROJECT LEGAL DOCUMENTS, *available at* https://www.efanniemae.com/sf/formsdocs/forms/pdf/projectrevs/1054.pdf (specifying that in order for a loan to be qualifying, "[a]ny first mortgagee who obtains title to a condominium unit pursuant to the remedies in the mortgage or through foreclosure will not be liable for more than six months of the unit's unpaid regularly budgeted dues or charges accrued before acquisition of the title to the unit by the mortgagee"); *see also Condominium Unit Mortgages—Project Analysis*, FREDDIE MAC (Apr. 2011), http://www.freddiemac.com/learn/pdfs/uw/condoprojectanalysis.pdf (requiring that the first mortgagee obtaining title to the unit be liable "for no more than six months of unpaid, regularly budgeted assessments or charges (for late fees and collection costs) accrued before acquisition").

259. Financing for non-qualifying loans is increasingly hard to obtain in the current economic climate. *See* Dunn, *supra* note 23, at G1 (discussing Rhode Island foreclosure).

These definitions of qualifying mortgages make it impossible for a state to increase the priority of a community assessment. Such funding or insuring requirements therefore indirectly, but effectively, limit a community's ability to fully recover delinquent assessments at foreclosure of an underwater unit. These federal guidelines drive the bulk of all mortgage lending and unless the six-month limitation is changed, will prevent state legislatures from acting to solve the community assessment delinquency problem.

In addition to their priority requirements for qualifying mortgages, policies of these entities significantly limit finance capital availability for condominium units. The Department of Housing and Urban Development ("HUD") maintains a list of "Approved Condominium Projects," and FHA, Fannie Mae, and Freddie Mac will not insure or purchase mortgages to units in condominiums that are not on the approved list.[260] The new approval process implemented in the wake of the Housing and Economic Recovery Act of 2008 now disallows "spot loan" approvals—approvals based on applications for individual unit mortgages rather than the condominium as a whole.[261] Condominium projects will not be approved unless, *inter alia*, no more than 15% of the total units are in arrears (more than thirty days past due) of their association assessments.[262] An association with more than 15% delinquent owners can go after those owners personally for the unpaid amounts and would be wise to do so.[263] But if the owners are unable to

260. *See* Mortgagee Letter 2009-19 from Brian D. Montgomery, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees & All FHA Roster Appraisers 1 (June 12, 2009), *available at* http://www.bestfhalender.com/wp-content/uploads/2010/01/09-19ml.pdf [hereinafter Montgomery, Mortgagee Letter 2009-19] (stating that the FHA "will now allow lenders to determine project eligibility, review project documentation, and certify to compliance . . . . HUD will continue to maintain a list of Approved Condominium Projects"); Mortgagee Letter 2009-46A from David H. Stevens, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees 1 (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46aml.pdf ("This Mortgagee Letter (ML) waives five provisions of that guidance and serves as a temporary directive to address current housing market conditions."); Mortgagee Letter 2009-46B from David H. Stevens, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees and All FHA Roster Appraisers 1 (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46bml.pdf [hereinafter Stevens, Mortgagee Letter 2009-46B] (stating that the FHA will allow lenders to determine project eligibility, review project documentation, and certify compliance, but FHA will continue to have a list of approved condominium projects).

261. *See supra* note 260. Previously, individual loans in a community could earn HUD approval even if the community as a whole did not get blanket approval from HUD. Such per-unit approval is no longer an option.

262. Stevens, Mortgagee Letter 2009-46B, *supra* note 260, at 4.

263. *See supra* notes 159–77 and accompanying text (discussing association collection efforts).

pay, the paying members make up the budgetary shortfall, while they are simultaneously denied access to financing because of their neighbors' default. Even if a community earns a coveted spot on HUD's "Approved" list, that approval expires in two years unless all requirements are re-certified to the satisfaction of HUD.[264]

Other requirements for condominium project approval also impact the resolution of the assessment delinquency issue and have contributed to a slowdown in condominium unit sales in an already sluggish market.[265] HUD requires that "[n]o more than 10 percent of the units" be owned by one entity, and states that "[a]t least 50 percent of the units of a project must be owner-occupied."[266] Such limitations may practically limit the ability of a condomininm association to foreclose on liens for unpaid assessments and rent out units in the community in order to attempt to recover some amounts toward the delinquency while also prohibiting troubled owners from generating income from property rental to meet obligations.[267] Furthermore, such restrictions make it more difficult for a unit to be sold, since once a community passes the 15% delinquency tipping point (or the 50% rental tipping point), financing for would-be purchasers is essentially no longer available. And most ironically, if a condominium's documents restrict a unit owner's freedom to rent a unit, which it must do to ensure compliance with HUD's 50% rental limitation, the FHA has deemed the documents

264. *See* Montgomery, Mortgagee Letter 2009-19, *supra* note 260 (explaining that the recertification deadline for previously approved condominiums, previously set for December 7, 2010, was extended to dates from December 31, 2010 to March 31, 2010, staggered according to the original project approval date); *see also Government Affairs Update: FHA Condominium Recertification Requirements*, NAT'L ASS'N OF REALTORS (Dec. 8, 2010), http://www.realtor.org/wps/wcm/connect/15f94c8044f67a04b112f35d6aeab3b5/FHA%2BCondo%2BRecertification%2BRequirements%2B12.8.10.pdf?MOD=AJPERES&CACHEID=15f94c8044f67a04b112f35d6aeab3b5 ("Mortgagee Letter 2009-46B states that FHA approved condominium projects must be recertified every two years").

265. *See, e.g.*, Mandyvilla, Comment to *New FHA Condo Guidelines*, BROKER OUTPOST MORTGAGE FORUMS (Dec. 20, 2009, 7:55 AM), http://forum.brokeroutpost.com/loans/forum/2/283263.htm ("[Realtors should] motivate sellers to slash the price [of condominium units offered for sale] NOW on their listings before the market does it for them. . . . This is going to be the nail in the condo market. Values are going to plummet around here due to the number of projects that are at 51% concentration [of investor owners] and above.").

266. Montgomery, Mortgagee Letter 2009-19, *supra* note 260, at 4.

267. *See* DAVID H. STEVENS, ASSISTANT SEC'Y FOR HOUS./FED. HOUS. COMM'R, U.S. DEP'T OF HOUS. & URBAN DEV'T.: CONDO APPROVAL PROCESS (May 2010), *available at* http://portal.hud.gov/hudportal/documents/huddoc?id=MAY2010.pdf (noting that although David Stevens, Assistant Secretary of HUD, explained in May 2010 that HUD modified this "50% owner occupancy requirement to allow the exclusion of vacant and tenant-occupied REOs from the calculation," such exclusions do not apply to real estate owned by *associations* rather than *lending banks*).

as violating the "free transferability" provisions.[268] The result is that it is impossible for a condominium to be adequately approved for FHA insurance, either because it allows rentals or because it does not. Fannie Mae and Freddie Mac require similar owner-occupancy percentages, and thus, a condominium today cannot simultaneously satisfy the criteria of the GSEs and the FHA.[269]

Because nearly half of all mortgage loans are now insured by the FHA, and almost the entire remainder is sold on the secondary market to either Fannie Mae or Freddie Mac, the policies of the FHA, Fannie Mae, and Freddie Mac hugely impact resolution of the issue of assessment recovery.[270] The current requirements for loans, however, work at cross-purposes: while the delinquency rate is used as a proxy for community fiscal health, the priority limits on association assessments remove from a community a potentially crucial tool for ensuring the association's financial well-being. In recognition of the harm to communities and lenders that can result from a community with excessive delinquencies, it seems that the FHA, Fannie Mae, and Freddie Mac should use their market power and definitions of qualifying mortgages to support community health rather than place roadblocks to recovery.

c. State Efforts to Add or Enhance Lien Priority

Because capped lien priority typically protects only six months' worth of assessments, the longer it takes to get a paying owner to take title to the unit, the less protection the law provides. In early 2010, Lender Processing Services, Inc. estimated that on average, it took fifteen months for a home loan to go from being thirty days late to the property being sold in foreclosure.[271] The lengthy foreclosure timeline is caused in part by the sheer magnitude of the increase in foreclosure

268. 24 C.F.R. § 203.41 (2011).

269. Letter from Loura K. Sanchez, Managing Partner, Hindman Sanchez, to Comm. Ass'ns Inst. (Nov. 23, 2010) (on file with author).

270. *See* TREASURY/HUD REPORT, *supra* note 255, at 12 (explaining that the lack of private capital in the housing market since 2008 has led government agencies to insure or guarantee the vast majority of new mortgages); Jody Shenn & John Gittelsohn, *FHA Home-Loan Volume Is Sign of 'Very Sick System,' Agency's Stevens Says*, BLOOMBERG (May 24, 2010), http://www.bloomberg.com/news/2010-05-24/fha-home-loan-volume-is-sign-of-very-sick-system-agency-s-stevens-says.html (noting that the FHA, Fannie Mae and Freddie Mac have been financing more than 90% of U.S. home lending since the 2008 market collapse); Saskia Scholtes, *Fannie and Freddie Drive Home Loans*, FIN. TIMES (Apr. 2, 2008, 7:23 PM), http://www.ft.com/intl/cms/s/0/65c8ab08-00dd-11dda0c5000077b07658.html#axzz1TWkKeq6Y (discussing how government-sponsored mortgage companies have become the "backbone" of the U.S. mortgage market); *see also infra* Part II.A.1.c.

271. Viega, *supra* note 8.

volume over the past few years—in 2010, there were more foreclosures commenced each month than were typically commenced in an entire year prior to 2005.[272] The recent foreclosure moratoriums and government investigations into bank procedures, introduced in all fifty states in October 2010, significantly lengthened the time needed to complete foreclosure,[273] as lenders have (appropriately) responded to increased procedural scrutiny by slowing the process to ensure validity of the foreclosure.[274]

Some states have responded to the longer foreclosure timeline and the financial dire straits of associations by increasing the capped amount of their lien priority statutes. Nevada increased the six-month period to nine months,[275] and Florida increased its cap to the lesser of twelve months' worth of assessments or 1% of the outstanding mortgage loan amount.[276] Although both of these enhanced lien priority measures increased ultimate recovery by an association, they failed to solve the underlying problem that still plagues the six-month capped priority laws: once the designated period has elapsed (be it six or nine or twelve months), lenders have no further incentive to contribute to property upkeep or to expeditiously foreclose so that someone new can take title.

The housing crash prompted the Nevada Legislature to swiftly pass legislation strengthening lien priority protection for assessment liens, increasing the six-month lien priority to a nine-month priority, effective October 1, 2009.[277] The state legislators were mindful of the FHA and GSE guidelines, however, so the Nevada statute has an automatic carve-out for mortgages purchased by the GSEs, limiting the lien priority to the maximum allowed by such entities' guidelines (namely, six

272. *See supra* notes 18–19 and accompanying text (reporting 2010 foreclosure statistics).

273. Ariana Eunjung Cha & Dina Elboghdady, *50 State Attorneys General Announce Foreclosure Probe*, WASH. POST, Oct. 13, 2010, at A13.

274. Ensuring compliance with foreclosure procedure is crucial to protecting borrower rights and equity. Because the sale price at a foreclosure is not subject to substantive review, strict adherence to procedural safeguards is the only way that the system can ensure the price obtained is fair and that the borrower is given all notice and the right to redeem, which statutory law and equity require. *See, e.g.*, BFP v. Resolution Trust Corp., 511 U.S. 531, 545 (1994) (refusing to review the adequacy of a foreclosure sale price and instead focusing exclusively on the foreclosure process, stating, "[w]e deem, as the law has always deemed, that a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with").

275. NEV. REV. STAT. ANN. § 116.3116(2)(c) (2010).

276. FLA. STAT. ANN. § 718.116 (West 2010 & Supp. 2011), *preempted by In re* Spa at Sunset Isles Condo. Ass'n, Inc., No. 10-33758-PGH, 2011 WL 3290239 (Bankr. S.D. Fla. July 13, 2011).

277. NEV. REV. STAT. ANN. § 116.3116(2)(c) (2010).

months).[278] This carve-out undercuts the statute's effectiveness dramatically, as the vast majority of residential mortgage loans are originated for resale on the secondary market.[279] In addition, increasing the cap to nine months, even when applicable, rapidly became insufficient recovery as the post-default/pre-foreclosure duration of mortgages in the state increased.

Florida was the next state to increase the assessment lien priority cap amount. The Florida Distressed Condominium Relief Act of 2010, effective July 1, 2010, provides that a first mortgagee taking title to property through foreclosure is liable for the twelve months of unpaid common expenses and regular periodic assessments that came due during the immediately preceding year.[280] The total potential exposure of lenders under this statute, however, is capped at 1% of the outstanding mortgage debt.[281] While the previous change in the law implementing a six-month cap inspired widespread adherence among lenders who have not contested its retroactive application, Florida courts have not yet stated definitively that the Florida amendment creating a twelve-month cap can be applied retroactively.[282] In addition, although states like Colorado have specified that their statutory lien priority provisions trump association documents with provisions to the contrary, it is unclear whether this is true in Florida or whether Florida associations must amend their documents to take

278. *Id.*

279. *See* TREASURY/HUD REPORT, *supra* note 255, at 2. Secondary resales today are primarily through Fannie Mae and Freddie Mac. *Id.*

280. Distressed Condominium Relief Act, 2010 Fla. Sess. Law Serv. 36 (codified at Fla. Stat. Ch. 718.701–08). Previous modifications in the law increased the cap to twelve months for single family homes in CICs but left the cap at six months for condominium units. The 2010 amendment equalized recovery in both types of CICs. *Id.*

281. FLA. STAT. ANN. § 718.116(1)(b)2 (2011). According to some Florida lawyers, the new law permits unlimited recovery of unpaid assessments from third-party buyers at mortgage foreclosure (unlimited durability of the association lien) and caps recovery only from lenders. Telephone interview with Ben Solomon, Attorney, Association Law Group, P.L., North Bay Village, Fla. (Sept. 28, 2011) (notes on file with author) [hereinafter Solomon Interview]. Other Florida attorneys dispute this reading of the law, noting that the twelve-month cap applies to all foreclosure sales, regardless of the identity of the buyer, and expressing doubt that the new twelve-month limit will apply to foreclosures of mortgages originated before 2010. Telephone interview with Chuck Edgar, Attorney, Cherry, Edgar & Smith, P.A., Palm Beach Gardens, Fla. (Sept. 27, 2010) (notes on file with author) [hereinafter Edgar Interview]. Edgar agrees that the statutory language is ambiguous on this point but notes that there is nothing in the legislative history to suggest that Florida legislators intended to create a different rule for lender and third-party foreclosure buyers. *Id.*

282. Edgar notes that "Everyone is collecting the six months of assessments, and lenders aren't fighting it." Edgar Interview, *supra* note 281. But Edgar also opines that the twelve-month cap may not apply to mortgages originated prior to July 2010 and believes that the legislature in Florida cannot retroactively impose the cap, and only the federal government, not a state government, could pass a law that effects such an "impairment of contract." *Id.*

advantage of the enhanced lien priority if the documents reference the prior (six-month) capped level.[283] The flaws of Florida's newly amended statute are already apparent, and less than a year later, new legislation has been introduced to "refund and expand upon those amendments and to clarify other condo association issues."[284]

Florida has been coping with perhaps the worst volume and quality of foreclosures in the nation during the past few years, and the large quantity of foreclosures and many lender missteps have so far discouraged lenders at foreclosure from challenging the law or its application.[285] Even if unchallenged, the long delay between commencing and completing foreclosure proceedings in Florida makes the twelve-month capped priority still inadequate in many cases anyway.[286] In Florida, as in other states, the best way to ensure repayment of assessment amounts is to immediately start legal proceedings when a homeowner has not paid his dues to get a personal money judgment against the owner in order to compel collection. Pursuing a money judgment is often the cheaper and easier route for an association to take to recover unpaid assessments.

The Florida law is so new that the state's mortgage market has not yet reacted to the change. Interestingly, Florida's twelve-month limit does not have a GSE limit carve-out like the Nevada provision.[287] It is unclear how this limitation will play out in Florida with respect to availability of mortgage capital, since Fannie Mae and Freddie Mac specifically exclude debts for which a lender could be liable for more than six months of assessment charges from pools of qualifying mortgages.[288] Mortgage originators today almost never originate non-

283. *See id.* (noting that everyone is taking advantage of the six-month cap, despite the fact that it is unclear whether or not Florida associations need to amend their documents to take advantage of the enhanced lien priority); Solomon Interview, *supra* note 281 (stating that Florida law permits unlimited recovery of unpaid assessments from third-party buyers at mortgage foreclosure and caps recovery only from lenders).

284. Joshua Krut, *Board of Contributors: After Sweeping Changes in Florida's Condo Law, Expect New Revisions*, DAILY BUS. REV. (Feb. 23, 2011), http://www.law.com/jsp/article.jsp?id=1202482933797 (calling this pending legislation the "glitch bill" because it is designed to clarify unanswered questions relating to the amendments of the prior year).

285. *See* Edgar Interview, *supra* note 281 (agreeing that the statutory language is ambiguous but that the legislature did not intend to create a different rule).

286. *See, e.g.*, *supra* notes 110–12 and accompanying text (identifying incidents in which enhanced lien priority statutes failed to protect condominium associations).

287. It does, however, have a dollar-based cap of 1% of the mortgage loan amount. FLA. STAT. § 718.116(1)(b)2 (2010).

288. Section B4-2.1-06 of Fannie Mae's lending guidelines explicitly states that Fannie Mae will not purchase debt if the holder of the mortgage could be liable for more than six months of regular common expenses charged by a community association. *See* FANNIE MAE, SELLING GUIDE 575–76 (June 28, 2011).

FHA loans that they cannot sell on the secondary mortgage market, and the only truly active secondary residential mortgage market purchasers are the GSEs.[289] It remains to be seen if the Distressed Condominium Act adversely impacts the availability of mortgage financing in CIC homes in Florida, or if the GSEs will not enforce these guidelines there or will change their mandates.

After facing much resistance from lender lobbyists, the Maryland General Assembly approved a statute to grant CIC assessment liens a capped priority in mortgage lender foreclosure sales.[290] The new law requires that $1200 of assessments (or up to four months of assessments, if less) be paid to an association prior to payment on the mortgage debt at foreclosure.[291] Since foreclosure in Maryland takes a minimum of five months to complete,[292] this capped assessment liability is clearly inadequate to cover all of an association's costs during the pendency of foreclosure.

Bills specifically aimed at creating six-month limited priority for association assessment liens are currently pending in Ohio and Missouri. Each case is strongly supported by individuals who reside in CICs and community association lobbies, and each case is strongly opposed by bank lobbies. In Ohio, efforts to pass a UCIOA-based lien priority for assessments (House Bill 408) failed to achieve legislative action in the legislature's 2010 session.[293] The efforts are still alive, and proponents of the measure hope that 2011 will see passage of a law creating a provision for six months of assessments plus attorney fees, costs, and expenses to enjoy lien priority superior to all liens but those for property taxes. National and state lenders in Ohio have strongly opposed the bill, contending that it will increase lending costs and complexity and will chill mortgage lending in an already semi-frozen housing capital market.[294]

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289. *See* TREASURY/HUD REPORT, *supra* note 255, at 2 (discussing how the new plan developed by the administration will bring private capital into the market and decrease the role of Fannie Mae and Freddie Mac).

290. H.B. 1246, 428th Gen. Assemb. (Md. 2011). The original bill set the priority cap higher—six months plus late fees and collection costs—but this proposal met vigorous opposition by the Maryland Bankers Association. *Community Association Law Letter*, THOMAS SCHILD LAW GROUP LLC, 1 (Spring 2011), http://www.schildlaw.com/Spring%202011%20Newsletter.041811.pdf. The legislature cut down the cap in an effort to appease the mortgage lender lobby. *Id.*

291. Md. H.B. 1246.

292. *See* Mallory Malesky, *How Long Does Foreclosure Take in Maryland*, EHOW (Mar. 23, 2011), http://www.ehow.com/info_8098323_long-foreclosure-maryland.html (explaining Maryland foreclosure procedures).

293. *See* MALLACH, *supra* note 29 (discussing the foreclosure crisis in Ohio).

294. *See* Ann Fisher, *Condo Associations Want Plan to Make Owners Pay*, THE COLUMBUS

Banks are also concerned with potential retroactive application of the priority law with respect to loans that have already been funded.[295] While active debates on limited priority statutes remain in Ohio and Missouri, in many other states, efforts to create a limited lien priority for association assessments have never gained traction.[296]

d. Inadequacy of Limited Priority Liens

The priority law for community assessment liens varies among the states, but this problem has been insufficiently addressed in all of them. When unpaid upkeep costs are potentially unlimited, capped losses for the lender necessarily result in unlimited losses allocated to the members of the community. Thus, even a "super-priority" piece allocated to assessment liens becomes inadequate once that period has expired.

When foreclosure takes longer than six months and when foreclosure proceeds are inadequate to pay off a first mortgage—and both of these factors are more and more common today—only a fraction of unpaid assessments are paid, requiring paying members of the association to fund the remainder.[297] Furthermore, even in some jurisdictions with a limited association lien priority, proceeds at foreclosure do not automatically apply to unpaid assessments (the capped portion being deemed a durability rather than payment priority provision), and thus the association has to bring a lawsuit—and incur more community costs—just to recover the amounts that are legally theirs. Miami Beach Commissioner Jerry Libbin calls this problem an "outrageous loophole" in the law.[298]

DISPATCH, July 5, 2009, at 01B.

295. *See id.* ("Banks and other lenders typically have opposed such laws, contending that they increase the cost and complexity of lending.").

296. *See, e.g.*, S.B. 411, 2010 Gen. Assemb., Reg. Sess. (Va. 2010) (stricken Jan. 27, 2010) (establishing limited lien priority for condominium association assessments).

297. *See* Coleman, *supra* note 104, at 1A (noting that condominium owners in good standing are often charged "special assessments" to make up for unpaid fees from delinquents owners).

298. Admin, Comment to *Ruling May Help Homeowner Associations*, HISTORIC CITY NEWS (Feb. 6, 2010, 2:31 PM), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546. Libbin heralded the reverse foreclosure tactic, *see infra* Part II.A.2, as an important step toward protecting owners in condominiums. *See id.* (noting that Libbin applauded a Miami-Dade Circuit court ruling ordering a "reverse foreclosure"). Florida's legislature considered a bill that would have required banks to complete foreclosure after a year of filing or pay all unpaid assessments, but this proposal never came to a vote. *See* Rob Samouce, *Laws Needed to Get Delinquent Properties Back on Market*, NAPLES DAILY NEWS (Jan. 2, 2010), http://www.naplesnews.com/news/2010/jan/02/laws-needed-get-deliquent-properties-back-market/ (noting that strong bank lobbying was the cause of legislative inaction on the bill); *see also HOA's Forcing "Reverse Foreclosures,"* TITLE SEARCH BLOG (Mar. 1, 2010, 10:26 AM), http://titlesearchblog.com/2010/03/01/hoas-forcing-reverse-fore closures/ (remarking that the bill

The general problem of unpaid assessments is dramatically exacerbated in the current market context where lenders (sometimes deliberately) delay foreclosure on defaulting properties.[299] Lenders can—and today often do—delay foreclosure. It is true that foreclosure can take a long time for other reasons: mortgage loan servicers are currently overwhelmed with the number of defaulting borrowers, and lenders look hopefully to future market price rebounds to recover under-collateralized loan amounts. In addition, mortgage servicers' faulty record-keeping and failure to follow legally-mandated procedures operate to stretch out the foreclosure timeline as well.[300]

But lenders also sometimes strategically delay based on their calculation that they will be unable to sell the property at foreclosure or resell the property afterwards because of the sluggish housing market.[301] Procrastination can help lenders avoid incurring the obligations of home ownership, including property taxes and community association assessments. This is particularly true in cases where there is a very real risk that the ultimate sale price for the property will not reimburse such costs. Once the lender owns the real estate (real estate owned, or "REO" properties), the lender itself is responsible for assessment charges and, unlike insolvent mortgage borrowers, can typically be sued successfully for assessment payments they neglect to make.[302] Because this obligation is assumed upon taking title, lenders in many cases prefer to postpone foreclosure,

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"never saw the light of day for a vote by the legislature").

299. *See, e.g.*, Marshall L. Jones, *Condo Associations Battle Deadbeat Owners, Balky Banks in Collecting Fees*, REAL EST. L. & INDUS. REP., Apr. 6, 2010, at 3 ("As lenders institute foreclosure proceedings against defaulting condominium owners, some condominium associations are seeing lenders delay in completing the foreclosure process.").

300. *See supra* note 3 and accompanying text. In addition to servicer and bank moratoriums on foreclosures, several states, including Connecticut and Texas, froze all foreclosures in October 2010 pending inquiry into faulty and fraudulent loan servicing procedures. Several other states stopped foreclosures by J.P. Morgan Chase, GMAC and Ally Financial, the institutions tainted with the "robo-signing" scandal. *See* Cha, *supra* note 3, at A9 (noting that the moratoriums have now been lifted, but the pace of foreclosure remains slow).

301. *See* Coleman, *supra* note 104, at 1A (noting that some banks deliberately delay taking back property worth less than the outstanding mortgage); Benny L. Kass, *Condo Associations Saddled with Unpaid Dues Demand that Banks Stop Delaying Foreclosures*, WASH. POST, Nov. 20, 2010, at E3 (noting that condo associations are often left with unpaid dues when banks, wanting to avoid assuming liability on unpaid condominium dues and taxes, delay foreclosure on a unit).

302. *See, e.g.*, Leigh Katzman, *Waiting for the Bank to Foreclose: A Modern Day Story*, KATZMAN GARFINKEL ROSENBAUM, 1–3, http://kgblawfirm.com/pdfs/Waiting for the bank to foreclose-LCK.pdf (last visited Oct. 30, 2011) (detailing all the costs that a lender will incur upon taking title to real estate at a mortgage foreclosure sale and concluding that "the bank can comfortably delay completing its foreclosure action knowing the full extent of its liability for past due assessments").

hoping that the market will improve and property resale will be more quickly forthcoming. As Florida attorney Ben Solomon explains, "[t]he bottom line is the banks don't want to assume the liability associated with the unit, including the obligation to pay maintenance assessments to the association."[303] In the meantime, collateral values are preserved through assessments that lenders neither pay nor reimburse.

Today, the delay between initial mortgage default and actual foreclosure sale is longer than ever before. Since bank liability for previously unpaid assessments is capped—or, in many places, non-existent—mortgage lenders receive an unjust enrichment of collateral upkeep at the cost of other members of the community. Currently, there is nothing in the law to prevent such an outcome.

Foreclosure delays increase the ultimate charges borne by the non-defaulting neighbors but also cause neighboring owners to suffer in other ways. As unpaid assessments increase, dues increase, units fall into disrepair, and abandonment increases the likelihood of vandalism and squatters. When foreclosure finally happens, both property values and quality of life for the community have declined.[304]

Focusing on the complete lack of even a capped assessment priority in a majority of states, Washington, D.C. association law expert and syndicated columnist Benny Kass has publicly called for nationwide campaigns to create UCIOA-like provisions in those states that have not yet passed such a law.[305] But even if the thirty-three states with no limited priority passed UCIOA-based six-month (or larger) caps, the underlying problem would persist: lenders can offload a theoretically unlimited amount of upkeep costs of their collateral onto innocent members of the community with no adequate recourse at law for the community and its paying members. And since the limited priority of assessment liens under UCIOA and similar statutes only takes effect upon a first mortgage foreclosure, the limited priority lien fails to force the bank's hand and achieve a more expeditious resolution through conveying the unit to an owner willing and able to contribute to community costs.[306]

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303. Sutta, *supra* note 6.

304. *See, e.g.*, Rogers, *supra* note 181, at 1–3 (describing the course of foreclosure proceedings); *supra* Part I.B.2 (discussing the financial tragedy of the commons associated with foreclosures in condominium associations).

305. *See* Kass, *infra* note 356 (stating that such monthly-based limited priority lien systems "must be enacted all over the country as soon as possible").

306. Note that some creative litigators have attempted to do just that, with some limited success in Florida. *See infra* Part II.A.2.

State legislatures could close this "loophole" by mandating true priority for community assessment liens (at least with respect to dues that are unpaid during a period of mortgage default) or by making CIC assessment liens non-extinguishable in foreclosure. Capping community losses rather than lender losses would eliminate the distortion that the current potential "free ride" creates for lenders weighing the costs of foreclosure. This would encourage lenders to pay community assessments during borrower defaults, whether or not it also encourages the pace of foreclosure to increase. Either way, the community's losses and contagion effects of the distressed properties is contained: at some defined point in time, a solvent interest-holder in a unit will be encouraged to pay the unit's equitable allocation of costs. This type of limited priority would be vastly more equitable than the UCIOA-type of total-amount capped lien, both in terms of allocating upkeep costs and in terms of efficiently motivating housing rollover and market stability.

2. Creative Litigation Strategies

Florida is perhaps the epicenter of the CIC assessment crisis.[307] Florida was the site of one of the largest housing booms over the past few decades.[308] In particular, condominium development and financing flourished in Florida through 2007.[309] Condominiums in Florida

307. *See* ElBoghdady, *supra* note 10, at A14 (noting that nine of the twenty regions with the worst foreclosure rates were in Florida); Brad Heath, *Most Foreclosures Pack into a Few Counties*, USA TODAY, Mar. 6, 2009, at 1A (noting that eight counties in Arizona, California, Florida, and Nevada were responsible for one quarter of all foreclosures in the U.S. in 2008). *See generally* Prashant Gopal, *Florida Condo Owners Footing Bill for Foreclosures*, BLOOMBERG BUS. WK. (Nov. 29, 2007), http://www.businessweek.com/the_thread/hotproperty/archives/2007/11/florida_condo_o.html (detailing results of the 2009 Florida Community Association Mortgage Foreclosure Survey). Florida is also one of the states most impacted by the housing crisis in general.

308. *See* MAUREEN F. MAITLAND & DAVID M. BLITZER, S&P/CASE-SHILLER HOME PRICE INDICES 2009, A YEAR IN REVIEW 5–6 (2010), *available at* http://www.standardandpoors.com/indices/index-research/en/us/?type=All&category=Economic (follow "S&P/Case-Shiller Home Price Indices: 2009 A Year In Review (PDF)" hyperlink) (showing double-digit rise in home prices in Florida, followed by a precipitous decline as the real estate market went into crisis); Haya El Nasser, *Florida Growth Outpaces National Trend*, USA TODAY (Mar. 22, 2011, 3:25:38 PM), http://www.usatoday.com/news/nation/census/2011-03-17-florida-census_N.htm (comparing growth rates in Florida to the rest of the country); *see also South Florida Absorbs Growth Across the Board*, SE. REAL EST. BUS. (Sept. 2005), http://www.southeastrebusiness.com/articles/SEP05/highlight2.html (enthusiastically discussing the robust growth of the real estate market in Florida—which in hindsight seems ironic and naïve).

309. *See, e.g.*, Richard Peep, *Condo Culture: How Florida Became Floridistan*, NEWGEOGRAPHY (May 22, 2011), http://www.newgeography.com/content/002245-condo-culture-how-florida-became-floridastan (telling of the appeal and growth of condominium developments and investment properties in Florida in the 1990s).

attracted many real estate investor-buyers,[310] and the demographics of the state—in particular, the high percentage of retired persons—made low-maintenance/high amenity housing particularly appealing. But this same demographic makes the population more vulnerable to escalating monthly housing costs. Because of these factors, Florida today presents the most extreme case of foreclosure delay spillovers and community governance insolvency. This foreclosure delay is rampant: there are ample news reports of lenders' strategic postponement of public auctions,[311] and the average foreclosure now takes longer than a year and a half.[312] Although the amended Florida law permits a capped recovery after mortgage foreclosure of an amount equal to the lesser of twelve months' worth of unpaid association assessments or 1% of the outstanding mortgage loan amount,[313] in most cases this limited amount will not cover all of an association's unpaid assessments.

Florida attorneys representing community associations have become very creative in seeking recovery for their clients. One particularly interesting tactic has been termed a "reverse foreclosure."[314] To achieve a reverse foreclosure, the association must first foreclose on its assessment lien and take title to a delinquent unit subject to the first mortgage lien.[315] The association, as now-owner of the property, files a motion for summary judgment in the mortgage lender's own foreclosure action, seeking judgment in favor of the lender.[316] The association

310. A majority of the condominium units in Florida in 2007 were non-owner occupied (investor properties). *See* Shimberg Ctr. for Affordable Hous., *State of Florida's Housing, 2007 Executive Summary*, AFFORDABLE HOUS. ISSUES, Apr. 2008, at 1, 3, *available at* http://www.shimberg.ufl.edu/pdf/Newslet-Apr08.pdf (listing statistics for owner-occupied condos in Florida).

311. *See, e.g.*, Coleman, *supra* note 104, at 1A ("[L]enders are in no hurry to take back delinquent units, only to have to turn around and sell them amid a market that has crashed.").

312. Interview with Kevin Miller, Attorney (Oct. 2010) [hereinafter Miller Interview] (notes on file with author).

313. S.B. 1196, 2010 Sess. (Fla. 2010) (codified at FLA. STAT. § 718.116 (2010)).

314. *See* Coleman, *supra* note 104, at 1A (describing reverse foreclosures as a "a tool that can force banks to pay association maintenance fees when unit owners don't); Susannah Nesmith, *Ruling Could Give Embattled Associations Relief*, DAILY BUS. REV. (Jan. 27, 2010), http://www.law.com/jsp/article.jsp?id=1202466596282 (describing a "reverse foreclosure" ruling in a Miami-Dade Circuit Court case forcing a bank to take title to a property from a homeowner association); Paul Brinkman, *Miami Judge Grants Reverse Foreclosure*, S. FLA. BUS. J. (Jan. 25, 2010, 4:04 PM), http://www.bizjournals.com/southflorida/stories/2010/01/25/daily10.html (quoting attorney Ben Solomon, who notes that reverse foreclosures reverse "will finally help associations force banks to take title to financially upside down units much faster than ever before"); *"Reverse Foreclosure" Makes Banks Accountable to HOA*, FLA. L. J. (Jan. 25, 2010), http://www.thefloridalawjournal.com/2010/01/reverse-foreclosure-makes-banks-accountable-to-hoa/ (noting reverse foreclosure is a legal strategy for condominium and homeowners associations to prevent banks from stalling foreclosures).

315. *See* Nesmith, *supra* note 314 (describing the procedures for enforcing a reverse foreclosure).

316. *Id.*

waives all claims for notice and sale of the property under Florida's foreclosure laws and moves that the court immediately order the title to be transferred to the lender.[317]

Keys Gate Community Association successfully employed the reverse foreclosure approach on a home to which it had taken title in 2007 after the owners stopped paying assessments.[318] The first mortgage lender on the unit, HSBC Bank USA, filed its own notice to foreclose two months after the association took title, but the foreclosure sale never happened.[319] Finding itself stuck with an empty house and two-and-one-half years worth of unpaid dues (over $5000), the association attempted the new strategy of moving for summary judgment in favor of the mortgage lender.[320] In January 2010, Miami-Dade Circuit Judge Jerald Bagley accepted the association's argument and ordered title immediately transferred to HSBC, making it liable for all future community assessments.[321] The court also ordered HSBC to pay the association's legal fees and court costs in connection with the reverse foreclosure action as well as the capped lien priority amount that trumped the first mortgage lien. Because this amount was capped, the association had to write off $3820 in unpaid fees, but at least the long delay in finding a financially responsible unit owner was finally over.[322] As Keys Gate attorney Ben Solomon put it, "[t]he quicker we can move these distressed properties through the process and into the hands of somebody who will pay a mortgage and pay taxes and pay their dues, the quicker we can get the economy back on track."[323]

In the wake of the Keys Gate success, the reverse foreclosure strategy gained popularity during early 2010.[324] Ben Solomon's firm, Association Law Group, filed eighty-three foreclosures around the state,

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317. *Id.*; Paul Owers & Lisa J. Huriash, *Fighting Over Foreclosures—Homeowner Associations Target Delinquent Tenants, Lax Lenders*, SUN SENTINEL, Aug. 10, 2010, at 1A.

318. HSBC Bank USA v. Keys Gate Cmty. Ass'n, Inc. No. 07-18411 CA 09 (Fla. Jan. 12, 2010).

319. *Id.*

320. Coleman, *supra* note 104, at 1A.

321. Peter L. Mosca, *Florida Court Decision Could Impact Builders and Bank Foreclosure Processes*, REALTY TIMES (Feb. 17, 2010), http://realtytimes.com/rtpages/20100217_florida court.htm.

322. *Id.*; *see also* Coleman, *supra* note 104, at 1A (describing Keys Gate Community Association's use of the reverse foreclosure tactic).

323. Nesmith, *supra* note 314.

324. *See Ruling May Help Homeowner Associations*, HIST. CITY NEWS (Feb. 5, 2010), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546 (noting that some firms have been in favor of reverse foreclosure to avoid paying past due fees).

with varying success.[325] The reverse foreclosure concept is novel, and both judges and lenders were confused by the summary judgment motion.[326] Some courts did not realize that the association in such cases was arguing for judgment for the lender; some lenders did not realize this either. While the Miami-Dade judges have been receptive to the idea of a reverse foreclosure, no district court has yet considered and approved the tactic.[327]

In some cases, the exotic nature of the reverse foreclosure claim caused lenders to just walk away. For example, Citibank responded to a reverse foreclosure motion by just writing off the entire mortgage debt, leaving the association owners owning the unit.[328] However, the association had hoped to win a financially competent owner by losing the foreclosure case, and by winning the case, the association lost access to the bank's deep pocket for future assessment costs.[329]

The reverse foreclosure strategy is interesting, but it is legally cumbersome and unpredictable. In addition, this judicial tactic is limited to situations where (a) the association has previously foreclosed on its lien, subject to a first mortgage lien, and (b) the first mortgagee has already filed a foreclosure action. If a lender has not yet commenced a court action for foreclosure, no summary judgment motion can be filed. In addition, the reverse foreclosure requires the unreimbursed costs of the association's own foreclosure action. Furthermore, the entire recovery by the association in Florida is capped at 1% of the outstanding mortgage loan or twelve months of assessment costs.[330] If the unit in default already has a tenant, there is an even better option available to the association. Under the 2010 amendment, the association can collect rents from a defaulting unit without having to foreclose or file a motion in a lender's proceeding, which may permit a more immediate and greater recovery for the community.[331]

Association lawyers in Florida have made other attempts to find an avenue for recourse within the existing legal framework. The Association Law Group pioneered a tactic they call "The Mortgage Terminator" to wipe out a mortgage lien in cases where an association has foreclosed on the unit and the mortgage lender has not commenced

325. Solomon Interview, *supra* note 281.
326. *Id.*
327. Miller Interview, *supra* note 312.
328. Sutta, *supra* note 6.
329. *See id.* (discussing Citibank's willingness to hand over title).
330. FLA. STAT. ANN. § 718.116.(1)(b)(1)(a)-(b) (West 2011).
331. *Id.*

foreclosure proceedings.[332] The association title-holder of the property brought its own case against Wells Fargo in a Broward County case in 2010, claiming that the bank lost its equitable claim to its real estate collateral by deliberately delaying commencement of foreclosure proceedings.[333] The court agreed and wiped out the mortgage lien.[334]

In another case where the lender strategically delayed foreclosure, the condominium association sued to force the lender to act. The trial court, in *United States Bank National Ass'n v. Tadmore*, found the association's arguments compelling and ordered the lender to "diligently proceed with the pending foreclosure action . . . or pay monthly maintenance fees on the condominium unit in foreclosure."[335] The court based its holding on its general equitable powers, concluding that the association was unreasonably prejudiced by the lender's deliberate delay in pursuing foreclosure.[336] Thus, the court reasoned that it was fair and equitable to order the lender to pay monthly assessments even prior to foreclosure.[337] The trial court decision in *Tadmore* at first sparked a flurry of interest in the concept of using equity to force an expeditious foreclosure, but the holding was short-lived. The appellate district court in *Tadmore* reversed, holding that the lender could not be obliged to pay condominium assessments on a unit it did not (yet) own.[338] There was no contractual obligation to pay those fees, and no obligation would arise until the lender acquired title.[339] Although the association's claim was made in equity, the court of appeals held that equity could only follow the law, not divert from it.[340]

Other associations pin their hopes on provisions in the Florida foreclosure statute that mandate a foreclosure sale to be scheduled no sooner than twenty and no later than thirty-five days after court

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332. Daniel Vasquez, Broward *Case May be First of Many*, MIAMI HERALD (Oct. 10, 2010), http://www.algpl.com/news/press/MH-Oct-10-2010.pdf.

333. *Id.*

334. *Id.*

335. U.S. Bank Nat'l Ass'n v. Tadmore, 23 So. 3d 822, 822 (Fla. Dist. Ct. App. 2009).

336. *Id.* at 823.

337. *Id.*

338. *Id.*

339. *Id.*

340. The court noted that "equity follows the law" and reasoned that therefore, equity "cannot be utilized to impose this obligation without limitation before title is passed." *Id.* While the *Tadmore* approach was creative, it is unsurprising that the trial decision was reversed. There is a long-standing view that each lienholder can determine its own foreclosure timing. *See* NELSON & WHITMAN, *supra* note 58, at 612 (stating that a foreclosure on a junior lien cannot affect a senior mortgagee's interest because the senior should be allowed to choose when to sell).

filing.[341] Although Florida attorney Kevin Miller opines that an association might be able to claim violation of this provision when foreclosure is unduly delayed, lenders uniformly have maintained that the provision creates remedies for the mortgagee alone.[342] In addition, an association, as a junior lienholder, could ask the court for a management conference for the foreclosure case according to a procedural rule designed to move cases along.[343]

The Florida statute leaves unanswered the question of how far association documents can go to enhance the scope and priority of the assessment lien.[344] Citing the statutory provision giving mortgage lenders priority over association liens,[345] the court in *Coral Lakes Community Ass'n, Inc. v. Busey Bank, N.A.*, for example, refused to hold a foreclosing lender jointly and severally liable with its borrower for unpaid assessments despite language in the declaration to that effect.[346] In an earlier case with similar declaration language, however, a Florida district court held that a wholly-owned subsidiary of the mortgage lender who acquired title at foreclosure would be deemed a third party not entitled to protection by the assessment priority cap[347] and thus, could be sued personally for the entire unpaid assessment amount.[348] The details of which entities could and could not be sued personally for unpaid assessments, based on language in the association's declaration, could end up being quite complicated as the disputes regarding transfer of mortgages muddy the question of which entity holds what interest in the property. The Florida statute is unclear, and Florida laws are inconsistent on this point.

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341. FLA. STAT. ANN. § 45.031 (1) (a) (West 2011).

342. Miller Interview, *supra* note 312. Even if courts agreed with the association's arguments with respect to this provision, there would be no way to use the statute to force lenders to commence a foreclosure proceeding.

343. *Id.*

344. A fifteen-year-old Florida case suggests that total super-priority of an association lien could be created by the association declaration. Holly Lake Ass'n v. Fed. Nat'l Mortg. Ass'n, 660 So. 2d 266, 269 (Fla. 1995). The hope that such precedent would endure has been chilled by a more recent Florida decision where the association documents provided that any subsequent parcel owner "regardless of how his or her title has been acquired, including by purchase at a foreclosure sale" is personally, jointly and severally liable for all unpaid assessments, along with the prior delinquent owner. Coral Lakes Cmty. Ass'n, Inc. v. Busey Bank, N.A., 30 So. 3d 579, 582 (Fla. Dist. Ct. App. 2010).

345. FLA. STAT. ANN. § 720.3085 (6) (West 2010).

346. *Coral Lakes Cmty. Ass'n, Inc.*, 30 So. 3d at 584.

347. FLA. STAT. ANN. § 718.116(1) (West 2010).

348. Strangely, the court held that the statutory limitation on post-foreclosure recovery of assessments applied only to limit a lender-purchaser at foreclosure, leaving a third-party foreclosure purchaser fully responsible for unpaid assessments. Bay Holdings, Inc. v. 2000 Island Blvd. Condo. Ass'n, 895 So. 2d 1197, 1197 (Fla. Dist. Ct. App. 2005).

3. True Lien Priority: An Analogy to Property Taxes

Community associations function like governments: they perform public functions and are funded by assessments paid by their citizenry. In fact, the trend over the past few decades has been for public governments to assign to private communities more and more responsibility for services that a municipality would otherwise provide.[349] Community governance and upkeep costs incurred by municipalities are funded through property taxes, and unpaid property taxes are secured by a lien on the subject property that enjoys true super-priority status. Unpaid taxes are therefore paid first (or remain burdening the property) at the foreclosure sale. The simplest solution to the CIC tragedy of the commons posed by unpaid and uncollectable assessments would be to grant true priority to liens securing such amounts, analogizing the assessments to property taxes. If association liens were granted complete and true priority over mortgage liens, then the association foreclosure would necessarily bring mortgage lenders "to the table" to pay for their collateral upkeep charges or to participate in a joint foreclosure proceeding.

On the one hand, an analogy between community assessments and property taxes is compelling; both governments offer public upkeep to a community such as paving, snow removal, and open space maintenance. In these ways, the community functions like a municipality proxy by providing services to the public.[350] In fact, taxpayers who live in New Jersey CICs have successfully claimed the right to offset a portion of their community assessments from property taxes based on a double taxation complaint.[351] However, this analogy can only be taken so far. Many community-provided amenities are actually a supplement to municipal services rather than their replacement, and in the vast majority of states, assessments are not legally considered local "taxes."[352] To the extent that community services provide private community benefits (such as amenity upkeep), they represent individual

349. *See* TREESE ET AL., *supra* note 16, at 6 (stating that government privatizes its functions, requiring community associations to fulfill an otherwise municipal obligation).

350. The town of Reston, Virginia was the first CIC and provides many municipal government services. RESTON ASSOCIATION, http://www.reston.org/default.aspx?qenc=HzT9ACzZbNs%3d&fqenc=HzT9ACzZbNs%3d (last visited Aug. 1, 2011).

351. *See* HYATT, *supra* note 15, at 133 (citing Borough of Englewood Cliffs v. Estate of Allison, 174 A.2d 631, 640 (N.J. Super. Ct. 1961)) (reasoning that a property's true value does not include value of public rights transferred to a community).

352. Assessments are not deductible from federal and state tax impositions, for example, even when the community association services are a proxy for services normally provided by local municipalities. *See* HYATT, *supra* note 14, at 106 (arguing that community associations target assessments in a manner that local government cannot).

property-carrying costs rather than funding a benefit to the broader public, akin to property taxes.

Lenders would likely have strong objections to the idea that community assessments should be granted true priority by virtue of their tax-like function and likely will predict the disappearance of home mortgage credit should such a rule be adopted.[353] Nevertheless, having property taxes prime the mortgage lien has not dissuaded lenders from making mortgage loans. Lenders routinely protect themselves against any superior-priority payment obligation of their borrowers through establishing property tax escrow accounts. Lenders could demand similar escrow accounts for community assessments.[354] In fact, current Fannie Mae and Freddie Mac forms already specifically anticipate escrow account mandates for such amounts.[355]

4. Consent and Control by Community Members

Unlike a mortgage lender, who has the ability to perform a credit inquiry and refuse to lend money to a financially risky borrower, homeowners in condominiums and homeowner associations have no ability to force their neighbors to disclose the details of their finances. Even if this information were available, owners currently have little ability to control who buys properties in their community. One potential solution to the problem of financial interdependence in privately governed communities, however, would be to permit communities to perform credit diligence regarding prospective new members and control entry into the association. Washington, D.C. lawyer Benny Kass has suggested this type of solution: enable community boards of directors to approve or disapprove all potential purchasers of units.[356]

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353. The vigorous opposition mounted by the mortgage banking lobbyists to attempts to institute even a limited lien priority in states such as Ohio is a case in point. *See* Fisher, *supra* note 294, at 01B.

354. Such escrow accounts, however, might be more administratively expensive than those for insurance and taxes because many CICs assess monthly rather than yearly or bi-yearly.

355. *See* EFANNIEMAE.COM, https://www.efanniemae.com/sf/formsdocs/documents/sec instruments/ (last visited July 30, 2011) (providing mortgage documents by state). Associations, on the other hand, are vastly more limited in their ability to create property-specific escrow accounts upon, say, resale. Unless community documentation so provides, any efforts would be struck down as *ultra vires*.

356. Benny Kass, *Foreclosures are Impacting Condominium Projects*, REALTY TIMES (Apr. 30, 2007), http://realtytimes.com/rtnews/reu2pages/bennykass.htm?open&Vol=32&ID=715 realty (posing the question: "If the lenders will not screen their borrowers, why should a community association have to suffer by having a new owner who will not be able to meet his/her financial obligations to the association?").

Cooperatives have long had such ability to control the identity of their members.[357] New York cases have repeatedly upheld pre-approval provisions in cooperative documents and even individual denials of approval for cooperative membership based on criteria as indirectly relevant as an applicant's fame or legal training.[358] The justification for legally permitting such practices in cooperatives is typically its disparate ownership structure: owners are co-investors in an entity that holds title to the building in addition to being tenants of their particular unit. Financing of the building occurs at two levels: through the entity title holder and at the individual-unit-owner level. Because of this increased financial interconnectedness, courts have opined that cooperatives should be able to self-select their members.[359] In the context of condominiums and homeowner associations, however, power to disapprove would-be unit purchasers would be more problematic, opening a Pandora's Box of discrimination. The possible danger posed by such a solution underscores the importance of finding and enacting a viable solution through the priority law instead.

Property law is hostile to restraints on alienation, and courts suspiciously scrutinize restrictive covenants limiting the ability of an owner to sell his or her property. Economic theory in general argues for

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357. Cooperatives must still abide by the Fair Housing Act and may not discriminate based on membership in a protective class. Robinson v. 12 Lofts Realty, Inc., 610 F.2d 1032, 1036 (2d Cir. 1979).

358. *See, e.g.*, Weisner v. 791 Park Ave. Corp., 160 N.E.2d 720, 724 (N.Y. 1959) ("[T]here is no reason why the owners of the co-operative apartment house could not decide for themselves with whom they wish to share their [building]."); DeSoignies v. Cornasesk House Tenants' Corp., 800 N.Y.S.2d 679, 682 (N.Y. App. Div. 2005) (upholding the board's absolute right to control leasing "for any reason or no reason"); Simpson v. Berkley Owner's Corp., 623 N.Y.S.2d 583, 583 (N.Y. App. Div. 1995) (the cooperative board "had the right to withhold their approval of petitioners' purchaser for any reason or no reason"); Bachman v. State Div. of Human Rights, 481 N.Y.S.2d 858, 859–60 (N.Y. App. Div. 1984) (upholding the denial of a transfer of shares in an apartment because it was not discriminatory); Goldstone v. Constable, 443 N.Y.S.2d 380, 381–82 (N.Y. App. Div. 1981) (holding that "directors of this cooperative housing corporation have the contractual and inherent power to approve or disapprove the transfer of shares and the assignment of proprietary leases, absent discriminatory practices prohibited by law"). Cooperative boards have refused to permit owners to transfer units to many famous individuals, including Madonna, Gloria Vanderbilt, Mariah Carey, Calvin Klein, Antonio Banderas, Melanie Griffith, and former President Richard Nixon. MARRIANE M. JENNINGS, REAL ESTATE LAW 255 (8th ed. 2008) (citing Ellen Wulthorst, *New York Apartment Buyers Face Powerful Co-Op Boards*, EPOCH TIMES, Jan. 27–Feb. 2, 2005, at 13); *see also* Harvey S. Epstein, Note, Weisner *Revisited: A Reappraisal of a Co-op's Power to Arbitrarily Prohibit a Transfer of its Shares*, 14 FORDHAM URB. L.J. 477, 481–85 (1985–1986) (explaining that cooperative boards in New York arbitrarily prohibit transfer of residences, and applicants are subject to increasing scrutiny). For a current dispute involving the famous Dakota complex in Manhattan's Upper West Side, see Basil Katz, *Lawsuit Peeks into World of New York City Co-ops*, REUTERS, Feb. 3, 2011, *available at* http://www.reuters.com/article/2011/02/03/us-housing-newyork-idUSTRE7129IR20110203.

359. Subject to anti-discriminatory limitations imposed by the Fair Housing and the Civil Rights Acts.

free alienation of property so that society may achieve the property's highest and best use, as well as maximize its value.[360] Although free alienation increases individual member risks in the context of the entangled finances of a common interest community, courts typically strike down consent requirements as incompatible with fee simple absolute ownership rights.[361] Even explicit contract regimes restricting free transferability in the name of community, harmony, and joint objectives have been struck down as a restraint on alienation that is repugnant to the fee simple.[362] Retaining the right to approve purchasers through a covenant regime impermissibly recalls feudal controls; courts have consistently refused to enforce such restrictions.[363]

An association's right of first refusal to purchase a unit has been upheld, however, because an owner can be made economically whole by selling to the association in lieu of an objectionable buyer.[364] But such a provision will inadequately protect the financial interests of the community because it requires the community itself to fund the purchase and upkeep of a unit as the only way to block a prospective buyer. This is even more financially burdensome than permitting a prospective buyer to take title and then incur the costs of enforcing assessment obligations.

Although it is difficult to force bare approval requirements limiting an owner's ability to sell his unit in a condominium or homeowner association, it is very ordinary in a common interest community to control an owner's ability to rent a unit. Absolute prohibitions on renting are sometimes claimed to be an unreasonable restriction of fee title, but courts typically enforce initial limits on renting (an owner must occupy the unit for the first year, for example); limits on short-term

360. JOSEPH WILLIAM SINGER, PROPERTY LAW: RULES, POLICIES, AND PRACTICES 450 (4th ed. 2006).

361. *See, e.g.*, Northwest Real Estate Co. v. Scrio, 144 A. 245, 246 (Md. 1929) (holding that limitations on restraint of alienation are invalid).

362. *See, e.g.*, Riste v. E. Wash. Bible Camp, Inc., 605 P.2d 1294, 1295 (Wash. Ct. App. 1980) (holding that a clause preventing a grantee from transferring title for fee simple without approval from the grantor is a restraint on alienation and therefore void).

363. *See, e.g.*, Aquarian Found., Inc. v. Sholom House, Inc., 448 So. 2d 1166, 1169 (Fla. Dist. Ct. App. 1984) (holding that an association's right to withhold consent to a unit's transfer was "obviously an absolute restraint on alienation" because the association was not required to purchase the unit at fair market value itself upon refusing consent); *Northwest Real Estate Co.*, 144 A. at 246 (striking down as "clearly repugnant to fee-simple title" a deed covenant providing that land may not be subsequently sold without consent of the grantor); *Riste*, 605 P.2d at 1294 (refusing to enforce a restriction for a CIC limiting sale of land to persons approved by the seller church).

364. *See, e.g.*, Wolinsky v. Kadison, 449 N.E.2d 151, 155 (Ill. App. Ct. 1983) (holding that an association may exercise its right of first refusal after considering a prospective buyer's qualifications).

leasing (no leases with a term less than six months, for example); and even limits on the number of units in a community that can be rental-occupied at any time.[365] Such leasing limitations are typically upheld even when they are created in non-unanimous amendments to the governing documents.[366] Not only do courts enforce aggregate limitations on the percentage of units in a CIC that can be rented at any one time, but Fannie Mae, Freddie Mac, and the FHA have issued guidelines that limit the percentage of a community that can be rented out, likely as a proxy for financial health of the community.[367]

Although permitting association boards to exercise approval rights over sales might be judicially justified as an extension of the broad enforcement of leasing restrictions boards already can exercise in any case, it would be bad policy to rely on board diligence and approval as a way to protect the community's financial health, and this approach should be avoided. From a legal standpoint, requiring prior approval of purchasers would create a hardship for owners who are trying to sell, and indeed the approval right is repugnant to the fee. Such a requirement would mean that a would-be seller would not only have to find a willing buyer, but would also have to prove that the candidate was a credible financial risk. In a tight market, the hardship and delay caused by this requirement would further freeze out sales of units and would increase the possibility that an owner would default instead of re-selling.

In addition, the power to approve buyers is fraught with the potential for abuse by other members of the association, and to solve one problem (uncollectable assessments) by creating others (too much board power limiting freedom to transfer property and the potential for insidious discrimination) is nonsensical. These problems are already rampant and difficult to resolve in co-ops.[368] Further, using the CIC structure to

365. Woodside Vill. Condo. Ass'n, Inc. v. Jahen, 806 So. 2d 452, 462 (Fla. 2002) (holding that a leasing restriction was reasonable).

366. *See* Apple II Condo. Ass'n v. Worth Bank & Trust, 659 N.E.2d 93, 97 (Ill. App. Ct. 1995) (holding that the leasing restrictions were a valid exercise of association authority). Even disparate impact based on race does not invalidate a leasing restriction. *See* Villas West II of Willowridge v. McGlothin, 841 N.E.2d 584, 601 (Ind. Ct. App. 2006) (refusing to hold that every discriminatory action is illegal), *vacated*, 885 N.E.2d 1274 (Ind. 2008).

367. Fannie Mae and Freddie Mac will not buy loans secured by properties in common interest communities where more than 49% of the units are occupied by tenants rather than owners. *See* FANNIE MAE, CONDOMINIUM PROJECT REVIEW: OPTIONS FOR PROJECT APPROVAL 1–2 (2010), *available at* https://www.efanniemae.com/sf/refmaterials/approvedprojects/pdf/condoprojectreview.pdf (outlining the requirements for project approval); FREDDIE MAC, FREDDIE MAC CONDOMINUM UNIT MORTGAGES 3 (2011), *available at* http://www.freddiemac.com/learn/pdfs/uw/condo.pdf (outlining more requirements for project approval).

368. *See* Matt Chaban, *Board to Death: As Co-ops Swagger Back from the Brink, Brooklyn Pols Plot Their Demise*, N.Y. OBSERVER (Apr. 26, 2011), http://www.observer.com/2011/real-

create legal limits on a seller's right to transfer to certain types of borrowers harkens back to the days of racial discrimination because the perpetuation of racial segregation was the initial motivation for forming many early suburban CICs.[369]

The unsavory history of homeowner associations—still obvious from many first-generation restrictive covenants in the land records—reveals a dark side of private governments: racially segregated neighborhoods where restrictive covenants contractually barred would-be sellers from selling to certain would-be buyers based on pernicious discriminatory criteria. The U.S. Supreme Court in *Shelley v. Kraemer* held with tortured legal reasoning that racially-based restrictive covenants were unenforceable under the Fourteenth Amendment because the enforcement of a contract to discriminate would amount to government action.[370] Then, Congress passed the Fair Housing Act, which made discriminatory sale restrictions illegal and invalid.[371] Today, because of that Act, decisions to rent or sell housing may not lawfully be based on "race, color, religion, sex, familial status, or national origin."[372]

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estate/board-death-co-ops-swagger-back-brink-brooklyn-pols-plot-their-demise (reporting that cooperative boards in New York need not disclose the reason for disapproving a prospective member and that it remains difficult and unpredictable to obtain board approval and sell or buy in a cooperative in New York); *see also* Bay Holdings, Inc. v. 2000 Island Blvd. Condo. Ass'n, 895 So. 2d 1197, 1197 (Fla. Dist. Ct. Ap. 2005) (upholding a statutory cap that limits a first mortgagee's liability for unpaid assessments). A current bill proposes requiring cooperatives to provide a statement of the reasons for refusing consent to a transfer. A. 8347 § 1, 2011–2012 Reg. Sess. (N.Y. 2011), *available at* http://open.nysenate.gov/legislation/api/1.0/lrs-print/bill/A8347-2011. Several such bills have been introduced in the past. John Barone, *Limiting the Autonomy of Cooperative Apartment Corporation Governing Boards*, 2 CARDOZO PUB. L. POL'Y & ETHICS J. 179, 179 (2004).

369. In fact, many community association documents on the land records still contain racial occupancy clauses. Even though such clauses have no legal force today, their continuing existence in the chain of title serve as an unfortunate reminder of one of the initial motives of community ownership structures. It is well near impossible to strike such language from the record. *See* Stephen Magagnini, *Reminders of Racism, Old Covenants Linger on Records*, SACRAMENTO BEE, Jan. 17, 2005, at A1 (reporting on the difficulty of removing a restrictive racial occupancy clause from a Sacramento community association's property records).

370. 334 U.S. 1, 19 (1948) (holding that state action existed when a court enforced racial restrictions). The holding of *Shelley* has continually perplexed legal theorists because it was decided in the 1940s. *See, e.g.*, Francis A. Allen, *Remembering* Shelley v. Kraemer*: Of Public and Private Worlds*, 67 WASH. U. L. Q. 709, 710–12 (1989) (arguing that the significance of *Shelley* changes over time); Lino Graglia, *State Action: Constitutional Phoenix*, 67 WASH. U. L. Q. 777, 787 (1989) (stating that of the Supreme Court cases regarding state action, the *Shelley* holding is the most criticized); Mark Tushnet, Shelley v. Kraemer *and Theories of Equality*, 33 N.Y. L. SCH. L. REV. 383, 384–85 (1988) (arguing that the substantive holding in *Shelley* was identical to the state action holding).

371. Fair Housing Act of 1968, 42 U.S.C. §§ 3601–3619 (2006).

372. 42 U.S.C. § 3604 (2006).

On the one hand, it is perhaps too soon in our history to give blanket membership approval power to community associations because the original *raison d'etre* of homeowner associations was to keep certain people out of them.[373] If such power existed, courts would necessarily need to exercise some sort of oversight scrutiny to assess the reasonableness of any approval or denial to make sure it did not violate the provisions of the Fair Housing Act or otherwise impermissibly bar alienability of property. The benefits of any self-protecting membership approval empowerment, therefore, must be balanced against the costs of potential discrimination and the cost of judicial efforts needed to police appropriate disapprovals of neighbor sales.

Mortgage lenders (theoretically) already do credit diligence on would-be buyers in communities as part of their underwriting.[374] It would be costly and difficult to force an association to inquire as to credit scores, employment, and salary. Such inquires would also be unnecessary in cases where another entity is already assessing these exact same criteria for a would-be buyer—namely, his or her mortgage lender. It would be wasteful and inefficient to require the non-expert volunteer directors to try to replicate this effort.

Because neighbors do not (and probably should not) have the ability to do financial investigations of would-be buyers in their community, association members cannot manage their own risks in this regard. Mortgage lenders, on the other hand, are best able to do such investigations at the lowest cost because they specifically assess the financial health of potential borrowers and can set the terms or limit the availability of mortgage loans accordingly.[375]

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373. *See supra* note 370 and accompanying text.

374. From 2000 to 2007, many mortgage originators neglected to do any credit diligence or at least did a terrible job. *See* Yuliya Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, 24 REV. FIN. STUD. 1848, 1873–75 (2011) (showing a decrease in the spread between prime and subprime mortgages, which is typically used to compensate lenders for the increased risk of subprime mortgages, concluding that the decrease in this spread was not sustainable, and indicating that loosening underwriting standards was one of the factors). In 2006, Steven Krystofiak, president of the Mortgage Brokers Association for Responsible Lending, submitted a written statement into the record of a Federal Reserve public hearing on mortgage regulation, reporting that his organization had compared a sample of 100 stated income mortgage applications to IRS records and found almost 60% of the sampled loans had overstated their income by more than 50%. *Inside the Liar Loan: How the Mortgage Industry Nurtured Deceit*, SLATE MAG. (Apr. 24, 2008, 11:25 AM), http://www.slate.com/id/2189576 (citing Written Statement of Krystofiak, President, Mortgage Bankers Association for Responsible Lending, Building Sustainable Homeownership: Public Hearing on the Home Equity Lending Market Before the Federal Reserve Bank of San Francisco (June 16, 2006), http://www.federalreserve.gov/secrs/2006/august/20060801/op-1253/op-1253_3_1.pdf).

375. Mortgage lenders also perform collateral due diligence (property appraisals) and are therefore well-situated to prevent a property from being so over-burdened with debt that a

B. Eroding Mortgage Priority

1. Equitable Reallocation of Payment Default Costs

Capped recoveries and limited priority liens are ineffective in a climate of underwater loans and long foreclosure timelines. Reverse foreclosures and other creative litigation strategies may obtain relief in certain situations but are inadequate to generally protect communities from the fallout of foreclosure freezes. Although there is some appeal to analogizing assessments to property taxes and granting a true priority status to assessment liens, it would be almost impossible for such a proposal to garner sufficient political support to pass. Allowing community members more extensive approval rights over property transfers within their community raises property and liberty rights concerns that vastly outweigh the benefits of permitting self-policing due diligence in sales. The best party to perform credit diligence of new (or refinancing) members in a CIC is the party already performing this role: the mortgage lender.[376] The best party to control for unrealistic loans, sloppy foreclosure proceedings, and unwarranted delays is also the mortgage lender. Thus, the mortgage lender should bear costs occasioned by its failure to diligently protect against the foreseeable externalities of its lending activities. In a situation where the property is underwater, the only party with a valuable interest in the property is the mortgage lender. The lender, as the sole property interest holder in this case, should bear the upkeep costs that protect and enhance the value of its security pending foreclosure.

Statutes should be passed in each state to create proper incentives for lenders to monitor or pay assessment delinquencies. Rather than relying on limited-priority liens, this proposal—an eroding first priority for first mortgage liens—would treat the priority position of a lender's first lien as conditioned upon foreclosure within a certain amount of time after mortgage default (e.g., six months). Thereafter, every month of unpaid assessments would become secured by a lien superior in payment priority to the first mortgage. Importantly, such a lien would have no upside cap, meaning recovery by the association would theoretically be unlimited, while the maximum paid by the neighbors would be limited. Such an eroding mortgage approach would cap the loss to the association rather than the loss to the lender, which is appropriate because it is the lender who controls the timing of the foreclosure sale.

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foreclosure sale will not net sufficient proceeds to cover obligations secured by the property.

376. *See supra* note 375 and accompanying text (noting that mortgage lenders perform collateral due diligence).

Under this proposal, the priority of the assessment lien would effectively erode the first priority of the mortgagee. This would likely incentivize lenders to pay assessments on behalf of their borrowers who are delinquent and add such costs to the debt. Most mortgage instruments already permit lenders to do this. Increased lender responsibility for its share of community upkeep might also motivate more expeditious foreclosure proceedings. Either way, the costs borne by an association would be minimized.[377] This better cost allocation regime would make sure that lenders are no longer distorted in their foreclosure timing analyses, which would ensure that delays in foreclosure result from relevant loan and market factors, not from a lender's mere desire to free-ride by avoiding collateral upkeep costs.

Lenders would reasonably respond to such a law by making a better credit evaluation prior to advancing funds regarding a borrower's ability to pay not only the mortgage loan but also the applicable assessments. Lenders would also have even more reason to ensure an accurate appraisal of collateral value. Any change in the legal framework of home lending that achieves this outcome is likely beneficial to individuals and the economy as a whole.[378] Also, such an evaluation currently cannot be done by the association itself, but it can be easily and cheaply achieved by lenders.[379] Lenders might respond to such a law by establishing an escrow account for association assessments, similar to accounts lenders already require for property tax and insurance amounts (and as already anticipated by Fannie Mae and Freddie Mac form instruments).[380] Finally, this law would motivate lenders during foreclosure to pay outstanding assessments to avoid incurring additional costs and fees. Having an assessment back-up source would benefit all property values in the community and keep other owners from being penalized for having delinquent neighbors. Lender-funded upkeep also avoids the situation of unjust enrichment that currently exists when neighbors end up paying for the upkeep on mortgaged properties for which they hold no interest.

Allowing a first mortgage lender's priority to erode over time as foreclosure is delayed is therefore both equitable and efficient.

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377. Reasonable collection costs should be included in the priority lien amount; however, this proposal does raise the important question of collection cost and late fee abuses, discussed *infra* Part II.B.4.

378. *See generally supra* Part I.A.2 (discussing the negative externalities of constructive abandomnent).

379. Lenders today are evaluating not only their borrowers' ability to pay assessment obligations, but also the ability of all other owners in the community to pay their assessments.

380. *See supra* note 354 and accompanying text (noting that lenders routinely establish property tax escrow accounts to protect themselves against superior priority payment obligations).

Uncapping lender liability for assessments will lead to assessment obligations being met more frequently by someone. This approach will also create a disincentive for irresponsible delays in foreclosure and, unlike the six-month limited-priority regime, will continue to be effective even if foreclosure does take a long time to complete. A system of eroding mortgage priority could allocate some limited portion of unpaid assessments to a community or could allocate all unpaid amounts to the lender, depending on when the lien erosion "clock" would start.[381]

Unlike the limited lien priority system, an eroding first priority system will not merely reduce association losses—it will tangibly improve community stability. Because responsible neighbors will be insulated from default spillover, recovery can occur; investors can purchase units secure in the knowledge that their investment is not subject to the unforeseeable and uncontrollable default rates of neighboring property loans. Lenders can lend on units in CICs knowing that the community will continue to be maintained and property values will be preserved, all at a cost allocation that is fair and equitable.

Ultimately, this system even benefits the first mortgage lenders who bear priority erosion losses as well because the value of their collateral will be preserved. Eroding lien priority should lead to a better recovery in foreclosure sales, which should offset the priority losses the system entails. For this reason, the GSEs should revise their policies and permit uncapped lender responsibility for collateral upkeep. Although a six-month limit is easier for a lender to prospectively quantify (because the maximum amount of foreclosure proceeds paid to an association is pre-determined), this approach depresses the property's value and limits capital availability to the entire community. Allowing a fairer allocation of community costs justifiably supports values and stability in the community—an outcome beneficial for the community's lenders as well as its owners.

2. Promoting Foreclosure as Policy

One effect of the eroding mortgage priority solution is that lenders will be discouraged from delaying foreclosure just to avoid payment of community assessments. A possible result is that foreclosures of community association properties may proceed more expeditiously,

381. In lieu of having a front-end delay before erosion of a lien begins, a state could choose a shared-liability approach to assessments, mandating that a certain percentage of all unpaid assessments at foreclosure enjoy a payment priority. Under this system, the cost to a neighborhood would continue to grow as foreclosure is delayed, but so would the cost to a lender. This approach, however, would at least somewhat curtail the lender's collateral upkeep free-ride.

which is arguably harder on defaulting homeowners who face losing their homes more quickly. Although it is politically difficult for governments to push for quicker foreclosures (which is seen as making the poor owners lose vis-à-vis the banks), providing an incentive for banks to foreclose promptly is actually good in terms of the neighbors and the community as a whole.[382]

In some ways, both defaulting borrowers and mortgage lenders benefit from foreclosure delays, all at the expense of the community.[383] Delinquent owners can stay in their homes, cost-free,[384] and lenders can wait out a bad market while avoiding the carrying costs on a property.[385] The people who really lose from this delay are those least able to control for it: the innocent neighbors who fund the unpaid assessment bills.

Undue foreclosure delays adversely affect the wider market as well. Without lower-priced sales to pull down comparable sale values of homes, housing prices remain propped up at unsustainable levels. Delaying foreclosure sales, therefore, also delays the housing market

382. Politicians frequently balk at this approach of "getting it over with," and economists disagree about whether it is better to allow borrowers rent-free possession during a general market downturn or not. *See, e.g.*, Brady Dennis & Ariana Eunjung Cha, *Pelosi Calls for Federal Inquiry on Mortgage Lenders*, WASH. POST, Oct. 6, 2010, at A15 (discussing political reasons to push for foreclosure moratoriums while quoting Guy Cecala, the publisher of *Inside Mortgage Finance*, as warning that further slowdown in foreclosure sales would "delay significantly any recovery of the housing market"); Dina ElBoghdady, *Anxiously Waiting for the Sale to Go Through*, WASH. POST, Oct. 9, 2010, at A11 (discussing why foreclosure delays increase market uncertainty and the problems that result); Pearlstein, *supra* note 121, at A09 (explaining that "the longer the foreclosure process goes on, the longer it will take for the excess supply of houses to be absorbed, for prices to stabilize and for the real estate market to return to something closer to a normal equilibrium").

383. At the least, the parties benefit from delays where there is not a third party to buy the property from the lender at foreclosure or soon thereafter.

384. News stories tell of increasing numbers of homeowners who stop paying their mortgages, betting that it will take the lender a very long time to foreclose and explain that the threat of foreclosure is so temporally remote that it becomes merely "theoretical." *E.g.*, David Streitfeld, *Owners Stop Paying Mortgages . . . and Stop Fretting About It*, N.Y. TIMES, June 1, 2010, at A1 ("A growing number . . . are fashioning a sort of homemade mortgage modification, one that brings their payments all the way down to zero.").

385. *See* Ruger, *supra* note 2, at A1 ("[B]anks put off the foreclosure sales in many cases because once they take the property, they become liable for taxes, fees and maintenance."). Some banks even delay after acquiring the property at a foreclosure sale, waiting as long as possible to record the deed in order to procrastinate the day they are legally required to contribute to property upkeep. In the past year, some states legislatures have proposed laws to address this trend, requiring that deeds be filed within thirty or ninety days of a foreclosure sale. *See, e.g.*, S.B. 141, 150th Gen. Assemh., Reg. Sess. (Ga. 2009) (requiring foreclosure deeds to be recorded within ninety days); S.B. 128, 75th Sess. (Nev. 2009) (requiring foreclosure deeds to be recorded within thirty days).

from reaching equilibrium.[386] Only when prices reflect fundamental values will the market start recovering in earnest.

Undue foreclosure delays also discourage home buyers and investors who face uncertain timing and title.[387] Lenders avoid financing because of the uncertainty posed by community properties left in limbo.[388] In addition, delaying foreclosures also keeps the capital markets from establishing accurate pricing for mortgage-backed securities products, slowing the recovery in that market as well.[389]

During the limbo of threatened foreclosure, properties are generally not maintained at the optimal level.[390] This threat to quality of our housing stock is nowhere greater than in CICs, where a few delinquent properties can actually cause a decrease in the upkeep of the entire community. Our housing stock is at risk of deterioration if responsible "gatekeepers" are not funding its upkeep. The longer the limbo is drawn out, the more extreme upkeep problems will be.

It sounds draconian, but the best thing for the community in the case of a nonpaying unit owner facing foreclosure is to have the foreclosure sale take place as swiftly as possible. Unnecessary delay costs the entire community money and increases uncertainty. Any benefits accruing to the lender (or borrower) from such delay are purchased with other people's money. Plus, perceived lender benefits may be illusory because decline in collateral upkeep and increase in community assessment deficiencies will significantly drive down the value of the property and the lender's ultimate recovery at foreclosure.

3. Lender Disorganization and Misbehavior

Blame for the financial troubles of associations—like blame for the housing crisis—targets the mortgage lenders,[391] but the eroding lien

386. In 2006, the Office of Federal Housing Enterprise Oversight ("OFHEO") calculated the ratio of equivalent rents to home prices (comparing the amount for which a given home would rent to the home's purchase price) and found that nationwide, the average rental value of homes was only 70% of the purchase price. Stewart & Brannon, *supra* note 40, at 16 fig.1.

387. *See supra* note 122 and accompanying text (discussing how the uncertainty of assessments affects would-be buyers and new investors).

388. *See supra* notes 260–64 and accompanying text (describing the obstacles to financing faced by condominiums that are in limbo).

389. *See supra* notes 4 and 10 and accompanying text (discussing how many foreclosure sales do not even cover the amount owed on the mortgages and how the amount of mortgages in default force a fewer number of individuals to cover the burden of upkeep costs).

390. *See supra* Part I.A.2 (noting that a defaulting homeowner facing foreclosure has little incentive to make improvements on the home).

391. Miami Beach City Commissioner Jerry Libbin, for example, blames "greedy banks" that "refuse to take financial responsibility for their reckless lending" for causing the mass of association delinquencies that end up saddling the remaining owners of condominium units with

proposal is not punitive. Rather, proper upkeep allocation is a prerequisite to market recovery. Thus far, mortgage lenders have strongly objected to being forced to pay assessments on behalf of properties they are unable to sell quickly,[392] although their own self-interest leads banks to take on maintenance obligations for collateral not located in privately-governed communities. Governments and consumer protection groups have begged lenders to cut homeowners a break, yet homeowners face being sued by Florida associations for not foreclosing quickly enough.[393] The volume of defaulted properties is itself a barrier to expeditious foreclosure.[394] Servicers are overwhelmed with as many new mortgage defaults each month as previously occurred in an entire year.[395]

In the case of homes not located in CICs, lenders cannot avoid maintenance of constructively (or literally) abandoned properties prior to foreclosure. To prevent the ravages of permissive waste, lenders hire a manager to maintain such properties, buy insurance on the properties, and even pay to have necessary repairs done. Such collateral preservation steps are merely prudent business decisions and do not necessarily force lenders to foreclose at a time other than their choosing. Alternately, lenders can decide to modify loan obligations to free up borrower capital to meet needed upkeep costs. Lenders outside of CICs regularly act upon the clear understanding that maintenance of collateral value is in their own best interest. The only reason lenders do not incur such costs in CIC properties is that someone else is already doing the maintenance and picking up the tab.

"huge special assessments." *Miami Beach Commissioner Jerry Libbin Applauds 'Reverse Foreclosure' Ruling, Renews Call for State Lawmakers to Enact Comprehensive Foreclosure Reforms*, PR NEWSWIRE (Jan. 27, 2010), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546. Libbin has been "spearheading a state-wide campaign to protect condominium unit owners from unfair assessments levied on them" because of the housing meltdown, claiming that "loopholes in laws have allowed banks to escape from paying their fair share—forcing tens of thousands of Florida condo unit owners in good standing to pick up the tab." *Id.*

392. Alex Sanchez, president and CEO of the Florida Bankers Association, explains the lender perspective: "We get hit from every side. Some people say we're foreclosing too fast; others say we're foreclosing too slow [sic]. Bankers want to keep Florida families in their homes. Foreclosure is a last remedy." Coleman, *supra* note 104, at 1A.

393. *See supra* Part II.A.1.c (discussing government efforts to extend foreclosure timelines).

394. *See* Eunjung Cha & Dennis, *supra* note 3, at A9 (warning that uncertainty in foreclosure procedures scares away buyers and creates an even more "traumatic market" situation, where foreclosure buyers are even more scarce); Gretchen Morgenson & Geraldine Fabrikant, *Florida's High Speed Answer to a Foreclosure Mess*, N.Y. TIMES, Sept. 5, 2010, at BU1 (explaining that the huge backlog of foreclosure cases in Florida has led to some corner-cutting by the judicial department as well as lenders and that the backlog continues to increase anyway).

395. Viega, *supra* note 9.

Foreclosures cannot proceed when it is unclear who owns what loans.[396] Because a mortgage follows the note, only ownership (and, typically, possession) of the note evidencing the debt can permit an entity to foreclose on the mortgage. Before the advent of the secondary mortgage market and securitization, note ownership was easy to track because in most cases loan originators remained holders of the instrument. But with the growth of the secondary market and the innovation of mortgage-backed securitization and its related products, ownership of mortgage debt was passed on post-closing and became segmented through pools of loans.[397] By the mid-1990s, most mortgage

396. On October 13, 2010, all fifty states began a joint investigation into mortgage foreclosures. This investigation was sparked by the "robo-signing" scandal. Robo-signing refers to the practice of having employees sign off on thousands of foreclosure affidavits, stating that they had reviewed the underlying paperwork when, in fact, they had not. *See* Ennjung Cha & Dennis, *supra* note 382, at A15 (discussing House Speaker Nancy Pelosi's call for the Justice Department to investigate mortgage lenders and how Maryland joined other states that sought to halt foreclosure sales while lender forgery and fraud claims were fully explored). The robo-signing scandal and associated moratoriums slowed down the foreclosure process significantly and left millions of homes "in limbo." *Id.*; *see also Congressional Oversight Panel: Hearing on TARP Foreclosure Mitigation Programs*, 111th Cong. 3 (2010) (testimony of Julia Gordon, Center for Responsible Lending) (stating that servicers engaged in "shoddy, abusive, and even illegal practices related to the foreclosure process" cause a lack of confidence in the process among buyers, which slows the absorption of real estate-owned inventory and an overall recovery of the housing market); Eunjung Cha, Mufson & Yang, *supra* note 3, at A11 (discussing the political pressure for the federal government to impose a full moratorium on foreclosures due to concerns over banks' foreclosure procedures); *supra* note 3 and accompanying text (discussing the moratoriums on mortgage foreclosures announced by large lenders due to sloppy or fraudulent servicer foreclosure procedures, describing the political reaction to the moratoriums, and stating that the procedural concerns prompting the moratoriums still linger despite the fact that the moratoriums have since been lifted). Although the moratoriums have now been lifted, the pace of foreclosure has significantly slowed in the wake of such scandals, resulting in a renewed focus on foreclosure procedure and mortgage ownership. For a more detailed discussion of some of the problems of note ownership and chain of title for mortgage notes in the secondary market and a proposal regarding possible future systemic solutions, see Dale A. Whitman, *How Negotiability has Fouled up the Secondary Mortgage Market, and What to Do About It*, 37 PEPP. L. REV. 737, 757–69 (2010).

397. The securitization concept basically holds that by splitting a group (pool) of mortgage loans into multiple classes (tranches) with a hierarchy of repayment rights (the top tranche has the least risky position in terms of credit and repayment risk), the mere grouping and tranching of the pool will dramatically reduce risks for investors holding the top tier position because the lower-positioned investors provide a buffer by bearing the first loss. Theoretically, this is true even if the entire pool is made up of risky mortgage loans: the lower tranches act as a risk shock absorber. Wall Street opined that pooling and tranching can be done several times, supposedly reducing risk of top-tiered securities with each re-tranching. This theory, widely accepted in the dawn of the twenty-first century, seems to work less well under real market stress—as seen in the meltdown of the subprime market. The structure of securitization in the abstract was not the problem, it was rather the valuation model for securitized products that was inadequate. For an overview comparison of securitization and traditional bank lending, see Gerald Hanweck, Anthony Sanders & Robert Van Order, *Securitization Versus Traditional Banks: An Agnostic View of the Future of Fannie Mae, Freddie Mac and Banks*, FINREG21 (Sept. 28, 2009), http://www.finreg21.com/lombard-street/securitization-versus-traditional-banks-an-agnostic-

banks no longer intended to originate mortgages for their own portfolios but rather acted as intermediaries—originating mortgages in order to sell them on the secondary market in turn.[398]

Loan ownership changes, through secondary market sales of mortgage loans, pooling, tranching, and securitization sales of pieces of those loans, were supposedly all tracked through the Mortgage Electronic Registration System ("MERS").[399] Although MERS records of loans often do permit ownership to be tracked, the individual notes have in many cases become lost along the way.[400] Because the lien (the mortgage) follows the payment obligation (the note), production of the note or a court-allowed substitute is a prerequisite to commencing a foreclosure proceeding.[401]

The delay is unfortunate but unavoidable: foreclosure as a process requires strict adherence in order to assure the fairness of the result.[402] If foreclosures must slow down to ensure procedural due process, then a slower timeline is esseutial.[403] The costs of these foreclosure delays, however, should be borne by the entities who could have avoided the problems causing the delays—namely, the lenders or servicers. Hopefully, foreclosures will not be delayed more than necessary as a result of political posturing because foreclosure delay causes far more problems than it solves.[404]

Many of the problems plaguing the housing market today—from the robo-signing scandal to the poorly-underwritten loans in the first place—are products of lender sloppiness, disorganization, and (sometimes) misbehavior. The structure of the market itself encouraged

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view-future-fannie-mae-freddie-ma (providing a concise description of the development of mortgage-backed securitization); *see also* Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 535–51 (2002) (providing a summary of the basics of loan securitization).

398. ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 381–82 (3d ed. 2007). *See generally* ANDREW DAVIDSON, ANTHONY B. SANDERS & LAN-LING WOLFF, SECURITIZATION: STRUCTURING AND INVESTMENT ANALYSIS (2003).

399. *See* Whitman, *supra* note 396, at 765 n.157 (describing MERS, which was "created by the major participants in the secondary mortgage market to maintain an electronic, on-line registry of mortgage assignments").

400. *Id.* at 757.

401. *Id.* at 757–59.

402. This is very similar to how election law procedures assure fair election results and how trial procedures assure viable findings of fact.

403. It is paramount to ensure that foreclosure sales are valid because flawed foreclosures raise three problems that threaten housing markets and the broader economy: the foreclosure itself may not be warranted or conducted correctly (with proper parties); buyers at foreclosure are not assured of good title; and lack of confidence in titles to land slows housing market recovery.

404. *See supra* Part I.A.2 (discussing the negative impact of constructive abandonment).

risk-taking at the originating lender level. Because borrower credit risk was assumed by the secondary market purchaser and securitizer of the loans, often with insurance companies providing credit enhancement to the mortgage pool, and was then passed on (in whole or in part) to investors in the pool that provided the actual funds through purchasing mortgage-backed securities,[405] there was very little incentive for mortgage lenders to perform sufficient due diligence before advancing funds. The *New York Times* decries sloppy lending, property appraisals, and securities ratings, pointing out that "[s]ince we trust, why verify?" seems to have been the industry motto.[406]

Again, there were many guilty parties in sloppy lending and loan transfers. But as between the mortgage lenders and the borrower's neighbors, the lenders clearly emerge as more culpable. Thus, between these two categories of parties, the choice for cost allocation is likewise clear: the mortgage lender is the only party who can avoid similar problems in the future. As the least-cost avoider, economic theory supports the equitable judgment here: lenders should bear costs caused by their failure to carefully underwrite their lending, properly document their mortgage sales and securitizations, and promptly and correctly foreclose.[407]

Lenders uniformly lobby to keep the system as-is, particularly in states with no limited lien priority for assessments. But in reality, bankers' associations that decry a viable solution to private governance failure are acting against their own long-term interest. Although lenders may see themselves as paying the price of revisions in the lien priority scheme, they very well could also be lenders on non-defaulting units currently being burdened with increasing assessments or, at the very least, facing the uncertainty of assessment increases in the future. A lender may desire to make a loan on a unit in a community where a large percentage of owners could stop paying assessments at any time. This uncertainty hurts owners and their lenders.[408]

Alternatively, if the community could ensure the expected revenue stream, the risk to all lenders decreases even though their exposure in

405. *See supra* note 397 (describing the securitization concept involving pools and tranches).

406. Floyd Norris, *Banks Stuck with Bill for Bad Loans*, N.Y. TIMES, Aug. 20, 2010, at B1.

407. This is not to say that uncertain foreclosures should be permitted. Strict procedural protections and requirements must be maintained. But any additional community costs incurred by lender missteps must be borne by lenders alone—not by the neighborhoods in which their collateral is located.

408. This is why Fannie Mae, Freddie Mac, FHA, and other lenders impose a limit on the percentage of delinquencies before they will purchase or insure (or originate) loans in a community association. It is also why the GSEs want to approve community reserves levels. *See supra* Part II.A.1.b (discussing how lender policies affect assessment recovery).

terms of their non-paying borrowers goes up. The downside, however, should not pose a problem; lenders can manage this risk much more easily than the uncertainty risk related to potentially unrecoverable assessments. Lenders already take measures to protect themselves against property tax amounts that can accrue and are payable prior to their mortgage loan out of foreclosure proceeds. Lenders need only to set up reserve accounts and affirmatively require payment of association assessments to control for borrower misbehavior and their own loss exposure from the loss of lien priority.

Lenders also benefit from legislation empowering associations to ultimately recover their upkeep costs because, by keeping the community association solvent and active, lenders reap the benefits of supported property values and well-maintained communities. Even when lenders "save" money by delaying foreclosure to avoid paying assessments, they drive down the property value of their own collateral by causing community assessments to increase while services decline. In essence, lenders commit their own waste when they fail to ensure payment of association assessments.

4. Association Assessment Abuses

Some commentators target association expenditures in general as wasteful spending, but statutory oversight of association budgeting and amenities is not a good idea. Rather than pass laws requiring communities to tighten their belts, this is best left to the governance system in place. There is nothing preventing members from voting to cut back services and save community funds. Furthermore, if a lender begins paying assessments after foreclosure, the lender will be able to assert the unit's voting rights and have some input into community costs and fees.

Associations are typically empowered to charge late fees and collection costs in addition to delinquent assessments.[409] Clearly, associations must be able to recoup the costs of collecting delinquent assessments. Some assert, however, that late fees and collection costs are out of control.[410] Allegations abound that community associations hire lawyers who abuse the system by charging outrageous fees.[411]

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409. HYATT, *supra* note 15, at 121–22 (describing two methods of imposing late fees in CIC associations: flat rate and monthly interest fees).

410. *See, e.g.*, Ngoc Nguyen, *Hard-Pressed Homeowners Facing Another Financial Threat*, N.Y. TIMES, Apr. 15, 2011, at A19A (depicting cases where association debts were "turned over" to collection agencies and the tenfold increase in the amount owing due to fees and interest).

411. *Id.*; *see also* Shirley Wise, *Reverse Foreclosures—Are the Associations the Victims Here?*, EZINEARTICLES (Aug. 30, 2010), http://ezinearticles.com/?Reverse-Foreclosures---Are-the-Associations-the-Victims-Here?&id=4879390 (reporting that "the association attorneys add

Some California lawmakers, for example, have highlighted the danger of so-called "foreclosure factories"—law firms and collection agencies that charge an association $1500 to $2000 for taking over a foreclosure proceeding against a delinquent owner.[412] The associations tack the amount paid to assessment collectors onto the delinquent charges, and the collection cost amounts can be "shockingly high."[413]

Current government oversight of collection cost charges is minimal: only the California State Legislature has considered specifically limiting debt collection practices of CIC associations.[414] Recent attention to the plight of both association residents and nonpaying owners facing foreclosure suggests that additional state regulation of assessment collection may be on the horizon.[415]

Concern over unconscionably high late fees and collection costs may be warranted, as there are few legal limits on what a CIC association can impose on its members as long as it follows the procedures set forth in its governing documents.[416] If mortgage lenders are on the hook for

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outrageous fees for their services," are "unwilling to discount the amount not even by a dollar" and that these unfair practices "need to be questioned"). *See generally* EVAN MCKENZIE, PRIVATOPIA: HOMEOWNER ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENT (1996) (criticizing the entire governance system of CICs as prone to abuse).

412. *Id.*; *see also* Wasserman, *supra* note 12 (describing the problems related to associations that can easily foreclose on homes and describing recent legislative efforts to make foreclosure more difficult).

413. Ngai Pindell, *Tensions Between HOA Super Liens and Purchasers at Foreclosure*, LAND USE PROF BLOG (Jan. 29, 2010), http://lawprofessors.typepad.com/land_use/2010/01/tensions-between-hoa-super-liens-and-purchasers-at-foreclosure.html. Collection costs charged by associations are much maligned. Professor Pindell opines that "the only entities capable of engendering more ill will than over-zealous lenders are HOAs" and notes that "many see these perceived, excessive HOA charges as yet another manifestation of unchecked and intrusive power over homes and communities." *Id.*

414. *See* S.B. 561, 2011–2012 Reg. Sess. (Cal. 2011) (providing that "an association shall not voluntarily assign or pledge the association's right to collect payment or assessments to a third party . . . [unless] the third party agrees in writing to collect payments or assessments on behalf of the association in the manner set forth in this chapter" and prohibiting "a third party that has contracted with an association to collect assessments, fees, or payments . . . [from] act[ing] as trustee in foreclosure proceedings"); *see also* Nguyen, *supra* note 411, at A19A (reporting that "the California Senate Judiciary Committee passed a bill to curtail predatory practices by collection agencies" for homeowner association debt). The federal Fair Debt Collection Practices Act may also apply to limit the tactics an association may employ to collect unpaid assessments. *See* Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692–1692p (2006); *supra* note 162 and accompanying text (discussing the Fair Debt Collection Practices Act).

415. Pending bills in Utah and Arizona bar the use of debt collectors to obtain unpaid assessments. Conlin & Lush, *supra* note 5.

416. *See, e.g.*, O'Buck v. Cottonwood Vill. Condo. Ass'n, 750 P.2d 813, 818 (Alaska 1988) (upholding association rule banning television antennae in spite of no showing of adverse effect on the value of units and holding that owners of units in CICs "consciously sacrifice some freedom of choice in their decision to live in this type of housing"); Villa de las Palmas Homeowners Ass'n v. Terifaj, 90 P.3d 1223, 1234–35 (Cal. 2004) (upholding amendment to

unpaid assessments plus fees, such lenders might validly complain that an association might manipulate costs in order to obtain coverage of community expense from lenders' deep pockets. There may therefore be compelling reasons to have statutory limits on late fees and charges that an association can impose in order to prohibit a paying majority from unfairly allocating association costs. Some statutory oversight would be particularly warranted in cases where such charges are ultimately recoverable in full from a first mortgage lender in its foreclosure sale. Just as the current inequitable allocation of costs among members is unfair, it would be equally unfair to pass on a lion's share of community costs to lenders.

CONCLUSION

Today's unprecedented delay in foreclosures of vast numbers of financially underwater property harms non-defaulting owners in privately governed communities. The financial "commons" of entangled fiscal fortunes in such neighborhoods illustrates a fundamental flaw in the common interest community system of ownership that must be remedied to prevent the potential failure of such governance forms during periods of great economic stress. The adverse external impact of community assessment delinquencies is an important but often overlooked problem, which under the current housing crisis is reaching critical levels in some localities. Certain government and market actions, including current foreclosure moratoriums and delays, exacerbate the problem, spreading financial distress to innocent homeowners and bringing property values down in a tangible and significant way. Leaving community associations effectively bankrupt is a lose-lose scenario and we need prompt legislative action to prevent this result.

Current lien priority laws fail to protect the interests of such communities and their paying members. Even in the handful of states that have enacted protective limited lien priority provisions with respect to community association assessments, assessment lien priority is almost always capped at six months' worth of delinquent assessments. Because foreclosures take months or years longer than the time period representing the recoverable assessment amounts, such laws provide no real incentive for lender responsibility or expeditious foreclosure sales. As foreclosure is delayed, costs continue to mount while neighbors pay the costs left unpaid by delinquent owners.

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condominium declaration banning pets despite statute providing that no declaration can prohibit all pets).

To effectively preserve property values and protect blameless homeowners in planned communities, states across the nation must adopt measures to enable private governments to perform their roles. Allowing delayed foreclosures to erode the lien priority of a first mortgage achieves the needed result with the most contained and best-allocated costs. Although creating incentives for prompt foreclosures may at first glance seem perverse in a difficult economy, it is the only answer to the insolvency contagion threatened by assessment delinquencies and foreclosure delays. Finding solvent owners to replace those who hold title to houses they can ill afford—both in terms of financing and upkeep costs—is paramount. Continuing to mandate that paying members of a community association provide private financial support to the defaulting homeowners is unfair, inefficient, and poor policy indeed.

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CLERK OF THE COURT

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DISTRICT COURT

CLARK COUNTY, NEVADA

WINGBROOK CAPITAL, LLC., Plaintiff, vs. PEPPERTREE HOMEOWNERS ASSOCIATION; and DOES 1-10 and ROE ENTITIES 1-10, INCLUSIVE Defendants.	Case No. A-11-636948-B Dept. No. XI **ORDER**

This matter came before the Court on May 24, 2011 at 9:00 a.m., upon the Plaintiff's Motion for Summary Judgment on Claim of Declaratory Relief. James R. Adams, Esq., of Adams Law Group, Ltd., and Puoy K. Premsrirut, Esq., of Puoy K. Premsrirut, Esq., Inc., appeared on behalf of the Plaintiff. Kurt Bonds, Esq., of Alverson, Taylor, Mortensen & Sanders appeared on behalf of the Defendant. The Honorable Court, having read the briefs on file and having heard oral argument, and for good cause appearing hereby rules:

WHEREAS the Parties have engaged in and have concluded a Nevada Real Estate Division mediation (ADR #11-25) wherein the Parties mediated a dispute over the sum of $13,190.33; and

WHEREAS the subject of the mediation was whether NRS 116.3116 permitted Defendant to charge to Plaintiff $14,037.83, or whether some lesser amount was due pursuant to NRS 116.3116; and

WHEREAS, the Court has determined that a justiciable controversy exists in this matter as Defendant claims it has a right pursuant to NRS 116.3116 to charge and retain proceeds in the amount $14,037.83 from Plaintiff and Plaintiff, a purchaser of a home at foreclosure which is located within the Defendant homeowners' association, contests this charge and claims that Defendant exceeded the limits of NRS 116.3116 and overcharged it for the super priority lien; and

WHEREAS there exists in this case a controversy in which a claim of right is asserted by Plaintiff against Defendant who has an interest in contesting it; and

WHEREAS Plaintiff and Defendant, the contesting parties hereto, are clearly adverse and hold different views regarding the meaning and applicability of NRS §116.3116 (including whether Defendant charged too much for the super priority lien); and

WHEREAS Plaintiff has a legal interest in the controversy as it was Plaintiff's money which had been demanded and transferred to Defendant and it was Plaintiff's property that had been the subject of a homeowners' association lien by Defendant; and

WHEREAS the issue of the meaning, application and interpretation of NRS 116.3116 is ripe for determination in this case as the present controversy is real, it exists now, and it affects the Parties hereto; and

WHEREAS, therefore, the Court finds that issuing a declaratory judgment relating to the meaning and interpretation of NRS 116.3116 would terminate some of the uncertainty and controversy giving rise to the present proceeding; and

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WHEREAS, pursuant to NRS 30.040 Plaintiff and Defendant are parties whose rights, status or other legal relations are affected by NRS 116.3116 and they may, therefore, have determined by this Court any question of construction or validity arising under NRS 116.3116 and obtain a declaration of rights, status or other legal relations thereunder;

THE COURT, THEREFORE, DECLARES, ORDERS, ADJUDGES AND DECREES as follows:

1. NRS 116.3116 is a statute which creates for the benefit of Nevada homeowners' associations a lien against a homeowner's unit for any construction penalty that is imposed against the unit's owner pursuant to NRS 116.310305, any assessment levied against that unit or any fines imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due (the "Statutory Lien"). The homeowners' associations' Statutory Lien is noticed and perfected by the recording of the associations' declaration and, pursuant to NRS 116.3116(4), no further recordation of any claim of lien for assessment is required.

2. Pursuant to NRS 116.3116(2), the homeowners' association's Statutory Lien is junior to a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent ("First Security Interest") except for a portion of the homeowners' association's Statutory Lien which remains prior to the First Security Interest (the "Super Priority Lien").

3. Homeowners' associations, therefore, have a Super Priority Lien which has priority over the First Security Interest on a homeowners' unit. However, the Super Priority Lien amount is not without limits and NRS 116.3116 provides that the amount of the Super Priority Lien (i.e., that amount of a homeowners' associations' Statutory Lien which retains priority status over the First Security Interest) is limited "to the extent" of those assessments for common expenses based upon the associations' periodic budget that would have become due in the 9 month period immediately preceding an

associations' institution of an action to enforce its Statutory Lien and "to the extent of" external repair costs pursuant to NRS 116.310312.

4. The words "to the extent of" contained in NRS 116.3116(2) mean "no more than," which clearly indicates a maximum figure or a cap on the Super Priority Lien which cannot be exceeded.

5. Therefore, after the foreclosure by a First Security Interest holder of a unit located within a homeowners' association, pursuant to NRS 116.3116 the monetary limit of a homeowners' association's Super Priority Lien is limited to a maximum amount equaling 9 times the homeowners' association's monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the institution of an action to enforce the lien (the "Assessment Cap Figure") plus external repair costs pursuant to NRS 116.310312.

6. While assessments, penalties, fees, charges, late charges, fines and interest may be included within the Assessment Cap Figure, in no event can the total amount of the Assessment Cap Figure exceed an amount equaling 9 times the homeowners' association's monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the association's institution of an action to enforce the lien.

7. The Super Priority Lien equals the Assessment Cap Figure plus external repair costs pursuant to NRS 116.310312.

8. After providing a homeowner with notice and hearing, NRS 116.310312 permits a homeowners' association to enter the grounds of a homeowners' unit and maintain the exterior of the unit in accordance with the standards set forth in the association's governing documents. Pursuant to NRS 116.310312(2)(b), a homeowners' association may also remove or abate a public nuisance on the exterior of a unit. The association may order that the costs of such maintenance or abatement, including interest, inspection fees, notification fees and collection costs for such maintenance

or abatement to be charged against the unit ("Exterior Repair Costs"). NRS 116.310312(9)(a) provides that "Exterior" of the unit includes, without limitation, all landscaping outside of a unit and the exterior of all property exclusively owned by the unit owner.

9. Therefore, the Super Priority Lien consists solely and exclusively of the Assessment Cap Figure and the Exterior Repair Costs. No other costs, fees, fines, penalties, assessments, charges, late charges, or interest or any other costs may be included within the Super Priority Lien.

10. Pursuant to NRS 116.3116, the maximum amount of the Assessment Cap Figure portion of Defendant's Super Priority Lien cannot exceed $1,552.50 which equals 9 times the Defendant's monthly assessments. As Defendant has assessed against Plaintiff $1,552.50 for past due assessments incurred prior to Plaintiff's ownership of the property, the additional late fees of $135.00 and accrued interest on the Assessment Cap Figure are impermissible and cannot be included in the Assessment Cap Figure as the addition of those costs exceed the Assessment Cap Figure of $1,552.50 and violates NRS 116.3116.

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11. The External Repair Costs portion of the Super Priority Lien shall be determined by this Court at a later date when the Court is provided with all necessary evidence to make that determination.

IT IS SO ORDERED.

DISTRICT COURT JUDGE

June 2, 2011
Date

BK

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DISTRICT COURT

CLARK COUNTY, NEVADA

PECCOLE RANCH COMMUNITY ASSOCIATION, a domestic non-profit homeowners association corporation, Plaintiff, vs. ELSINORE, LLC, a Nevada Limited Liability Company, Defendant. ELSINORE, LLC., on behalf of itself and as representatives of the class herein defined Counter Claimant, vs. PECCOLE RANCH COMMUNITY ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Counter Defendant.	CASE NO. A-12-658044-C DEPT. NO. XV Date of Hearing: August 29, 2012 Time of Hearing: 9:00 a.m. **ORDER DENYING IN PART AND GRANTING IN PART PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT**

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DISTRICT COURT

CLARK COUNTY, NEVADA

PECCOLE RANCH COMMUNITY ASSOCIATION, a domestic non-profit homeowners association corporation, Plaintiff, vs. ELSINORE, LLC, a Nevada Limited Liability Company, Defendant. ELSINORE, LLC., on behalf of itself and as representatives of the class herein defined Counter Claimant, vs. PECCOLE RANCH COMMUNITY ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Counter Defendant.	CASE NO. A-12-658044-C DEPT. NO. XV Date of Hearing: August 29, 2012 Time of Hearing: 9:00 a.m. **ORDER DENYING IN PART AND GRANTING IN PART PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT**

42798

SEP 07 2012

This matter came before the Court on August 29, 2012, at 9:00 a.m., upon the Plaintiff's MOTION FOR PARTIAL SUMMARY JUDGMENT. James R. Adams, Esq., of ADAMS LAW GROUP, LTD., and Puoy K. Premsrirut, Esq., of PUOY K. PREMSRIRUT, ESQ., INC., appeared on behalf of the Defendant/Counter Claimant. Don Springmeyer, Esq., of WOLF, RIFKIN, SHAPIRO, SCHULMAN & RABKIN, LLP., appeared on behalf of the Plaintiff/Counter Defendant. The Honorable Court, having read the briefs on file and having heard oral argument, and for good cause appearing hereby, DECLARES, ORDERS, ADJUDGES AND DECREES that Plaintiff's Motion for Partial Summary Judgment is denied in part and granted in part.

WHEREAS, the undisputed facts are as follows: Plaintiff is a Nevada homeowners association. Defendant was an owner of residential real property located within the Peccole Ranch Community Association. In particular, Defendant purchased the property located at 2209 Storkspur, Las Vegas, NV, at a foreclosure sale on or about September 8, 2008. Defendant had obtained title to the property through a trustee's sale whereby a secured first trust deed holder foreclosed on the property thereby extinguishing Plaintiff's statutory general homeowners' association lien against the property, but for the super priority portion of that general lien. According to Defendant, the Association by itself or through its authorized agents, demanded and collected amounts from the Defendant. The amount demanded was $2,580.70. The amount allegedly paid by Defendant was $2,649.90.

IT IS FURTHER ORDERED that NRCP 56(b) provides as follows: A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in the party's favor as to all or any part thereof.

The Court may enter summary judgment on questions of law where the facts are not in dispute. *Exchange Bank v. Strout Realty*, 94 Nev. 86, 525 P.2d 589 (1978). Thus, this Court may issue partial summary judgment on the declaratory issues pertaining to NRS 116.3116 and CC&Rs Section 8.3. Summary judgment is appropriate only when the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no

genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. NRCP 56(c); *Pegasus v. Reno Newspapers, Inc.*, 118 Nev. 706, 713 (2002). "A factual dispute is genuine when the evidence is such that a rational trier of fact could return a verdict for the nonmoving party." *Wood v. Safeway, Inc.*, 121 Nev. 724, 731 (2005). The substantive law controls which factual disputes are material and will preclude summary judgment; factual disputes not germane and central to the claims for relief are irrelevant. *Id.* The burden to establish the absence of a triable issue of fact is on the moving party, and the court is obligated to construe the evidence in the light most favorable to the party against whom the motion is directed. *Butler v. Bogdonovich*, 101 Nev. 449, 451 (1985); *Hidden Wells Ranch, Inc. v. Strip Realty, Inc.*, 83 Nev. 143, 145 (1967). Where the party moving for summary judgment will bear the burden of persuasion at trial, it must present evidence that would entitle it to judgment as a matter of law in the absence of contrary evidence. *Francis v. Wynn Las Vegas, LLC*, 127 Nev. Adv. Rep. 60 (2011) (quoting *Cuzze v. Univ. & Comm. Coll. Sys. of Nev.*, 123 Nev. 598, 602-03 (2007)). If the nonmoving party will bear the burden of persuasion at trial, the moving party may satisfy the burden of production by either (1) submitting evidence that negates an essential element of the nonmoving party s claim or (2) pointing out ... that there is an absence of evidence to support the nonmoving party's case. *Id.* In such instances, the nonmoving party must do more than simply show that there is some metaphysical doubt as to the operative facts to defeat a motion for summary judgment. *Wood, supra* (quoting *Matsushita Electric Industrial Co. v. Zenith Radio*, 475 U.S. 574 (1986)). When the motion is made and supported as required by Rule 56, the nonmoving party must transcend the pleadings and, by affidavit or other admissible evidence, introduce specific facts that show a genuine issue of material fact. *Francis*, 262 P.3d at 714-15. The non-moving party's documentation must be admissible evidence, and he or she is not entitled to build a case on the gossamer threads of whimsy, speculation and conjecture. *Posadas v. City of Reno*, 109 Nev. 448, 452 (1993) (quoting *Collins v. Union Fed. Savings & Loan*, 99 Nev. 284 (1983)). In considering a motion for summary judgment, the court should not regard Rule 56 as a disfavored procedural shortcut, but should instead view it as an integral part of the ... Rules [of Civil Procedure] as a whole, which are designed to secure the just,

speedy and inexpensive determination of every action. *Wood*, 121 Nev. at 730-31 (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986)). Accordingly, when the movant has met the standard and the non-moving party has failed to establish a genuine issue of material fact, it is incumbent upon the court to grant the judgment sought forthwith. NRCP 56(c); *Dzack v. Marshall*, 80 Nev. 345 (1964).

The Plaintiff Association requested the following relief:

1. That pursuant to NRS 116.3116, the Association has a Super Priority Lien over a first security interest recorded against the property for nine (9) months of assessments immediately preceding institution of an action to enforce the lien.
2. That the Association's Super Priority Lien Amount pursuant to NRS 116.3116 includes interest, late fees and costs of collection, which are in addition to, not capped by, the applicable period of common expense assessments.
3. That the Association's Super Priority Lien Amount pursuant to NRS 116.3116(2) includes costs of collection, which pursuant to NRS 116.310313 may include any fee, including legal fees and costs, and
4. That NRS 116.3116 supersedes the provisions of Section 8.3 of the Association s CC&Rs.

The Court finds that, in accordance with recent rulings by the Eighth Judicial District Court Honorable Judges Gonzalez, Denton, and Scann, Summary Judgment on requests numbers 1, 2 and 3 are DENIED.

Summary judgment on Plaintiff's request number 4 is GRANTED.

Pursuant to NRS 116.3116(2), the Association's Statutory Lien has priority over a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent the (First Security Interest) only to the extent of those assessments for common expenses based upon the Association's periodic budget that would have become due in the 9 month period immediately preceding an the Association's institution of an action to enforce its statutory general lien and to the extent of external repair pursuant to NRS 116.310312. This portion will be

referred to as the "Super Priority Lien". The Super Priority Lien amount is not without limits. The Association's Super Priority Lien Amount pursuant to NRS 116.3116 may include interest, late fees and costs of collection, but is capped by the applicable period of common expense assessments, i.e., a figure equaling 9 months of common expense assessments based upon the Association's periodic budget. The words to the extent of contained in NRS 116.3116(2) mean no more than, which clearly indicates a maximum figure or a cap on the Super Priority Lien which cannot be exceeded.

Therefore, after the foreclosure by a First Security Interest holder of a unit located within a homeowners' association, pursuant to NRS 116.3116(2), the monetary limit of a homeowners' association's Super Priority Lien is limited to a maximum amount equaling 9 times the homeowners' association's monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the institution of an action to enforce the lien, plus external repair costs pursuant to NRS 116.310312.

For the foregoing reasons, the Court denies Plaintiff's Motion for Partial Summary Judgment on requests 1, 2 and 3 and grants request 4.

IT IS SO ORDERED.

DISTRICT COURT JUDGE — Date 9.13.12

Abbi Silver

Submitted by:

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DISTRICT COURT

CLARK COUNTY, NEVADA

PREM DEFERRED TRUST, on behalf of itself and as representatives of the class herein defined Plaintiff, vs. ALIANTE MASTER ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Defendant.	CASE NO. A-11-651107-B DEPT. NO 29 **ORDER**

This matter came before the Court on 07/24/2012, at 10:00 a.m., on Plaintiff and the Class' MOTION FOR SUMMARY JUDGMENT ON DECLARATORY RELIEF and Defendant Aliante Master Association's OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT ON CLAIM FOR DECLARATORY RELIEF AND COUNTER-MOTION FOR SUMMARY JUDGMENT. James R. Adams, Esq., of Adams Law Group, Ltd., appeared on behalf of the Plaintiff and the Class. Kurt Bonds, Esq., of Alverson, Taylor, Mortensen & Sanders appeared on behalf of the Defendant. Patrick Reilly, Esq., of Holland and Hart appeared on behalf of Nevada Association Services, Inc., and RMI Management, Inc., as Amici Curiae of the Court.

After review and consideration of all the pleadings and briefs of Plaintiff, Defendant and the Amici Curiae, including all exhibits attached thereto, and including the oral arguments of Counsel for Plaintiff and the Class, Counsel for Defendant and Counsel for the Amici Curiae, the Honorable Court hereby rules:

42905

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DISTRICT COURT

CLARK COUNTY, NEVADA

PREM DEFERRED TRUST, on behalf of itself and as representatives of the class herein defined Plaintiff, vs. ALIANTE MASTER ASSOCIATION, and DOES 1 through 10 and ROE ENTITIES 1 through 10 inclusive, Defendant.	CASE NO. A-11-651107-B DEPT. NO 29 **ORDER**

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After review and consideration of all the pleadings and briefs of Plaintiff, Defendant and the Amici Curiae, including all exhibits attached thereto, and including the oral arguments of Counsel for Plaintiff and the Class, Counsel for Defendant and Counsel for the Amici Curiae, the Honorable Court hereby rules:

42905

WHEREAS, the Court has determined that a justiciable controversy exists in this matter as Plaintiff and the Class have asserted a claim of right under NRS §116.3116(2) (the "Super Priority Lien" statute) against Defendant and Defendant has an interest in contesting said claim. The issue contained in the briefing is, therefore, ripe for determination. Further, the present controversy is between persons or entities whose interests are adverse and who have a legal interest in the controversy (*Kress v. Corey* 65 Nev. 1, 189 P.2d 352 (1948)); and

WHEREAS Plaintiff, the Class and the Defendant, the contesting parties hereto, are clearly adverse and hold different views regarding the meaning and applicability of NRS §116.3116; and

WHEREAS Plaintiff and the Class, and the Defendant have a legal interest in the controversy as it is Plaintiff's and the Class' property that is the subject of Defendant's Super Priority Lien and all parties, therefore, have a legal interest in a determination of to what extent the Super Priority Lien can exist; and

WHEREAS the issue of the meaning, application and interpretation of NRS §116.3116 is ripe for determination in this case as the present controversy is real, it exists now, and it affects the parties hereto; and

WHEREAS, therefore, the Court finds that issuing a declaratory judgment relating to the meaning and interpretation of NRS §116.3116 would terminate some of the uncertainty and controversy giving rise to the present proceeding; and

WHEREAS, pursuant to NRS §30.040 Plaintiff, the Class and the Defendant are parties whose rights, status or other legal relations are affected by NRS §116.3116 and they may, therefore, have determined by this Court any question of construction or validity arising under NRS §116.3116 and obtain a declaration of rights, status or other legal relations thereunder.

THE COURT, THEREFORE, DECLARES, ORDERS, ADJUDGES AND DECREES as follows:

1. Plaintiff's and the Class' MOTION FOR SUMMARY JUDGMENT ON CLAIM OF DECLARATORY RELIEF is granted.
2. Defendant's COUNTER-MOTION FOR SUMMARY JUDGMENT is denied.

3. NRS §116.3116(1) is a statute which creates for the benefit of Nevada homeowners' associations a statutory lien against a homeowner's unit for (a) any construction penalty that is imposed against the unit's owner pursuant to NRS §116.310305, (b) any assessment levied against that unit, and (c) any fines imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due (the "General Statutory Lien").

4. Pursuant to NRS §116.3116(2), the homeowners' association's General Statutory Lien is junior to a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent ("First Security Interest") except for a portion of the homeowners' association's General Statutory Lien which remains superior to the First Security Interest (the "Super Priority Lien").

5. Defendant, as a Nevada homeowners' association, therefore, has a Super Priority Lien which has payment priority over the First Security Interest on a homeowners' unit. However, the Super Priority Lien amount is not without limits and NRS §116.3116(2) is clear that the amount of the Super Priority Lien (that portion of the General Statutory Lien which retains a priority payment status over the First Security Interest) is limited "to the extent" of a homeowners' association's assessments for common expenses based upon the association's periodic budget that would have become due, in the absence of acceleration, in the 9 month period immediately preceding Defendant's institution of an action to enforce its General Statutory Lien (which is 9 months of regular, common assessments) and "to the extent of" external repair costs pursuant to NRS §116.310312 unless regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien.

6. The base assessment figure used in the calculation of the Super Priority Lien is the unit's un-accelerated, monthly assessment figure for association common expenses which is wholly determined by the homeowners association's "periodic budget," as adopted by the association, and not determined by any other document or statute. Thus, the phrase contained in NRS §116.3116(2) which states, "... to the extent of the assessments for common expenses

based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien..." means a maximum figure equaling 9 months of an association's regular, monthly (not annual) assessments. If assessments are paid quarterly, then 3 quarters of assessments (i.e., 9 months) would equal the Super Priority Lien, plus external repair costs pursuant to NRS §116.310312.

7. The words "to the extent of" contained in NRS §116.3116(2) mean "no more than," which clearly indicates a maximum figure or a cap on the Super Priority Lien which cannot be exceeded.

8. Thus, while assessments, penalties, fees, charges, late charges, fines and interest may be included within the Super Priority Lien, in no event can the total amount of the Super Priority Lien exceed an amount equaling 9 months of the Defendant's regular monthly assessment amount to unit owners for common expenses based on the periodic budget which would have become due immediately preceding the association's institution of an action to enforce the lien, plus external repair costs pursuant to NRS 116.310312.

9. In addition to the arguments of counsel contained in the briefs on file, in rendering this decision, the Court considered all exhibits appended to such all briefs, including but not limited to law review articles, the legislative history of NRS 116.3116, the history of the Uniform Common Interest Ownership Act, intermediate appellate and supreme court case law of other states, and the Commission on Common-Interest Communities & Condominium Hotels' Advisory Opinion which opined that a homeowners' association may collect as a part of the Super Priority Lien interest, late fees or charges, and the costs of collecting, but did not directly opine upon the issue of whether there was a maximum limit to the Super Priority Lien regardless of the constituent elements thereof, which was the question before this Court.

10. While the Court considered all such supporting materials, the Court is bound by the precedent of the Nevada Supreme Court which directs trial courts that, "[W]here a statute is clear on its face, a court may not go beyond the language of the statute in determining the

legislature's intent." *Diaz v. Eighth Judicial Dist. Court ex rel. County of Clark*, 116 Nev. 88, 94, 993 P.2d 50 (2000).

11. The Court finds that NRS 116.3116 is clear on its face. After the foreclosure by a first security interest on a unit recorded before the date on which the assessment sought to be enforced became delinquent, a portion of a homeowners' association's statutory lien under NRS 116.3116(1) is prior to the first security interest only to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 (exterior repair costs) and only to the extent of the assessments for common expenses which are based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien. The 9 month figure is derived by taking the monthly assessment figure for common expenses as contained in the association's periodic budget which existed immediately prior to the association's institution of an action to enforce its lien, and multiplying by 9.

12. Prior to the October 1, 2009, amendment increasing the Super Priority Lien, the maximum amount of the Super Priority Lien was limited to the extent of the assessments for common expenses which are based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien.

IT IS SO ORDERED.

DISTRICT COURT JUDGE Sept. 27, 2012 Date

Submitted by:

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Director

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DEPARTMENT OF BUSINESS AND INDUSTRY
REAL ESTATE DIVISION
www.red.state.nv.us

December 12, 2012

Prem Investments
520 South Fourth Street, Second Floor
Las Vegas, Nevada 89101

Dear Prem Investments:

In November, the prior Director of the Nevada Department of Business & Industry, Terry Johnson, informed you that your request for an advisory opinion from the Director's office was sent by Director Johnson to the Real Estate Division. Enclosed please find the Division's Advisory Opinion #13-01, issued in response to your request for an advisory opinion on the questions posed concerning the super priority lien in NRS 116.3116.

This advisory opinion will be posted on the Division's web site. It provides the Division's interpretation of NRS 116 statutes applicable to the questions posed.

Sincerely,

Gail J. Anderson
Administrator

Encl. Advisory Opinion 13-01

C: James R. Adams, Esq.

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STATE OF NEVADA
DEPARTMENT OF BUSINESS AND INDUSTRY
REAL ESTATE DIVISION
ADVISORY OPINION

Subject:	Advisory No. 13-01	20 pages
The Super Priority Lien	Issued By: Real Estate Division	
	Amends/ Supersedes	N/A
Reference(s): NRS 116.3102; ; NRS 116.310312; NRS 116.310313; NRS 116.3115; NRS 116.3116; NRS 116.31162; Commission for Common Interest Communities and Condominium Hotels Advisory Opinion No. 2010-01		Issue Date: December 12, 2012

QUESTION #1:

Pursuant to NRS 116.3116, may the portion of the association's lien which is superior to a unit's first security interest (referred to as the "super priority lien") contain "costs of collecting" defined by NRS 116.310313?

QUESTION #2:

Pursuant to NRS 116.3116, may the sum total of the super priority lien ever exceed 9 times the monthly assessment amount for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115, plus charges incurred by the association on a unit pursuant to NRS 116.310312?

QUESTION #3:

Pursuant to NRS 116.3116, must the association institute a "civil action" as defined by Nevada Rules of Civil Procedure 2 and 3 in order for the super priority lien to exist?

SHORT ANSWER TO #1:

No. The association's lien does not include "costs of collecting" defined by NRS 116.310313, so the super priority portion of the lien may not include such costs. NRS 116.310313 does not say such charges are a lien on the unit, and NRS 116.3116 does not make such charges part of the association's lien.

SHORT ANSWER TO #2:

No. The language in NRS 116.3116(2) defines the super priority lien. The super priority lien consists of unpaid assessments based on the association's budget and NRS 116.310312 charges, nothing more. The super priority lien is limited to: (1) 9 months of assessments; and (2) charges allowed by NRS 116.310312. The super priority lien based on assessments may not exceed 9 months of assessments as reflected in the association's budget, and it may not include penalties, fees, late charges, fines, or interest. References in NRS 116.3116(2) to assessments and charges pursuant to NRS 116.310312 define the super priority lien, and are not merely to determine a dollar amount for the super priority lien.

SHORT ANSWER TO #3:

No. The association must *take action* to enforce its super priority lien, but it need not institute a civil action by the filing of a complaint. The association may begin the process for foreclosure in NRS 116.31162 or exercise any other remedy it has to enforce the lien.

ANALYSIS OF THE ISSUES:

This advisory opinion – provided in accordance with NRS 116.623 – details the Real Estate Division's opinion as to the interpretation of NRS 116.3116(1) and (2). The Division hopes to help association boards understand the meaning of the statute so they are better equipped to represent the interests of their members. Associations are encouraged to look at the entirety of a situation surrounding a particular deficiency and evaluate the association's best option for collection. The first step in that analysis is to understand what constitutes the association's lien, what is not part of the lien, and the status of the lien compared to other liens recorded against the unit.

Subsection (1) of NRS 116.3116 describes what constitutes the association's lien; and subsection (2) states the lien's priority compared to other liens recorded against a unit. NRS 116.3116 comes from the Uniform Common Interest Ownership Act (1982) (the "Uniform Act"), which Nevada adopted in 1991. So, in addition to looking at the language of the relevant Nevada statute, this analysis includes references to the Uniform Act's equivalent provision (§ 3-116) and its comments.

I. NRS 116.3116(1) DEFINES WHAT THE ASSOCIATION'S LIEN CONSISTS OF.

NRS 116.3116(1) provides generally for the lien associations have against units within common-interest communities. NRS 116.3116(1) states as follows:

> The association has a lien on a unit for **any construction penalty that is imposed against the unit's owner pursuant to NRS 116.310305, any assessment levied against that unit or any fines** imposed against the unit's owner from the time the construction penalty, assessment or fine becomes due. **Unless the declaration otherwise provides, any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of NRS 116.3102 are enforceable as assessments** under this section. If an assessment is payable in installments, the full amount of the assessment is a lien from the time the first installment thereof becomes due.

(emphasis added).

Based on this provision, the association's lien includes assessments, construction penalties, and fines imposed against a unit when they become due. In addition – unless the declaration otherwise provides – penalties, fees, charges, late charges, fines, and interest charged pursuant to NRS 116.3102(1)(j) through (n) are also part of the association's lien in that such items are enforceable as if they were assessments. Assessments can be foreclosed pursuant to NRS 116.31162, but liens for fines and penalties may not be foreclosed unless they satisfy the requirements of NRS 116.31162(4). Therefore, it is important to accurately categorize what comprises each portion of the association's lien to evaluate enforcement options.

A. "COSTS OF COLLECTING" (DEFINED BY NRS 116.310313) ARE NOT PART OF THE ASSOCIATION'S LIEN

NRS 116.3116(1) does not specifically make costs of collecting part of the association's lien, so the determination must be whether such costs can be included under the incorporated provisions of NRS 116.3102. NRS 116.3102(1)(j) through (n) identifies five very specific categories of penalties, fees, charges, late charges, fines, and interest associations may impose. This language encompasses all penalties, fees,

charges, late charges, fines, and interest that are part of the lien described in NRS 116.3116(1).

NRS 116.3102(1)(j) through (n) states:

> 1. Except as otherwise provided in this section, and subject to the provisions of the declaration, the association may do any or all of the following: ...
> (j) Impose and receive any payments, fees or charges for the use, rental or operation of the common elements, other than limited common elements described in subsections 2 and 4 of NRS 116.2102, and for services provided to the units' owners, including, without limitation, any services provided pursuant to NRS 116.310312.
> **(k) Impose charges for late payment of assessments pursuant to NRS 116.3115.**
> (l) Impose construction penalties when authorized pursuant to NRS 116.310305.
> (m) Impose reasonable fines for violations of the governing documents of the association only if the association complies with the requirements set forth in NRS 116.31031.
> (n) Impose reasonable charges for the preparation and recordation of any amendments to the declaration or any statements of unpaid assessments, and impose reasonable fees, not to exceed the amounts authorized by NRS 116.4109, for preparing and furnishing the documents and certificate required by that section.

(emphasis added).

Whatever charges the association is permitted to impose by virtue of these provisions are part of the association's lien. Subsection (k) – emphasized above – has been used – the Division believes improperly – to support the conclusion that associations may include costs of collecting past due obligations as part of the association's lien. The Commission for Common Interest Communities and Condominium Hotels issued Advisory Opinion No. 2010-01 in December of 2010. The Commission's advisory concludes as follows:

> An association may collect as a part of the super priority lien (a) interest permitted by NRS 116.3115, (b) late fees or charges authorized by the declaration, (c) charges for preparing any statements of unpaid assessments and (d) the "costs of collecting" authorized by NRS 116.310313.

Analysis of what constitutes the *super priority lien* portion of the association's lien is discussed in Section III, but the Division agrees that the association's lien does include items noted as (a), (b) and (c) of the Commission's advisory opinion above. To support item (d), the Commission relies on NRS 116.3102(1)(k) which gives associations the power to: "Impose charges for late payment of assessments pursuant to NRS 116.3115." This language would include interest authorized by statute and late fees if authorized by the association's declaration.

"Costs of collecting" defined by NRS 116.310313 is too broad to fall within the parameters of charges for late payment of assessments.[1] By definition, "costs of collecting" relate to the collection of past due "obligations." "Obligations" are defined as "any assessment, fine, construction penalty, fee, charge or interest levied or imposed against a unit's owner."[2] In other words, costs of collecting includes more than "charges for late payment of assessments."[3] Therefore, the plain language of NRS 116.3116(1) does not incorporate costs of collecting into the association's lien. Further review of the relevant statutes and legislative action supports this conclusion.

B. PRIOR LEGISLATIVE ACTION SUPPORTS THE POSITION THAT COSTS OF COLLECTING ARE NOT PART OF THE ASSOCIATION'S LIEN DESCRIBED BY NRS 116.3116(1).

The language of NRS 116.3116(1) allows for "charges for late payment of assessments" to be part of the association's lien.[4] "Charges for late payments" is not the same as "costs of collecting." "Costs of collecting" was first defined in NRS 116 by the adoption of NRS 116.310313 in 2009. NRS 116.310313(1) provides for the association's

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[1] Charges for late payment of assessments comes from NRS 116.3102(1)(k) and is incorporated into NRS 116.3116(1).
[2] NRS 116.310313.
[3] "Costs of collecting" includes any fee, charge or cost, by whatever name, including, without limitation, any collection fee, filing fee, recording fee, fee related to the preparation, recording or delivery of a lien or lien rescission, title search lien fee, bankruptcy search fee, referral fee, fee for postage or delivery and any other fee or cost that an association charges a unit's owner for the investigation, enforcement or collection of a past due obligation. The term does not include any costs incurred by an association if a lawsuit is filed to enforce any past due obligation or any costs awarded by a court. NRS 116.310313(3)(a).
[4] NRS 116.3102(1)(k) (incorporated into NRS 116.3116(1)).

right to charge a unit owner "reasonable fees to cover the costs of collecting any past due obligation." NRS 116.310313 is not referenced in NRS 116.3116 or NRS 116.3102, nor does NRS 116.310313 specifically provide for the association's right to lien the unit for such costs.

In contrast, NRS 116.310312, also adopted in 2009, allows an association to enter the grounds of a unit to maintain the property or abate a nuisance existing on the exterior of the unit. NRS 116.310312 specifically provides for the association's expenses to be a lien on the unit and provides that the lien is prior to the first security interest.[5] NRS 116.3102(1)(j) was amended to allow these expenses to be part of the lien described in NRS 116.3116(1). And NRS 116.3116(2) was amended to allow these expenses to be included in the association's super priority lien.

The Commission's advisory opinion from December 2010 also relies on changes to the Uniform Act from 2008 to support the notion that collection costs should be part of the association's super priority lien. Nevada has not adopted those changes to the Uniform Act. Since the Commission's advisory opinion, the Nevada Legislature had an opportunity to clarify the law in this regard.

In 2011, the Nevada Legislature considered Senate Bill 174, which proposed changes to NRS 116.3116. S.B. 174 originally included changes to NRS 116.3116(1) such that the association's lien would specifically include "costs of collecting" as defined in NRS 116.310313. S.B. 174 proposed changes to NRS 116.3116 (1) and (2) to bring the statute in line with the changes to the same provision in the Uniform Act amended in 2008.

The Uniform Act's amendments were removed from S.B. 174 by the first reprint. As amended, S.B. 174 proposed changes to NRS 116.3116(2) expanding the super priority lien amount to include costs of collecting not to exceed $1,950, in addition to 9 months

[5] See NRS 116.310312(4) and (6).

of assessments. S.B. 174 was discussed in great detail and ultimately died in committee.[6]

Also in 2011, Senate Bill 204 – as originally introduced – included changes to NRS 116.3116(1) to expand the association's lien to include attorney's fees and costs and "any other sums due to the association."[7] The bill's language was taken from the Uniform Act amendments in 2008. All changes to NRS 116.3116(1) were removed from the hill prior to approval.

The Nevada Legislature's actions in the 2009 and 2011 sessions are indicative of its intent not to make costs of collecting part of the lien. The Nevada Legislature could have made the costs of collecting part of the association's lien, like it did for costs under NRS 116.310312. It did not do so. In order for the association to have a right to lien a unit under NRS 116.3116(1), the charge or expense must fall within a category listed in the plain language of the statute. Costs of collecting do not fall within that language. Based on the foregoing, the Division concludes that the association's lien does not include "costs of collecting" as defined by NRS 116.310313.

A possible concern regarding this outcome could be that an association may not be able to recover their collection costs relating to a foreclosure of an assessment lien. While that may seem like an unreasonable outcome, a look at the bigger picture must be considered to put it in perspective. NRS 116.31162 through NRS 116.31168, inclusive, outlines the association's ability to enforce its lien through foreclosure. Associations have a lien for assessments that is enforced through foreclosure. The association's expenses are reimbursed to the association from the proceeds of the sale. NRS 116.31164(3)(c) allows the proceeds of the foreclosure sale to be distributed in the following order:

(1) The reasonable expenses of sale;

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[6] See http://leg.state.nv.us/Session/76th2011/Reports/history.cfm?ID=423.
[7] Senate Bill No. 204 – Senator Copening, Sec. 49, ln. 1-16, February 28, 2011.

(2) The reasonable expenses of securing possession before sale, holding, maintaining, and preparing the unit for sale, including payment of taxes and other governmental charges, premiums on hazard and liability insurance, and, to the extent provided for by the declaration, reasonable attorney's fees and other legal expenses incurred by the association;
(3) Satisfaction of the association's lien;
(4) Satisfaction in the order of priority of any subordinate claim of record; and
(5) Remittance of any excess to the unit's owner.

Subsections (1) and (2) allow the association to receive its expenses to enforce its lien through foreclosure *before* the association's lien is satisfied. Obviously, if there are no proceeds from a sale or a sale never takes place, the association has no way to collect its expenses other than through a civil action against the unit owner. Associations must consider this consequence when making decisions regarding collection policies understanding that every delinquent assessment may not be treated the same.

II. NRS 116.3116(2) ESTABLISHES THE PRIORITY OF THE ASSOCIATION'S LIEN.

Having established that the association has a lien on the unit as described in subsection (1) of NRS 116.3116, we now turn to subsection (2) to determine the lien's priority in relation to other liens recorded against the unit. The lien described by NRS 116.3116(1) is what is referred to in subsection (2). Understanding the priority of the lien is an important consideration for any board of directors looking to enforce the lien through foreclosure or to preserve the lien in the event of foreclosure by a first security interest.

NRS 116.3116(2) provides that the association's lien is prior to all other liens recorded against the unit *except:* liens recorded against the unit before the declaration; first security interests (first deeds of trust); and real estate taxes or other governmental assessments. There is one exception to the exceptions, so to speak, when it comes to priority of the association's lien. This exception makes a portion of an association's lien prior to the first security interest. The portion of the association's lien given priority status to a first security interest is what is referred to as the "super priority lien" to

distinguish it from the other portion of the association's lien that is subordinate to a first security interest.

The ramifications of the super priority lien are significant in light of the fact that superior liens, when foreclosed, remove all junior liens. An association can foreclose its super priority lien and the first security interest holder will either pay the super priority lien amount or lose its security. NRS 116.3116 is found in the Uniform Act at § 3-116. Nevada adopted the original language from § 3-116 of the Uniform Act in 1991. From its inception, the concept of a super priority lien was a novel approach. The Uniform Act comments to § 3-116 state:

> [A]s to prior first security interests the association's lien does have priority for 6 months' assessments based on the periodic budget. A significant departure from existing practice, the 6 months' priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders. As a practical matter, secured lenders will most likely pay the 6 months' assessments demanded by the association rather than having the association foreclose on the unit. If the lender wishes, an escrow for assessments can be required.

This comment on § 3-116 illustrates the intent to allow for 6 months of assessments to be prior to a first security interest. The reason this was done was to accommodate the association's need to enforce collection of unpaid assessments. The controversy surrounding the super priority lien is in defining its limit. This is an important consideration for an association looking to enforce its lien. There is little benefit to an association if it incurs expenses pursuing unpaid assessments that will be eliminated by an imminent foreclosure of the first security interest. As stated in the comment, it is also likely that the holder of the first security interest will pay the super priority lien amount to avoid foreclosure by the association.

III. THE AMOUNT OF THE SUPER PRIORITY LIEN IS LIMITED BY THE PLAIN LANGUAGE OF NRS 116.3116(2).

NRS 116.3116(2) states:

> A lien under this section is prior to all other liens and encumbrances on a unit except:
> (a) Liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances which the association creates, assumes or takes subject to;
> (b) A first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent or, in a cooperative, the first security interest encumbering only the unit's owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent; and
> (c) Liens for real estate taxes and other governmental assessments or charges against the unit or cooperative.
> ***The lien is also prior to all security interests described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien***, unless federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien. If federal regulations adopted by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association require a shorter period of priority for the lien, the period during which the lien is prior to all security interests described in paragraph (b) must be determined in accordance with those federal regulations, except that notwithstanding the provisions of the federal regulations, the period of priority for the lien must not be less than the 6 months immediately preceding institution of an action to enforce the lien. This subsection does not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association.

(emphasis added)

Having found previously that costs of collecting are not part of the lien means they are not part of the super priority lien. The question then becomes what can be included as part of the super priority lien. Prior to 2009, the super priority lien was limited to 6 months of assessments. In 2009, the Nevada legislature changed the 6 months of

assessments to 9 months and added expenses for abatement under NRS 116.310312 to the super priority lien amount. But to the extent federal law applicable to the first security interest limits the super priority lien, the super priority lien is limited to 6 months of assessments.

The emphasized language in the portion of the statute above identifies the portion of the association's lien that is prior to the first security interest, i.e. what comprises the super priority lien. This language states that there are two components to the super priority lien. The first is "to the extent of any charges" incurred by the association pursuant to NRS 116.310312. NRS 116.310312(4) makes clear that the charges assessed against the unit pursuant to this section are a lien on the unit and subsection (6) makes it clear that such lien is prior to first security interests. These costs are also specifically part of the lien described in NRS 116.3116(1) incorporated through NRS 116.3102(1)(j). This portion of the super priority lien is specific to charges incurred pursuant to NRS 116.310312. Payment of those charges relieves their super priority lien status. There does not seem to be any confusion as to what this part of the super priority lien is. Analysis of the super priority lien will focus on the second portion.

A. THE SUPER PRIORITY LIEN ATTRIBUTABLE TO ASSESSMENTS IS LIMITED TO 9 MONTHS OF ASSESSMENTS AND CONSISTS ONLY OF ASSESSMENTS.

The second portion of the super priority lien is "to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to NRS 116.3115 which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien."

The statute uses the language "to the extent of the assessments" to illustrate that there is a limit on the amount of the super priority lien, just like the language concerning expenses pursuant to NRS 116.310312, but this portion concerns assessments. The limit on the super priority lien is based on the assessments for

common expenses reflected in a budget adopted pursuant to NRS 116.3115 which would have become due in 9 months. The assessment portion of the super priority lien is no different than the portion derived from NRS 116.310312. Each portion of the super priority lien is limited to the specific charge stated and nothing else.

Therefore, while the association's *lien* may include any penalties, fees, charges, late charges, fines and interest charged pursuant to NRS 116.3102 (1) (j) to (n), inclusive, the total amount of the *super priority lien* attributed to assessments is no more than 9 months of the monthly assessment reflected in the association's budget. Association budgets do not reflect late charges or interest attributed to an anticipated delinquent owner, so there is no basis to conclude that such charges could be included in the super priority lien or in addition to the assessments. Such extraneous charges are not included in the association's super priority lien.

NRS 116.3116 originally provided for 6 months of assessments as the super priority lien. Comments to the Uniform Act quoted previously support the conclusion that the original intent was for 6 months of the assessments alone to comprise the super priority lien amount and not the penalties, charges, or interest. It is possible that an argument could be made that the language is so clear in this regard one should not look to legislative intent. But considering the controversy surrounding the meaning of this statute, the better argument is that legislative intent should be used to determine the meaning.

The Commission's advisory opinion of December 2010 concluded that assessments *and* additional costs are part of the super priority lien. The Commission's advisory opinion relies in part on a Wake Forest Law Review[8] article from 1992 discussing the Uniform Act. This article actually concludes that the Uniform Act language limits the

[8] See James Winokur, *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 353, 366-69 (1992).

amount of the super priority lien to 6 months of assessments, but that the super priority lien does not necessarily consist of only delinquent assessments.[9] It can include fines, interest, and late charges.[10] The concept here is that all parts of the lien are prior to a first security interest and that reference to assessments for the super priority lien is only to define a specific dollar amount.

The Division disagrees with this interpretation because of the unreasonable consequences it leaves open. For example, a unit owner may pay the delinquent assessment amount leaving late charges and interest as part of the super priority lien. If the super priority lien can encompass more than just delinquent assessments in this situation, it would give the association the right to foreclose its lien consisting only of late charges and interest prior to the first security interest. It is also unreasonable to expect that fines (which cannot be foreclosed generally) survive a foreclosure of the first security interest. Either the lender or the new buyer would be forced to pay the prior owner's fines. The Division does not find that these consequences are reasonable or intended by the drafters of the Uniform Act or by the Nevada Legislature. Even the 2008 revisions to the Uniform Act do not allow for anything other than assessments and costs incurred to foreclose the lien to be included in the super priority lien. Fines, interest, and late charges are not *costs* the association incurs.

In 2009, the Nevada Legislature revised NRS 116.3116 to expand the association's super priority lien. Assembly Bill 204 sought to extend the super priority lien of 6 months of assessments to 2 years of assessments.[11] The Commission's chairman, Michael Buckley, testified on March 6, 2009 before the Assembly Committee on Judiciary on A.B. 204 that the law was unclear as to whether the 6 month priority can

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[9] See id. at 367 (referring to the super priority lien as the "six months assessment ceiling" being computed from the periodic budget).
[10] See id.
[11] See http://leg.state.nv.us/Session/75th2009/Reports/history.cfm?ID=416.

include the association's costs and attorneys' fees.[12] Mr. Buckley explained that the Uniform Act amendments in 2008 allowed for the collection of attorneys' fees and costs incurred by the association in foreclosing the assessment lien as part of the super priority lien. Mr. Buckley requested that the 2008 change to the Uniform Act be included in A.B. 204. Mr. Buckley's requested change to A.B. 204 to expand the super priority lien never made it into A.B. 204. Ultimately, A.B. 204 was adopted to change 6 months to 9 months, but commenting on the intent of the bill, Assemblywoman Ellen Spiegel stated:

> Assessments covered under A.B. 204 are the regular monthly or quarterly dues for their home. *I carefully put this bill together to make sure it did not include any assessments for penalties, fines or late fees.* The bill covers the basic monies the association uses to build its regular budgets.

(emphasis added).[13]

It is significant that the legislative intent in changing 6 months to 9 months was with the understanding that no portion of that amount would be for penalties, fines, or late fees and that it only covers the basic monies associations use to build their regular budgets. It does make sense that a lien superior to a first security interest would not include penalties, fines, and interest. To say that the super priority lien includes more than just 9 months of assessments allows several undesirable and unreasonable consequences.

B. NEVADA HAS NOT ADOPTED AMENDMENTS TO THE UNIFORM ACT TO ALTER THE ORIGINAL INTENT OF THE SUPER PRIORITY LIEN.

The changes to the Uniform Act support the contention that only what is referenced as the super priority lien in NRS 116.3116(2) is what comprises the super priority lien. In 2008, § 3-116 of the Uniform Act was revised as follows:

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[12] See Minutes of the Meeting of the Assembly Committee on Judiciary, Seventy-fifth Session, March 6, 2009 at 44-45.

[13] See Minutes of the Senate Committee on Judiciary, Seventy-fifth Session, May 8, 2009 at 27.

SECTION 3-116. LIEN FOR ~~ASSESSMENTS~~; SUMS DUE ASSOCIATION; ENFORCEMENT.

(a) The association has a statutory lien on a unit for any assessment ~~levied against~~ attributable to that unit or fines imposed against its unit owner. Unless the declaration otherwise provides, reasonable attorney's fees and costs, other fees, charges, late charges, fines, and interest charged pursuant to Section 3-102(a)(10), (11), and (12), and any other sums due to the association under the declaration, this [act], or as a result of an administrative, arbitration, mediation, or judicial decision are enforceable in the same manner as unpaid assessments under this section. If an assessment is payable in installments, the lien is for the full amount of the assessment from the time the first installment thereof becomes due.

(b) A lien under this section is prior to all other liens and encumbrances on a unit except:

~~(i)~~(1) liens and encumbrances recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances ~~which~~ that the association creates, assumes, or takes subject to~~,~~ ;

~~(ii)~~(2) except as otherwise provided in subsection (c), a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent, or, in a cooperative, the first security interest encumbering only the unit owner's interest and perfected before the date on which the assessment sought to be enforced became delinquent~~,~~; and

~~(iii)~~(3) liens for real estate taxes and other governmental assessments or charges against the unit or cooperative.

(c) A ~~The~~ lien under this section is also prior to all security interests described in subsection (b)(2) ~~clause (ii) above~~ to the extent of both the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien and reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien. ~~This subsection~~ Subsection (b) and this subsection ~~does~~ do not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association. [~~The~~ A lien under this section is not subject to ~~the provisions of~~ [insert appropriate reference to state homestead, dower and curtesy, or other exemptions].]

Explaining the reason for the changes to these sections, the Uniform Act includes the following comments:

> Associations must be legitimately concerned, as fiduciaries of the unit owners, that the association be able to collect periodic common charges from recalcitrant unit owners in a timely way. To address those concerns, the section contains these 2008 amendments:
>
> First, subsection (a) is amended to add the cost of the association's reasonable attorneys fees and court costs to the total value of the association's existing 'super lien' – currently, 6 months of regular common assessments. This amendment is identical to the amendment adopted by Connecticut in 1991; see C.G.S. Section 47-258(b). The increased amount of the association's lien has been approved by Fannie Mae and local lenders and has become a significant tool in the successful collection efforts enjoyed by associations in that state.

The Uniform Act's amendment in 2008 is very telling about § 3-116's original intent. The comments state reasonable attorneys' fees and court costs are *added* to the super priority lien stating that it is currently 6 months of regular common assessments. The Uniform Act adds attorneys' fees and costs to subsection (a) which defines the association's lien. Those attorneys' fees and costs attributable to foreclosure efforts are also added to subsection (c) which defines the super priority lien amount.

If the association's lien ever included attorneys' fees and court costs as "charges for late payment of assessments" or if such sum was part of the super priority lien, there would be no reason to add this language to subsection (a) and (c). Or at a minimum, the comments would assert the amendment was simply to make the language more clear. It is also clear by the language that only what is specified as part of the super priority lien can comprise the super priority lien. The additional language defining the super priority lien provides for costs that are *incurred* by the association foreclosing the lien. This is further evidence that the super priority lien does not and never did consist of interest, fines, penalties or late charges. These charges are not incurred by the association and they should not be part of any super priority lien.

The Nevada Legislature had the opportunity to change NRS 116.3116 in 2009 and 2011 to conform to the Uniform Act. It chose not to. While the revisions under the

Uniform Act may make sense to some and they may be adopted in other jurisdictions, the fact of the matter is, Nevada has not adopted those changes. The changes to the Uniform Act cannot be insinuated into the language of NRS 116.3116. Based on the plain language of NRS 116.3116, legislative intent, and the comments to the Uniform Act, the Division concludes that the super priority lien is limited to expenses stemming from NRS 116.310312 and assessments as reflected in the association's budget for the immediately preceding 9 months from institution of an action to enforce the association's lien.

IV. "ACTION" AS USED IN NRS 116.3116 DOES NOT REQUIRE A CIVIL ACTION ON THE PART OF THE ASSOCIATION.

NRS 116.3116(2) provides that the super priority lien pertaining to assessments consists of those assessments "which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien." NRS 116.3116 requires that the association take action to enforce its lien in order to determine the immediately preceding 9 months of assessments. The question presented is whether this action must be a civil action.

During the Senate Committee on Judiciary hearing on May 8, 2009, the Chair of the Committee, Terry Care, stated with reference to AB 204:

> One thing that bothers me about section 2 is the duty of the association to enforce the liens, but I understand the argument with the economy and the high rate of delinquencies not only to mortgage payments but monthly assessments. Bill Uffelman, speaking for the Nevada Bankers Association, broke it down to a 210-day scheme that went into the current law of six months. Even though you asked for two years, I looked at nine months, thinking the association has a duty to move on these delinquencies.

NRS 116 does not require an association to take any particular action to enforce its lien, but that it institutes "an action." NRS 116.31162 provides the first steps to foreclose the association's lien. This process is started by the mailing of a notice of delinquent

assessment as provided in NRS 116.31162(1)(a). At that point, the immediately preceding 9 months of assessments based on the association's budget determine the amount of the super priority lien. The Division concludes that this action by the association to begin the foreclosure of its lien is "action to enforce the lien" as provided in NRS 116.3116(2). The association is not required to institute a civil action in court to trigger the 9 month look back provided in NRS 116.3116(2). Associations should make the delinquent assessment known to the first security holder in an effort to receive the super priority lien amount from them as timely as possible.

ADVISORY CONCLUSION:

An association's lien consists of assessments, construction penalties, and fines. Unless the association's declaration provides otherwise, the association's lien also includes all penalties, fees, charges, late charges, fines and interest pursuant to NRS 116.3102(1)(j) through (n). While charges for late payment of assessments are part of the association's lien, "costs of collecting" as defined by NRS 116.310313, are not. "Costs of collecting" defined by NRS 116.310313 includes costs of collecting any *obligation*, not just assessments. Costs of collecting are not merely a charge for a late payment of assessments. Since costs of collecting are not part of the association's lien in NRS 116.3116(1), they cannot be part of the super priority lien detailed in subsection (2).

The super priority lien consists of two components. By virtue of the detail provided by the statute, the super priority lien applies to the charges incurred under NRS 116.310312 and up to 9 months of assessments as reflected in the association's regular budget. The Nevada Legislature has not adopted changes to NRS 116.3116 that were made to the Uniform Act in 2008 despite multiple opportunities to do so. In fact, the Legislative intent seems rather clear with Assemblywoman Spiegel's comments to A.B. 204 that changed 6 months of assessments to 9 months. Assemblywoman Spiegel stated that she "carefully put this bill together to make sure it did not include any

assessments for penalties, fines or late fees." This is consistent with the comments to the Uniform Act stating the priority is for assessments based on the periodic budget. In other words, when the super priority lien language refers to 9 months of assessments, assessments are the only component. Just as when the language refers to charges pursuant to NRS 116.310312, those charges are the only component. Not in either case can you substitute other portions of the entire lien and make it superior to a first security interest.

Associations need to evaluate their collection policies in a manner that makes sense for the recovery of unpaid assessments. Associations need to consider the foreclosure of the first security interest and the chances that they may not be paid back for the costs of collection. Associations may recover costs of collecting unpaid assessments if there are proceeds from the association's foreclosure.[14] But costs of collecting are not a lien under NRS 116.310313 or NRS 116.3116(1); they are the personal liability of the unit owner.

Perhaps an effective approach for an association is to start with foreclosure of the assessment lien after a nine month assessment delinquency or sooner if the association receives a foreclosure notice from the first security interest holder. The association will always want to enforce its lien for assessments to trigger the super priority lien. This can be accomplished by starting the foreclosure process. The association can use the super priority lien to force the first security interest holder to pay that amount. The association should incur only the expense it believes is necessary to receive payment of assessments. If the first security interest holder does not foreclose, the association will maintain its assessment lien consisting of assessments, late charges, and interest. If a loan modification or short sale is worked out with the owner's lender, the association is better off limiting its expenses and more likely to recover the assessments. Adding unnecessary costs of collection – especially after a short period of delinquency – can

[14] NRS 116.31164.

make it all the more impossible for the owner to come current or for a short sale to close. This situation does not benefit the association or its members.