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Clerk of Supreme Court

**IN THE SUPREME COURT OF THE STATE OF NEVADA**

VILLA PALMS COURT 102 TRUST, No. 62528

Appellant,

vs.

WILLIAM L. RILEY, AN  
INDIVIDUAL; AND DEUTSCHE  
BANK NATIONAL TRUST  
COMPANY, AN EXPIRED  
NEVADA CORPORATION IN ITS  
CAPACITY AS INDENTURE  
TRUSTEE FOR THE  
NOTEHOLDERS OF AAMES  
MORTGAGE INVESTMENT  
TRUST 2005-3, A DELAWARE  
STATUTORY TRUST,

Respondents.

**STATE BAR OF NEVADA REAL PROPERTY SECTION'S**  
**AMICUS CURIAE BRIEF REGARDING LIEN PRIORITY ISSUE**

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**TABLE OF CONTENTS**

TABLE OF AUTHORITIES.....3

I. AMICUS CURIAE.....4

II. ARGUMENT.....4

III. ATTORNEY’S NEV.R.APP.PROC.28A CERTIFICATE.....7

1  
2  
3  
4  
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**TABLE OF AUTHORITIES**

**STATUTES**

NRS 116.3116

**Secondary Sources**

Unif. Common Interest Ownership Act § 3-116

## I. AMICUS CURIAE

The Common-Interest Committee, Real Property Section, State Bar of Nevada, has been granted permission by this Court to submit this brief in amicus curiae. Our interest in this appeal is to assist this Court in deciding the issue of whether a first security interest on a real property is extinguished by operation of law as a result of a community interest community homeowner's association's foreclosure of its assessment lien pursuant to NRS 116.3116 *et seq.*

## II. ARGUMENT

The Common-Interest Committee, Real Property Section, State Bar of Nevada (the "*Section*"), submits this brief in *amicus curiae* to assist the Court in deciding the issue of whether a first security interest on real property (i.e., a first mortgage lien) is extinguished by operation of law as a result of an association's foreclosure of its assessment lien pursuant to NRS 116.3116 *et seq.* (the "*Lien Priority Issue*"). The issue derives from language in NRS 116.3116(2) providing that:

the [association's] lien is also prior to all security interests described in paragraph (b) [i.e., first priority mortgage lien] . . . 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 . . . .

1 This issue is of substantial interest to the members of the Section, whose  
2 practitioners' clients include both first mortgage lenders and associations.  
3  
4 Through its Executive Committee the Section sought and obtained approval  
5 of the State Bar of Nevada ("State Bar") to file this brief, the limited purpose  
6 of which is to direct the Court's attention to the current national discussion  
7 regarding both the policy and the interpretation of Section 3-116 of the  
8 Uniform Common Interest Ownership Act (UCIOA), the basis of NRS  
9 116.3116.  
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12 On August 22, 2013, the Joint Editorial Board for Uniform Real  
13 Property Acts ("Board") issued a three page "Request for Public Comment  
14 Regarding Amendment to Section 3-116 of the Uniform Common Interest  
15 Ownership Act" (the "Request"), a copy of which is attached hereto as  
16 Exhibit A. Accompanying the Request is an 18-page report entitled "The  
17 Six-Month 'Limited Priority Lien' for Association Fees under the Uniform  
18 Common Interest Ownership Act," a copy of which is attached hereto as  
19 Exhibit B.  
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23 The Request has two stated purposes. The first is a matter of  
24 legislative policy, noted here for the limited purpose of placing the current  
25 discussion in context. Because, according to the Request, "the real estate  
26 market facing common interest communities today" no longer reflects the  
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1 basic assumptions underlying the policy of UCIOA's six-month "super  
2 priority" lien,<sup>1</sup> the Board recommended to the Uniform Law Commission  
3 ("ULC") in June 2013 that the ULC consider an amendment to UCIOA 3-  
4 116 "that would strike a more appropriate balance between the interests of  
5 first mortgage lenders and common interest community associations and  
6 their residents."  
7

8  
9 Of particular relevance, however, to the present case is the Report's  
10 second stated purpose, resulting from "the increasing volume of litigation  
11 regarding the interpretation of the existing six-month limited priority  
12 provision reflected in UCIOA 3-116." As stated by the Board, "to protect  
13 the integrity of §3-116 and to provide guidance to the courts, the Board has  
14 prepared the JEB Report to clarify the intended application of § 3-116(c)'s  
15 limited priority lien in a variety of scenarios in which priority disputes might  
16 arise."  
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20 NRS 116.1109(2) states NRS Chapter 116 "must be applied and  
21 construed so as to effectuate its general purpose to make uniform the law  
22 with respect to the subject of this chapter among states enacting it."  
23 Accordingly, the Section respectfully submits this brief and attached exhibits  
24 to assist the Court in deciding the Lien Priority Issue.  
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1 Nevada has extended the super priority lien to nine months in 2009. 2009 Statutes of Nevada, Page 1207 (Chapter 286, AB 204).

1 DATED this 25<sup>th</sup> day of February, 2014.  
2

3 FENNEMORE CRAIG JONES VARGAS  
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**III.**

**ATTORNEY'S NEV.R.APP.PROC. 28A CERTIFICATE**

I hereby certify that I have read the foregoing State Bar of Nevada Real Property Section's *Amicus Curiae* Brief Regarding Lien Priority Issue and to the best of my knowledge, information, and belief, this Brief is not frivolous or interposed for any improper purpose. I further certify that this Brief complies with all applicable Nevada Rules of Appellate Procedure, including the requirement of Nev.R.App.Proc. 28(e), which requires every assertion in the Brief regarding matters in the record to be supported by appropriate references to the record on appeal. I understand that I may be subject to sanctions in the event that the accompanying Brief is not in conformity with the requirements of the Nevada Rules of Appellate Procedure.

DATED this 25<sup>th</sup> day of February, 2014.

FENNEMORE CRAIG JONES VARGAS

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**CERTIFICATE OF SERVICE**

Pursuant to NRAP 25(b), I certify that I am an employee of Robison, Belaustegui, Sharp & Low, and that on this date I caused to be served a true copy of STATE BAR OF NEVADA REAL PROPERTY SECTION'S AMICUS CURIAE BRIEF REGARDING LIEN PRIORITY ISSUE on all parties to this action by the method(s) indicated below:

\_\_\_\_\_ by placing an original or true copy thereof in a sealed envelope, with sufficient postage affixed thereto, in the United States mail at Reno, Nevada, addressed to:

X\_\_\_\_\_ by using the Court's CM/ECF Electronic Notification System addressed to:

Michael V. Infuso  
Zachary P. Takos

\_\_\_\_\_ by personal delivery/hand delivery addressed to:

DATED this 25th day of February, 2014.

/s/ Joan E. Peyser

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**EXHIBIT A**

# **REPORT OF THE JOINT EDITORIAL BOARD FOR UNIFORM REAL PROPERTY ACTS**

## **THE SIX-MONTH “LIMITED PRIORITY LIEN” FOR ASSOCIATION FEES UNDER THE UNIFORM COMMON INTEREST OWNERSHIP ACT**

**JUNE 1, 2013**

*The Joint Editorial Board for Uniform Real Property Acts (the “Board”) provides guidance to the Uniform Law Commission (ULC) and others regarding potential subjects for uniform laws relating to real estate, as well as advice regarding potential amendments to existing uniform laws relating to real estate. The Board is comprised of representatives of the ULC, the American Bar Association Real Property, Trust and Estate Law Section, and the American College of Real Estate Lawyers, as well as liaisons from the American College of Mortgage Attorneys, the American Land Title Association, and the Community Associations Institute.*

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## JOINT EDITORIAL BOARD FOR UNIFORM REAL PROPERTY ACTS

### THE SIX-MONTH "LIMITED PRIORITY LIEN" FOR ASSOCIATION FEES UNDER THE UNIFORM COMMON INTEREST OWNERSHIP ACT

#### Introduction

*Role of Association Assessments.* In the modern common interest community (the most common forms of which are the condominium, the planned community, and the cooperative), each unit/parcel is subject to an assessment for its proportionate share of the common expenses needed to operate the owners' association (the "association") and to maintain, repair, replace, and insure the community's common elements and amenities. Assessments constitute the primary source of revenue for the community, and the ability to collect assessments is crucial to the association's ability to provide the maintenance and services expected by community residents. If some owners do not pay their proportionate share of common expenses, the association will be forced to shift the burden of delinquent assessments to the remaining unit owners through increased assessments or reduced services and maintenance, potentially threatening property values within the community.

*Statutory Lien.* To facilitate the association's ability to collect assessments, assessments unpaid by an owner constitute a lien on the owner's unit/parcel. In theory, the lien provides the association with the leverage needed to assure timely collection of assessments. If an owner fails to pay assessments, the association can institute an action to foreclose on the owner's interest in the unit/parcel and can use the proceeds of the foreclosure sale to satisfy the balance of the unpaid assessments (along with interest, costs, and to the extent authorized by the declaration and applicable law, attorney's fees incurred by the association in enforcing its lien).

*Uniform Law Treatment.* The Uniform Common Interest Ownership Act (UCIOA) — along with its predecessor acts, the Uniform Condominium Act, the Model Real Estate Cooperative Act, and the Uniform Planned Community Act (collectively, the "Uniform Laws") — facilitate an association's ability to collect common expense assessments by providing that, subject to limited exceptions, the association's lien is prior to all encumbrances that arise after the recording of the declaration. The rationale for this approach lies in the realization that (1) the association is an involuntary creditor that is obligated to advance services to owners in return for a promise of future payments; and (2) the owners' default in these payments could impair the association's financial stability and its practical ability to provide the obligated services. The priority of the association's lien is critical because if there is insufficient equity in a unit/parcel to provide a full recovery of unpaid assessments, the association must (as explained above) either reassess the remaining unit owners or reduce maintenance and services. The potential impact of these acts on the community and the association's status as an

involuntary creditor argue in favor of providing the association lien with priority vis-à-vis competing liens.

Nevertheless, many practical and regulatory barriers militate against complete priority for an association's assessment lien. Because the interests of the general public outweigh the interests of the community alone, real estate tax liens and other governmental charges should have priority over an association's assessment lien. Likewise, complete priority for association liens could discourage common interest community development. Traditional first mortgage lenders might be reluctant to lend from a subordinate lien position if there was no "cap" on the potential burden of the an association's assessment lien. In addition, some federally- or state-regulated lenders face regulatory restrictions on the amount of mortgage lending they can undertake involving security other than first lien security.

For these and other reasons, the general rule in the Uniform Laws (granting the association's lien priority as of the recording of the declaration) does not apply to first mortgages. Instead, the priority of the association's lien with respect to first mortgages is a function of the time the assessment becomes due. If the assessment becomes due after a first mortgage is of record, the assessment lien is generally subordinate to the lien of the first mortgage. However, this subordination is not absolute; under UCIOA § 3-116(c), the association's lien is given a limited or "split" priority over the first mortgage lien to the extent of six months' worth of assessments based on the association's periodic budget.<sup>1</sup>

A lien under this section is also prior to [a first mortgage lien] 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.

In this way, the Uniform Laws mark a substantial deviation from prior law, striking what the drafters described as "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." UCIOA § 3-116, comment 1. Since its introduction in 1976, the six-month priority for association liens has been adopted in more than twenty

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<sup>1</sup> Comparable priority provisions appear in the Uniform Condominium Act [UCA § 3-116], the Model Real Estate Cooperative Act [MRECA § 3-115], and the Uniform Planned Community Act [UPCA § 3-116].

jurisdictions, either through adoption of the UCA, UCIOA, or in nonuniform legislation comparable in substance to UCIOA § 3-116.<sup>2</sup>

The drafters of § 3-116(c) believed that the six-month association lien priority struck a workable and functional balance between the need to protect the financial integrity of

<sup>2</sup> The relevant Uniform Laws include Ala. Code § 35-8A-316(b) (six-month limited priority for assessment lien for condominium association); Alaska Stat. Ann. § 34.08.470(b) (six-month limited priority for assessment lien for common interest community association); Colo. Rev. Stat. Ann. § 38-33.3-316(b) (six-month limited priority for assessment lien for common interest community association); Conn. Gen. Stat. Ann. § 47-258(b) (six-month limited priority for assessment lien for common interest community association, plus association's costs and attorney fees in enforcing its lien); Del. Code Ann. tit. 25, § 81-316(b) (six-month limited priority for assessment lien for common interest community association); Minn. Stat. Ann. § 515B.3-116(c) (six-month limited priority for assessment lien for common interest community association); Vernon's Ann. Mo. Stat. § 448.3-116(2) (limited priority for six months of condominium association assessments and fines which are due at time of subsequent refinancing); Nev. Rev. Stat. Ann. § 116.3116(2) (nine-month limited priority for assessment lien for common interest community association; although duration may be reduced to six months if required by federal regulation); Purdon's Pa. Cons. Stat. Ann. tit. 68, § 5315(b) (six-month limited priority for assessment lien for planned community association); *id.* § 3315(b) (six-month limited priority for assessment lien for condominium association); *id.* § 4315(b) (six-month limited priority for assessment lien for cooperative association); R.I. Gen. Laws Ann. § 34-36.1-3.16(b) (six-month limited priority for assessment lien for condominium association); Vt. Stat. Ann. tit. 27A, § 3-116(b) (six-month limited priority for assessment lien for common interest community association); Rev. Code Wash. Ann. § 64.34.364(3) (six-month limited priority for assessment lien for condominium association); W. Va. Code § 36B-3-116(b) (six-month limited priority for assessment lien for common interest community association).

Jurisdictions that have not enacted one of the Uniform Laws, but that have adopted a limited priority lien provision, include the District of Columbia, D.C. Code § 42-1903.13(a)(2) (six-month limited priority for assessment lien for condominium association); Florida, Fla. St. Ann. §§ 718.116(1)(b), 720.3085(2)(c) (priority for assessment lien for association limited to twelve months of assessments or one percent of the original mortgage debt); Illinois, 765 Ill. Comp. Stat. § 605/9(g)(4) (six-month limited priority for assessment lien for condominium association); Maryland, Md. Code Real Prop. § 11B-117(c) (four-month limited priority for assessment lien of homeowners association); Massachusetts, Mass. Gen. Laws Ann. ch. 183A, § 6(c) (six-month limited priority for assessment lien for condominium association); New Hampshire, N.H. Rev. Stat. § 356-B:46(l) (six-month limited priority for assessment lien for condominium association); New Jersey, N.J. Stat. Ann. § 46:8B-21 (six-month limited priority for assessment lien for condominium association); and Tennessee, Tenn. Code Ann. § 66-27-415(b) (six-month limited priority for assessment lien for condominium association).

Although Kentucky, Maine, Nebraska, New Mexico, North Carolina, Texas, and Virginia each adopted versions of the UCA, those states did not enact the six-month limited-priority for condominium association liens. Ky. Rev. Stat. Ann. § 381.9193; Me. Rev. Stat. Ann. tit. 33, § 1603-116(b); Neb. Rev. Stat. § 76-874; N.M. Stat. Ann. § 47-7C-16; N.C. Gen. Stat. § 47C-3-116; Tex. Prop. Code § 82.113(b); Va. Code Ann. § 55-79.84.

the association and the legitimate expectations of first mortgage lenders. Fundamental to that belief was the assumption that, if an association took action to enforce its lien and the unit/parcel owner failed to cure its assessment default, the first mortgage lender would promptly institute foreclosure proceedings and pay the prior six months of unpaid assessments to the association to satisfy the limited priority lien — thus permitting the mortgage lender to preserve its first lien position and deliver clear title in its foreclosure sale. The drafters further understood — based on circumstances then existing — that the first mortgage lender's foreclosure proceeding would likely be completed within six months (particularly in jurisdictions with nonjudicial foreclosure) or a reasonable period of time thereafter, minimizing the period during which unpaid assessments would accrue for which the association would not have first lien priority. Finally, the drafters anticipated that the unit/parcel would, in the typical situation, have a value sufficient to enable the first mortgagee to recover the both the unpaid mortgage balance and the cost of six months of assessments. Once a buyer was in place — whether the foreclosing first mortgagee or a third party — that buyer would have to begin making monthly assessment payments, thus preserving the association's ability to carry out its maintenance and services obligations.

*Today's Marketplace.* The real estate market facing common interest communities today is quite different from the one contemplated by the drafters of the Uniform Laws:

- Many units/parcels in common interest communities are “underwater,” with values below the outstanding first mortgage balance.
- More significantly — particularly in states with judicial foreclosure — there are long delays in the completion of foreclosures. During this time, neither the unit/parcel owner nor the mortgagee typically pays the common expense assessments — the unit/parcel owner is unable or unwilling to do so, and the mortgagee is not legally obligated to do so prior to acquiring title.

If it takes 24 months for a mortgagee to complete a foreclosure, but the association has a first priority lien for only the immediately preceding six months of unpaid assessments, the consequences for the association can be devastating. The association may receive payment of six months worth of assessments, but because of depressed unit/parcel values, the sale will not generate surplus proceeds from which the association could satisfy the subordinate portion of its lien — and the association likely could not collect a judgment against the unit/parcel owner for that unpaid balance.

Because an association's sources of revenues are usually limited to common assessments, the remaining residents of the community bear the consequences of default by a unit/parcel owner of its assessment obligations, unless the state's statute requires the mortgagee to bear some portion of that cost. As suggested above, § 3-116(c)'s “split” priority for association liens was premised on the assumption that the six-



month limited priority lien would protect the mortgagee's expected first lien position while enabling an association to recover a substantial portion of the common expense costs that would accrue during a period in which the first mortgagee was foreclosing on the unit/parcel. However, if foreclosure takes substantially longer than six months and foreclosure proceeds are inadequate to pay off the first mortgage, the association can collect only a fraction of unpaid assessments from the mortgagee, effectively forcing the remaining owners to bear increased assessments or decreased maintenance/services.

This problem has become extreme in the current economic environment, in which long foreclosure delays have become commonplace. In some cases, delay is attributable to the size of defaulted mortgage portfolios having overwhelmed the capacity of lenders and their servicers. Faulty record-keeping and transaction practices by both lenders and servicers have prompted statutory and judicial responses that have lengthened the foreclosure timeline in judicial foreclosure states.<sup>3</sup> Further, anecdotal evidence suggests that some mortgage lenders are delaying the institution of foreclosure proceedings on units/parcels affected by common interest assessments. If the lender acquires such a unit/parcel at a foreclosure sale via credit bid, the lender (as a successor owner of the unit/parcel) becomes legally obligated to pay assessments arising during the lender's period of ownership. The lender may fear that it may be unable to resell the unit/parcel quickly and for an appropriate return in a depressed housing market — recognizing that it will incur liability for assessments during any period in which it holds the unit/parcel for resale. Thus, for two reasons, the lender has a substantial economic incentive to delay the foreclosure. First, the lender may benefit from a higher recovery in the event that the local housing market experiences any recovery during the period of delay. Second, the delay enables the lender to avoid incurring any legal obligation to pay common expense assessments on the unit/parcel as those assessments accrue during the delay prior to foreclosure.

While the existing legal infrastructure gives the mortgage lender a substantial economic incentive to delay foreclosure, the consequences of this delay are devastating to the community and the remaining residents. To account for the unpaid assessments, the association must either increase the assessment burden on the remaining

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<sup>3</sup> The Federal Housing Finance Authority, conservator for Fannie Mae and Freddie Mac, has published foreclosure timelines for all 50 states, reflecting the "periods within which Enterprise servicers are expected to complete the foreclosure process for mortgages that did not qualify for loan modification or other loss mitigation alternatives." Notice, State-Level Guarantee Fee Pricing, Federal Housing Finance Agency (September 25, 2012), 77 Fed. Reg. 58991, 58992. FHFA prepared these timelines from an analysis of the actual experience of Fannie Mae and Freddie Mac with foreclosure processing in each state, as adjusted for each state's statutory requirements and changes in law or practice in response to the foreclosure crisis. *Id.* The national average of the FHFA timelines is 396 days, ranging from 270 days (a common timetable in nonjudicial foreclosure states such as Georgia, Michigan, Minnesota and Missouri) to 750 days in New Jersey and 820 days in New York. *Id.* at 58992, 58993.

unit/parcel owners or reduce the services the association provides (e.g., by deferring maintenance on common amenities). If the other community residents have to pay the burden of increased assessments to preserve community services/amenities, the delaying lender receives a benefit — the value of its collateral is preserved, to some extent, while the lender waits to foreclose. Yet this preservation of the mortgage lender's collateral value comes through the community's imposition of assessments that the lender does not have to pay or reimburse. This benefit arguably constitutes unjust enrichment of the mortgage lender, particularly to the extent that the lender enjoys this benefit by virtue of a conscious decision to delay instituting or prosecuting a foreclosure. See generally Andrea Boyack, *Community Collateral Damage: A Question of Priorities*, 43 Loy.U.Chi.L.Rev. 53 (2011).

### THE PURPOSE OF THIS REPORT

The Board has two primary purposes in issuing this Report. The first purpose is to address the appropriate interpretation of the existing six-month limited priority lien provision in the Uniform Acts. In states that have adopted § 3-116(c) or a provision substantially comparable to it, the pressures described in the Introduction have produced an increasing volume of litigation between associations and first mortgage lenders regarding the proper scope of the association's lien priority. This litigation may include not only questions regarding the effect of foreclosure proceedings by the association and/or the first mortgage lender, but also questions regarding whether an association can assert its six-month assessment lien priority only on a one-time basis or on a recurring basis (i.e., each time it brings an action to enforce its lien for unpaid assessments). As a result, the Board has prepared this Report to clarify, for the benefit of parties and courts faced with these disputes, the intended application of § 3-116(c) in a variety of scenarios in which priority disputes might arise.

The second purpose is to acknowledge — as addressed in the Introduction — that the existing law governing the relative priority of association liens and first mortgage liens is unsatisfactory. In a slight majority of states, association liens are subordinate to first mortgage liens and mortgage lenders have no obligation to pay or reimburse assessments that accrued prior to the lender's acquisition of title in a foreclosure sale. As a result, first mortgage lenders effectively can shift the costs of preserving the value of their collateral onto the remaining unit/parcel owners. Even in states that have adopted § 3-116(c) or a comparable limited priority rule for association liens, the six-month period of limited priority has proven insufficient to protect the community's financial interests. The Board thus encourages the ULC to consider preparing a uniform law that would strike a more appropriate balance between the interests of first mortgage lenders and common interest community associations and their residents.<sup>4</sup>

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<sup>4</sup> In a state that has adopted § 3-116(c) of the Uniform Laws or a similar provision, the new uniform law would effectively function as an amendment to the existing state statute. In states

### **APPLICATION OF § 3-116(c) AND THE SIX-MONTH LIMITED PRIORITY LIEN**

This portion of the Report addresses the intended application of § 3-116(c) through examining a series of examples, the facts of which are reflective of those in judicial opinions addressing the relative priority of association liens and mortgage liens under § 3-116(c). Each example presumes the following facts: Pinecrest is a common interest community created by virtue of a recorded declaration pursuant to UCIOA. Under the declaration, parcels or units within Pinecrest are subject to a mandatory annual common expense assessment of \$3,000, payable to Pinecrest Property Owners Association (PPOA) in monthly installments of \$250. The assessments pay for operating expenses of PPOA, including the maintenance and insurance of common facilities and recreational areas within Pinecrest.

Unpaid assessments constitute a lien in favor of PPOA upon the affected parcel or unit. Homeowner is the owner of a parcel or unit within Pinecrest, which parcel or unit is subject to a properly recorded mortgage or deed of trust in favor of Bank, securing the repayment of the unpaid balance of Homeowner's mortgage debt to Bank in the amount of \$200,000. In each example, Homeowner is in default to Bank on its debt secured by a mortgage or deed of trust, and is also in default to PPOA in payment of assessments.

***Example One: Homeowner has failed to pay both its common expense assessments and its mortgage for a period of 12 months, Bank institutes a foreclosure proceeding, joining PPOA as a party. Bank ultimately proceeds with a proper foreclosure sale, at which Buyer purchases the unit/parcel for \$150,000.***

Section § 3-116(c) establishes that the association's assessment lien is "prior to" even the lien of a first mortgage to the extent of "common expense assessments ... which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien." This means that prior to the sale, PPOA had a first priority lien in the unit/parcel to secure the payment of the preceding six months of common expense assessments (\$1,500); Bank effectively had a second priority lien to secure the outstanding mortgage balance (\$200,000); and PPOA had a third priority lien to secure the payment of the additional six months of unpaid assessments (\$1,500).

When Bank forecloses its mortgage in this context, the foreclosure sale extinguishes its mortgage and PPOA's subordinate lien, with these liens being transferred to the sale proceeds. Bank's foreclosure sale does not extinguish PPOA's first priority "limited priority lien" for the immediately preceding six months of assessments, as that lien is senior under § 3-116(c) and is thus unaffected by Bank's foreclosure sale. Buyer will thus take title to the unit/parcel subject to PPOA's six-month limited priority lien; Buyer

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that do not currently have a limited priority provision for association liens, the new uniform law could be enacted as a freestanding statute.

must pay \$1,500 to PPOA to extinguish this lien and clear her title.<sup>5</sup> The \$150,000 sale proceeds will be applied first to costs of sale, then to the unpaid balance of Bank's mortgage. As the sale proceeds are insufficient to satisfy Bank's claim, PPOA is left with an unsecured claim for unpaid assessments beyond its six-month priority.

In Example One, it is conceivable that PPOA and Bank may agree, in advance, that the foreclosure sale will deliver clear title to the foreclosure sale purchaser. If PPOA and Bank so agree, the sale would also extinguish PPOA's six-month limited priority lien. If that sale produced a price of \$151,500,<sup>6</sup> the proceeds would be applied first to costs of sale; the next \$1,500 would be distributed to PPOA on account of its limited priority lien, and the balance would be distributed to Bank to be applied to the unpaid mortgage balance. Again, as the sale proceeds would be insufficient to satisfy Bank's claim, PPOA would be left with an unsecured claim for unpaid assessments beyond its six-month priority.

As described above, Example One involves a third party buying the property at Bank's foreclosure sale. It is perhaps more likely that Bank would end up as the foreclosure sale buyer by means of a credit bid, but this would not make a difference in terms of the appropriate application of § 3-116(c). If Bank buys the property for a credit bid in an amount less than or equal to the unpaid mortgage balance, Bank will receive clear title only if it pays PPOA \$1,500 to satisfy its assessment limited priority lien; to the extent Bank does not pay that amount, Bank will take title subject to PPOA's lien, which PPOA could enforce by bringing a foreclosure proceeding of its own.

***Example Two: Homeowner has failed to pay its common expense assessment for 12 consecutive months (a total unpaid balance of \$3,000). PPOA brings an action to foreclose its lien, joining Homeowner and Bank as parties. Bank does not institute a foreclosure action. PPOA obtains a judgment allowing it to foreclose; neither Homeowner nor Bank takes steps to redeem their respective interests. At the sale, Buyer purchases Homeowner's interest for a cash bid of \$207,000. PPOA incurs costs and attorney's fees of \$5,000 in conjunction with the sale.***

This example is based in part on the facts of *Summerhill Village Homeowners Association v. Roughley*, 270 P.3d 639 (Wash. Ct. App. 2012). In *Summerhill Village*, the association commenced an action against the unit owner and her mortgagee (GMAC) to obtain a judgment for unpaid assessments and to foreclose its lien. The association obtained a default judgment and sold the unit to a third-party buyer for

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<sup>5</sup> If Buyer redeems her title by paying off the lien before PPOA brings an action to enforce it, Buyer can redeem by paying only the six months of unpaid assessments. By contrast, if Buyer does not pay off the lien until after PPOA brings an action to enforce it, Buyer must also pay the costs and reasonable attorney's fees incurred by PPOA in its lien enforcement action.

<sup>6</sup> In this context, the sale should produce a higher price (by an increment of \$1,500) as the foreclosure sale purchaser will receive clear title rather than title subject to PPOA's senior lien for \$1,500 worth of assessments.

\$10,302 (\$100 over the balance of the judgment). GMAC later sought to set aside the default judgment and establish the priority of its mortgage lien (or, in the alternative, to redeem the property). The Washington Court of Appeals held that under the six-month limited priority lien as incorporated in Washington's version of the Uniform Condominium Act, Rev. Code Wash. Ann. § 64.34.364(3), the association's foreclosure sale had extinguished the lien of the mortgagee. Under this view, the association's six-month limited priority lien constituted a true lien priority and not merely a distributional preference in favor of the association.

To the extent that *Summerhill Village* held that the association's foreclosure sale extinguished GMAC's mortgage lien,<sup>7</sup> the decision is consistent with the proper understanding of the six-month limited priority lien reflected in § 3-116. Section 3-116(c) establishes that the association's lien is "prior to" even the lien of a first mortgage to the extent of both "common expense assessments ... 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." A foreclosure sale of the association's lien (whether judicial or nonjudicial)<sup>8</sup> is governed by the principles generally applicable to lien foreclosure sales, i.e., a foreclosure sale of a lien entitled to priority extinguishes that lien and any subordinate liens, transferring those liens to the sale proceeds. Nothing in the Uniform Laws establishes (or was intended to establish) a contrary result.<sup>9</sup>

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<sup>7</sup> The *Summerhill Village* court also concluded that under Washington's post-sale redemption statute, GMAC was not entitled to redeem the property. As the question of GMAC's right to redeem did not involve the interpretation of § 3-116(c), this Report expresses no opinion as to that aspect of the *Summerhill Village* decision.

<sup>8</sup> The Uniform Laws provide that in a condominium or planned community, the association must foreclose its lien in the manner in which a mortgage is foreclosed. Thus, an association may foreclose its lien by nonjudicial proceedings if the state permits nonjudicial foreclosure. See UCIOA § 3-116(k), UCA § 3-116(a).

<sup>9</sup> Two recent Nevada federal decisions interpreting Nevada's limited priority lien statute, Nev. Rev. Stat. § 116.3116(2)(c), rejected the reasoning of *Summerhill Village* and concluded that an association's nonjudicial foreclosure of its assessment lien did not extinguish the lien of the senior mortgage lender. See *Weeping Hollow Avenue Trust v. Spencer*, 2013 WL 2296313 (D. Nev. May 24, 2013); *Diakonos Holdings, LLC v. Countrywide Home Loans, Inc.*, 2013 WL 531092 (D. Nev. Feb. 11, 2013). For example, in *Weeping Hollow*, the court held that the limited priority lien provision did not create a true lien priority, but instead merely provided that the association's lien would continue to encumber the property following a foreclosure sale by the first mortgagee, to the extent of the assessments unpaid during the preceding nine months. *Weeping Hollow*, 2013 WL 2296313, at \*5 ("Read in its entirety, NRS 116.3116(2)(c) states that an HOA's unpaid charges and assessments incurred during the nine months prior to the foreclosure of a first position mortgage continue to encumber the property after the foreclosure of the first position deed of trust.... However, the super priority lien does not extinguish the first position deed of trust."). These decisions misread and misinterpret the Uniform Laws limited

As a result, in Example Two, under a proper application of § 3-116(c), PPOA would have a first priority lien on Homeowner's unit/parcel to the extent of \$6,500, reflecting six months of unpaid assessments (\$1,500) and the reasonable costs and attorney's fees incurred by PPOA in its foreclosure (\$5,000). Bank would have a second priority lien on the unit/parcel to the extent of the \$200,000 unpaid balance of Homeowner's mortgage debt. PPOA would have a third priority lien to the extent of the unpaid assessments beyond the six-month threshold (a total of \$1,500).

PPOA's foreclosure sale in Example Two would extinguish both of its liens (the six month "limited priority lien" as well as the third-priority lien) as well as the Bank's mortgage lien, thereby delivering a clear title to Buyer. The extinguished liens would transfer to the \$207,000 sale proceeds in the same order of priority. PPOA would receive the first \$6,500 of the sale proceeds on account of its limited priority lien. Bank would receive the next \$200,000 in sale proceeds on account of its mortgage lien. PPOA would receive the final \$500 of sale proceeds on account of its third-priority lien, and the remaining \$1,000 of PPOA's claim would be unsecured.

***Example Three. Because of a dispute over PPOA's enactment of parking rules and imposition of parking fines, Homeowner withheld payment of the monthly installment of assessments. After six months, PPOA brings an action to enforce its lien for the six preceding months of unpaid assessments and to collect fines (joining Bank as a party). Homeowner continues to withhold assessments. Six months later, while the first action is still pending, PPOA brings a second action to enforce another lien for the most recent six months of unpaid assessments and fines. Again, PPOA joins Bank as a party and seeks to establish its lien priority over Bank for the additional six months of unpaid assessments. Bank objects that PPOA is entitled to only one six-month limited priority lien and cannot extend its lien priority through successive actions.***

Example Three is based upon the facts in *Drummer Boy Homes Association, Inc. v. Britton*, 2011 Mass. App. Div. 186 (2011). In *Drummer Boy*, the association commenced three successive actions, seeking to establish lien priority for a total of 18 months of unpaid assessments. The association argued that the six-month limited priority lien provision in the Massachusetts statute [Mass. Gen. Laws Ann. Ch. 183A, § 6(c)] did not explicitly forbid — and thus presumptively permitted — successive actions to extend the association's six-month lien priority. The court rejected this view, instead concluding that the association's lien priority was limited to only six months of unpaid assessments:

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priority lien provision, which provides the association with priority to the extent of assessments accruing in the period immediately prior to the association's enforcement of its lien. As discussed in the text, this constitutes a true lien priority, and thus the association's proper enforcement of its lien would thus extinguish the otherwise senior mortgage lien.

Under the Association's theory, however, a condominium association could file successive suits and thereby enlarge the priority portion of its lien such that its entire lien, no matter how large and no matter how much time was encompassed, would be prior to the first mortgage. If the Legislature had intended to make the condominium lien prior to the first mortgage, it could have done so explicitly.... Recognizing that a condominium association's lien could be extinguished entirely by a foreclosing first mortgagee, the legislature gave condominium associations a limited six-month period of priority. This was meant to be 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 mortgage lenders." [quoting Uniform Condominium Act (1980) § 3-116, Comment 2.]

On its face, the language of § 3-116(c) does not explicitly address whether an association may file successive actions every six months to extend its limited priority lien priority. Section 3-116(c) provides, in pertinent part:

A lien under this section is also prior to [a first mortgage recorded prior to the due date of the unpaid assessments] 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.

Nevertheless, the result reached by the court in *Drummer Boy* is consistent with the appropriate understanding of § 3-116(c). See also *Hudson House Condo. Ass'n v. Brooks*, 223 Conn. 610, 61 A.2d 862 (1992) (rejecting the view that Connecticut six-month limited priority lien statute permitted an association to institute a foreclosure proceeding every six months and thereby obtain perpetual superpriority over mortgagee). Section 3-116(c) provides an association with a first priority lien for the common expense assessments accruing during the six months preceding the filing of "an action" to foreclose (either an action by the association to foreclose its lien, or by the first mortgagee to foreclose the mortgage). The second and third lien foreclosure actions commenced by the association in *Drummer Boy* were not necessary to enforce the association's lien; only one such action is needed for the purpose of selling the unit/parcel and delivering clear title.<sup>10</sup> Thus, the association's commencement of the successive actions could only have been to extend the association's lien priority beyond the six months reflected in § 3-116(c). In such a situation, a court should properly consolidate those successive actions into a single action — in which the association would receive first lien priority only for the immediately preceding six months of unpaid assessments.

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<sup>10</sup> Recognizing this, the court in *Drummer Boy* properly consolidated the three actions into a single action. *Drummer Boy*, 2011 Mass.App.Div. 186, at \*1.

Thus, in Example Three, Bank can redeem its first mortgage lien from the burden of PPOA's limited priority lien by payment of \$1,500 (reflecting the immediately preceding six months of unpaid assessments) plus the costs (including reasonable attorney's fees) incurred by PPOA in bringing the action to enforce its lien).<sup>11</sup> Once Bank has paid this amount to PPOA, PPOA's foreclosure sale to enforce the balance of unpaid assessments would transfer title to the unit/parcel subject to the remaining balance of Bank's first mortgage. PPOA's lien for the unpaid assessment balance would transfer to the proceeds of the sale (if there are any proceeds).<sup>12</sup>

*Once the Association Brings an Action to Enforce Its Lien, Is Its Lien Priority Limited to the Prior Six Months of Unpaid Assessments, or Does Its Priority Extend to Include Any Assessments that Accrue During the Pendency of the Lien Enforcement Action?* Example Three addressed whether an association could extend its lien priority by filing successive lien enforcement actions every six months. In a recent set of Vermont decisions, however, several associations argued that once an association files an action to enforce its lien, its lien priority should extend not only to the unpaid assessments that had accrued during the preceding six months, but also to all assessments that accrued and remained unpaid during the pendency of the lien enforcement action. Two recent Vermont Superior Court decisions have accepted this argument. *Bank of America, N.A. v. Morganbesser*, No. 675-10-10 (Jan. 18, 2013); *Chase Home Finance, LLC v. Maclean*, <http://www.vermontjudiciary.org/20112015%20Tcdecisioncvl/2012-5-25-13.pdf> (Jan. 31, 2012). In the *Morganbesser* case, the court concluded that section 3-116(c) is "silent" as to the issue of continuing priority, and reasoned that continuing priority is justified because the association could "extend its superpriority merely by filing a new action for unpaid assessments which have come due every six months" and requiring the association "to repeatedly file new actions simply to extend its priority position serves no purpose." In addition, the court in *Morganbesser* justified its interpretation of section 3-116(c) by observing that "[e]xtending the superpriority from 6 months prior to institution through to the end of the action also provides the mortgage lender with an incentive, albeit a small one, to proceed as expeditiously as permitted in their foreclosure actions."

As explained in Example Three, however, section 3-116(c) does not (and was not intended to) authorize an association to file successive lien enforcement actions every six months as a means to extend the association's limited lien priority. Only one action

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<sup>11</sup> In this situation, the court might reasonably conclude that the attorney fees incurred by PPOA in bringing a repetitive action were not reasonable and thus not secured by PPOA's superlien.

<sup>12</sup> If the value of the unit/parcel is less than the remaining balance due to Bank, of course, PPOA will have no substantial incentive to proceed with the foreclosure sale. No third party will agree to purchase the unit/parcel without an agreement by Bank to reduce the mortgage loan balance. PPOA could acquire the unit by credit bid, but this would obligate PPOA to pay ongoing assessments — accentuating the burden on the rest of the residents of the community, who will have to bear assessment increases or service decreases until PPOA could re-sell the unit/parcel.



is necessary to permit the association to enforce its lien, sell the unit/parcel, and deliver clear title; accordingly, successive actions would only serve to extend the association's lien priority beyond the six-month period expressed in section 3-116(c). Two other Vermont Superior Court decisions have disagreed with *Morganbesser* and *Maclean*, correctly concluding that section 3-116(c) places a six-month limit on the association's lien priority. See *Vermont Hous. Fin. Auth. v. Coffey*, S0367-11 CnC (Aug. 11, 2011) (Toor, J.); *EverHome Mtge. Co. v. Murphy*, No. 115-3-10 Bncv (Dec. 6, 2011) (Hayes, J.).

***Example Four. Homeowner fails to pay common expense assessments and its mortgage debt for a period of six months. Both Bank and PPOA institute foreclosure proceedings. In response to PPOA's foreclosure proceeding, Bank redeems its lien position by tendering payment of \$3,500 to PPOA (\$1,500 for six months of unpaid common expense assessments plus \$2,000 in costs and attorney fees incurred to that date by PPOA in enforcing its lien). For the next six months, while Bank's foreclosure action is pending, Homeowner again fails to pay common expense assessments. PPOA brings another action to enforce its lien, once again joining Bank as a party.***

Example Four is based upon the facts in *Lake Ridge Condominium Association, Inc. v. Vega*, No. NNHCV116021568S (Conn. Super. Ct. June 25, 2012). Example Four presents a question about the appropriate interpretation of UCIOA § 3-116(c). Is the six-month limited priority lien a "one-time" lien; i.e., once an association brings an action to enforce its limited priority lien and the mortgagee responds by redeeming that lien by paying six months of common expense assessments, does the association no longer have the right to assert the limited priority lien for any future unpaid assessments? Or is the six-month limited priority lien a potentially recurring lien; i.e., in Example Four, can PPOA assert the limited priority lien a second time, and thereby successfully obtain lien priority over Bank's mortgage lien to the extent of the most recent six months of unpaid assessments?

In *Lake Ridge*, the association commenced a second action to enforce its lien two years after the mortgagee had ostensibly redeemed the association's priority by paying off the then-immediately preceding six months of assessments. The association argued that under the text of the statute and sound policy, there was no bar on repetitive association foreclosures and that in each such proceeding the association should be permitted to assert a limited priority lien for assessments unpaid during the immediately preceding six months. The mortgagee disagreed, asserting that under UCIOA as adopted in Connecticut, Conn. Gen. Stat. § 47-258, the six-month limited priority lien created but a "one-time" lien priority over the mortgagee.

The Connecticut Superior Court agreed with the lender, stating that the association had "previously satisfied its 'superpriority' lien" and holding that the statute "allows the assertion of that lien only once during the pendency of either an action to enforce either

the association's lien or a security interest (first priority mortgage)." See also *Linden Condo. Ass'n, Inc. v. McKenna*, 247 Conn. 575, 726 A.2d 502 (1999) (statute prevents association from asserting limited priority lien more than once during the course of a foreclosure action by the mortgagee).

The result reached by the court in *Lake Ridge* is consistent with the appropriate understanding of § 3-116(c) as drafted. Section 3-116(c) provides an association with first lien priority only to the extent of the six months of unpaid common expense assessments that accrued immediately preceding a lien foreclosure action by either the association or the first mortgagee. In Example Four, Bank had a foreclosure action pending at the time it made the \$3,500 payment to redeem its mortgage from PPOA's limited priority lien, and that action remained pending at the time of PPOA's second lien enforcement proceeding. By its terms, § 3-116(c) does not permit PPOA to assert a first lien priority for more than six months of unpaid common expense assessments in the context of the same foreclosure proceeding by Bank.

As discussed in the Introduction, in fashioning the six-month limited priority lien, the drafters of UCIOA § 3-116(c) did not contemplate the now-common scenario in which the first mortgagee's foreclosure action might remain pending for two years or more. In such a situation, the mortgagee's delay in foreclosure may unreasonably force the community residents to bear either increased assessments or decreased maintenance/services.

***Example Five. Homeowner fails to pay common expense assessments for a period of six months. PPOA notifies Bank that Homeowner has not paid those assessments. Before PPOA commences an action to enforce its lien, Bank pays PPOA an amount equal to the preceding six months of common expense assessments. For the ensuing six months, Homeowner again fails to pay its common expense assessments. PPOA then commences an action to enforce its lien and joins Bank as a party. Bank responds by instituting a proceeding to foreclose its mortgage lien.***

In Example Five, Bank's payment of the unpaid common charges to PPOA does not prevent PPOA from now asserting its six-month limited priority lien. Under § 3-116(c), PPOA can assert a limited priority lien to the extent of "common expense assessments ... which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien." Under the proper understanding of § 3-116(c), PPOA can thus assert a limited priority lien either in (a) an action by PPOA to enforce its association lien, or (b) an action by Bank to foreclose its mortgage lien. In Example Five, at the time of Bank's payment of the unpaid common expense assessments, PPOA had not commenced an action to enforce its lien, nor had Bank instituted a foreclosure proceeding. Bank's payment of the unpaid common charges was a voluntary business decision which Bank was not compelled to make to

protect its lien priority.<sup>13</sup> As a result, the payment does not prevent PPOA from asserting its limited priority lien in PPOA's subsequent lien enforcement action. To redeem its lien priority in PPOA's action, Bank will have to pay PPOA the immediately preceding six months of unpaid common expense assessments, as well as costs and reasonably attorney's fees incurred by PPOA in its lien enforcement action.

### **CONCLUSION: A PROPOSAL FOR A NEW UNIFORM LAW**

As discussed above, existing law governing the relative priority of association liens and first mortgage liens is unsatisfactory. In many states, association liens are entirely subordinate to first mortgage liens, and mortgage lenders have no obligation to pay or reimburse assessments that accrued prior to the time that the lender acquired title in a foreclosure sale. This permits first mortgage lenders to delay in foreclosing mortgages on common interest units/parcels, while effectively and unjustly shifting the cost of preserving the value of their collateral onto the remaining unit/parcel owners. Even in states that have adopted § 3-116(c) or a comparable limited priority rule for association liens, the six-month period of limited priority has proven insufficient to protect the community's financial interests.

The Board thus encourages the ULC to consider preparing a uniform law that would strike a more appropriate balance between the interests of first mortgage lenders and common interest community associations and their residents. A new uniform law might take a number of potential approaches:

- It might simply extend the association's existing limited priority lien from six months to a longer fixed duration, such as one year or more. A uniform law taking this approach might reflect a more appropriate response to the longer foreclosure timetables that have resulted in the wake of the mortgage crisis.<sup>14</sup>
- It might establish alternatives for the duration of association's limited priority lien, such that the duration of the association's lien priority might vary from state to state. A uniform law taking this approach might acknowledge that differences in local circumstances (i.e., the duration of a state's foreclosure

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<sup>13</sup> Bank likely can add this payment to the balance of the Homeowner's mortgage debt as an amount advanced to protect Bank's security, at least to the extent permitted by the terms of Bank's mortgage or deed of trust (which typically provides that the lien shall secure such advances).

<sup>14</sup> It is worth noting that Florida's limited priority lien provides the association with priority to the extent of the lesser of twelve (12) months' worth of unpaid association assessments or one percent (1%) of the outstanding mortgage loan amount. Fla. Stat. Ann. § 718.116. Professor Andrea Boyack has observed that given the delays customarily experienced in Florida foreclosures, even this expanded lien priority has not been sufficient to permit Florida associations to recover all unpaid assessments. Andrea J. Boyack, *Community Collateral Damage: A Question of Priorities*, 43 Loy.U.Chl.L.Rev. 53, 116 (2011).

timetable, or the extent of decreases in unit values) might warrant local differences in the duration of an association's lien priority.

- It might preserve the state's existing priority rule as a general matter, but require that if the first mortgage lender delays foreclosure beyond a defined period of time, the lender must pay assessments as they accrue during that period of delay (or some portion of those assessments). This would permit a first mortgage lender to make a determination to delay in foreclosing if the lender concludes that delay is justified, but would prevent the lender from being unjustly enriched by forcing the remaining unit/parcel owners to bear the increased cost of preserving the lender's collateral.
- It might preserve the state's existing priority rule as a general matter, but require that if the first mortgage lender delays foreclosure beyond a defined period of time, the association's lien would have priority (or extended priority) for the assessments accruing during that period of delay.
- It could analogize common interest ownership assessments to real property taxes, and give the association full priority over the first mortgage lender for unpaid assessments to the same extent as real property taxes currently enjoy a superpriority over first mortgage liens.<sup>15</sup>

The Board does not advocate for any one of these approaches; a drafting committee should make a determination following deliberations involving the participation of all relevant stakeholder groups (including first mortgage lenders, community associations, and government-sponsored enterprises like Fannie Mae and Freddie Mac).

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<sup>15</sup> To a significant extent, an analogy between community assessments and property taxes is compelling, as the association often provides public services such as paving, snow removal, open space maintenance, and land use control/enforcement. First mortgage lenders would no doubt voice strong objections to giving association liens full priority, which raises a concern as to whether such a change would affect the availability of home mortgage credit for common interest units/parcels. Nevertheless, as Professor Boyack has noted, priority for real property taxes has not dissuaded lenders from making first mortgage loans; lenders have addressed this risk by requiring real property escrow accounts, and could demand similar escrow accounts for association assessments. Andrea J. Boyack, *Community Collateral Damage: A Question of Priorities*, 43 Loy.U.Chi.L.Rev. 53, 116, 122 (2011).

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# JOINT EDITORIAL BOARD *for* UNIFORM REAL PROPERTY ACTS

August 22, 2013

## DISTRIBUTION OF JEB REPORT ON COMMON INTEREST ASSESSMENT LIEN PRIORITY

### REQUEST FOR PUBLIC COMMENT REGARDING AMENDMENT TO SECTION 3-116 OF THE UNIFORM COMMON INTEREST OWNERSHIP ACT

*The Joint Editorial Board for Uniform Real Property Acts (the "Board") provides guidance to the Uniform Law Commission (ULC) and others regarding potential subjects for uniform laws relating to real estate, as well as advice regarding potential amendments to existing uniform laws relating to real estate. The Board is comprised of representatives of the ULC, the American Bar Association Real Property, Trust and Estate Law Section, and the American College of Real Estate Lawyers, as well as liaisons from the American College of Mortgage Attorneys, the American Land Title Association, and the Community Associations Institute.*

This letter accompanies the attached Report ("JEB Report") entitled "The Six-Month 'Limited Priority Lien' for Association Fees Under the Uniform Common Interest Ownership Act." Uniform Common Interest Ownership Act (UCIOA) § 3-116 (and comparable provisions of its predecessor acts, the Uniform Condominium Act, the Model Real Estate Cooperative Act, and the Uniform Planned Community Act) provides that a common interest community association's lien for unpaid assessments has a priority over the lien of an otherwise first-lien mortgage lender to the extent of six months' worth of regularly-budgeted but unpaid assessments at the time of a foreclosure (either by the association foreclosing its assessment lien, or by the mortgage lender foreclosing its mortgage lien). Section 3-116's limited priority lien marked a substantial departure from prior law and struck what the drafting committee characterized as 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." UCIOA § 3-116, comment 1. UCIOA § 3-116 (or nonuniform legislation comparable in substance) has been enacted in more than 20 jurisdictions.

The drafters of UCIOA § 3-116 believed that the six-month association lien priority struck a functional balance between the need to protect the financial integrity of community associations and the legitimate expectations of first mortgage lenders. This belief was premised on the assumption that a first mortgage lender holding a defaulted mortgage would take prompt action to enforce that mortgage via foreclosure, and that in most states such a foreclosure could be completed within six months or a reasonable period of time thereafter, minimizing the period during which unpaid assessments would accrue for

which the association would not have first lien priority. This belief was further premised on the assumption that a common interest unit would typically have a value sufficient to allow the recovery of both the first mortgage balance and six months of unpaid assessments.

The real estate market facing common interest communities today does not reflect these basic assumptions. Many common interest units are “underwater,” with values below the outstanding first mortgage balance. Furthermore, and particularly in states with judicial foreclosure, there are long delays in the completion of foreclosures. During these delays, neither the defaulting unit owners nor the first mortgagee typically pay the assessments on the unit. [Under existing law, the mortgagee does not become legally liable to pay assessments on the unit unless and until the mortgagee acquires title to the unit via a foreclosure sale or a deed in lieu of foreclosure.] Many lenders have chosen to delay instituting foreclosure proceedings on common interest units, thereby delaying the lender’s potential acquisition of title and the lender’s potential liability for future assessments. The consequences of such delay are devastating to a common interest community and its remaining residents. To account for the unpaid assessments, the association must either increase the assessment burden upon the remaining unit/parcel owners or reduce the services the association provides (e.g., by deferring maintenance on common amenities). If the other community residents have to pay the burden of increased assessments to preserve community services/amenities, the delaying lender receives a benefit — the value of its collateral is preserved while the lender waits to foreclose. Yet this preservation of the mortgage lender’s collateral value comes through the community’s imposition of assessments that the lender does not have to pay or reimburse.

**The JEB Report.** The Board has prepared and issued the JEB Report for two reasons. First, the current economic climate facing community associations has produced an increasing volume of litigation regarding the interpretation of the existing six-month limited priority lien provision reflected in UCIOA § 3-116. This litigation has addressed not only the effect of foreclosure proceedings by the association and/or the first mortgage lender, but also whether an association can assert its six-month lien priority only on a one-time basis or on a recurring basis (i.e., each time it brings an action to enforce its lien for unpaid assessments). To protect the integrity of § 3-116 and to provide guidance to courts, the Board has prepared the JEB Report to clarify the intended application of § 3-116(c)’s limited priority lien in a variety of scenarios in which priority disputes might arise.

Second, the Board believes that recent experience has demonstrated that existing law governing the relative priority of association liens and first mortgage liens is not satisfactory. For this reason, in June 2013, the Board submitted an earlier draft of the JEB Report to the ULC, along with a recommendation that the ULC appoint a drafting committee to prepare an amendment to § 3-116 that would strike a more appropriate balance between the interests of first mortgage lenders and common interest community associations and their residents. At its 2013 Annual Meeting in Boston, MA, the ULC Executive Committee agreed that amendment of § 3-116 is appropriate, and directed the Board to draft an amendment in consultation with the appropriate representatives of stakeholder groups.

**Preparation of Amendment and Request for Comments.** Consistent with the instructions of the ULC Executive Committee, the Board is undertaking to prepare a proposed amendment to § 3-116. The Board will begin by soliciting written comments from any interested persons or stakeholder groups. Following this comment period, the Board expects to conduct a public meeting in December

Distribution of JEB Report  
Request for Public Comments  
August 22, 2013  
Page 3

2013 (date and time to be announced) in Washington, DC, to consider the appropriate scope of the priority to be accorded to common interest assessment liens. At this meeting, all interested persons or stakeholder groups are welcome to attend and express their opinions to the Board. The Board will then prepare a proposed amendment to § 3-116 and submit the amendment to the ULC for its consideration at the ULC's 2014 Annual Meeting in Seattle, WA.

As noted above, all interested persons or stakeholder groups are welcome to express their views as to the appropriate scope of the priority to be accorded to common interest assessment liens. Comments should be submitted to the Board in writing by October 31, 2013, and may be submitted by mail or by e-mail as follows:

Joint Editorial Board for Uniform Real Property Acts  
c/o R. Wilson Freyeremuth, Executive Director  
University of Missouri School of Law  
215 Hulston Hall  
Columbia, MO 65211  
[frevermuthr@missouri.edu](mailto:frevermuthr@missouri.edu)

Commenters are welcome to express their views in general terms, with specific proposed statutory language, or both. Comments will be catalogued and made available for public viewing on the websites of the ULC and the Board.

COMMENT DEADLINE: October 31, 2013.