EXHIBIT 1

MEMORANDUM

To: Commissioners of the Uniform Law Commission

From: Joint Editorial Board for Uniform Real Property Acts

Date: June 11, 2014

Re: Proposed Amendments to Text and Comments of Section 3-116 of the Uniform Common Interest Ownership Act

Introduction. In June 2013, the Joint Editorial Board for Uniform Real Property Acts (JEBURPA) proposed that the Uniform Law Commission (ULC) should appoint a drafting committee to prepare amendments to § 3-116 of the Uniform Common Interest Ownership Act and its provisions concerning the six-month "limited priority" lien for unpaid common expense assessments owed to community associations.

In July 2013, the ULC Executive Committee determined not to appoint a drafting committee, but instead asked the JEBURPA to prepare proposed amendments to the text and comments to UCIOA Section 3-116 for the ULC's consideration, after gathering appropriate input from interested stakeholder groups.

In August 2013, the JEBURPA invited public comments from a range of industry groups and academic voices regarding the appropriate scope of the priority to be accorded to an association's assessment lien. Following the receipt of these comments, the JEBURPA conducted a meeting with interested stakeholders on December 10, 2013, in Washington, DC. The meeting included representatives of Fannie Mae, Freddie Mac, the American Bankers Association, the Community Associations Institute, the American Land Title Association, and lawyers involved in litigation over the scope of an association's lien priority under statutes based on existing UCIOA § 3-116.

Following this stakeholder meeting and further discussion by the JEBURPA at its meeting in March 2014, the JEBURPA has prepared proposed amendments to the text and comments of § 3-116. A redlined version of the text and comments, showing the changes to the text and comments by comparison to the existing 2008 text, is attached to this memorandum. This memorandum provides further background on the problems that have resulted in the proposal and an explanation of the proposed amendments.

Background. In its current form, 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 unpaid assessments at the time of a foreclosure.[1] This limited priority lien marked a substantial

[1] UCIOA § 3-116(b) (as most recently amended in 2008) provides that an association's lien for unpaid assessments is "prior to all other liens and encumbrances on a unit except: (1) liens and encumbrances

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 (2008 text). UCIOA § 3-116 (or nonuniform legislation comparable in substance) has been enacted in more than 20 jurisdictions.

The drafters of § 3-116 believed that the six-month association lien priority reflected an appropriate sharing of the risk of assessment nonpayment between associations and 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 — thereby 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. Further, and particularly in states with judicial foreclosure, there is often a long delay in the completion of a foreclosure. During this delay, the defaulting unit owner is not paying assessments on the unit (either because the unit owner cannot pay them or, facing a certain foreclosure, chooses not to pay them). Likewise, during this delay, the first mortgagee does not pay the assessments on the unit, as the mortgagee does not become legally liable to pay the unit assessments unless and until the mortgagee acquires title to the unit by way of a foreclosure sale or a deed in lieu of foreclosure.

Further, anecdotal evidence indicates that mortgagees — fearful of being unable to sell units for an acceptable amount in a down market — sometimes choose strategically to delay instituting foreclosure proceedings, thereby delaying their potential acquisition of title and their corresponding liability for future assessments. The consequences of such delay are devastating to a common interest community and its remaining unit owners. To

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recorded before the recordation of the declaration and, in a cooperative, liens and encumbrances that the association creates, assumes, or takes subject to; (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 (3) liens for real estate taxes and other governmental assessments or charges against the unit or cooperative." In pertinent part, Section 3-116(c) then provides the six-month limited priority for the association lien:

> (c) A lien under this section is also prior to all security interests described in subsection (b)(2) 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. Subsection (b) and this subsection do not affect the priority of mechanics' or materialmen's liens, or the priority of liens for other assessments made by the association.

account for the unpaid assessments, the association must either increase the assessment burden upon the remaining unit 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 and 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. See Andrea Boyack, *Community Collateral Damage: A Question of Priorities*, 43 Loy.U.Chi.L.Rev. 53 (2011); 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).

Finally, the recent economic climate and real estate downtown has produced a substantial and increasing volume of litigation regarding the interpretation of the existing six-month limited priority lien contained in current UCIOA § 3-116. This litigation has included:

- Whether an association's limited priority lien under § 3-116 constitutes a "true" lien priority — i.e., whether a foreclosure sale by the association to enforce its association lien would extinguish the otherwise first mortgage lender's lien. As originally drafted, § 3-116(c) was intended to create a true lien priority, and thus the association's foreclosure properly should be viewed as extinguishing the lien of the otherwise first mortgagee (to the same extent that foreclosure of a real estate tax lien would extinguish that same mortgage). See, e.g., *7912 Limbwood Court Trust v. Wells Fargo Bank, N.A.*, ___ F.Supp.2d ___, 2013 WL 5780793 (D.Nev.2013); *Summerhill Village Homeowners Ass'n v. Roughley*, 270 P.3d 639 (Wash.Ct.App. 2012). Nevertheless, several trial court decisions have held that an association's nonjudicial foreclosure of its assessment lien does not extinguish the lien of the first mortgage lender. See, e.g., *Weeping Hollow Ave. 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); *JPMorgan Chase Bank, N.A. v. Chase Plaza Condo. Ass'n*, No. 2010 CA 005826 R(RP) (D.C.Super.Ct. Oct. 21, 2012).

- Whether an association can assert its six-month lien priority only once, or whether it can assert that priority on a recurring basis by instituting additional lien foreclosure proceedings every six months. Compare *Drummer Boy Homes Ass'n v. Britton*, 2011 Mass. App. Div. 186 (2011) (UCIOA lien priority cannot be extended beyond six months through repetitive foreclosure actions by association) with *Bank of America, N.A. v. Morganbesser*, No. 675-10-10 (Vt. Super. Ct. Jan. 18, 2013) (recognizing continuation of association's priority for assessments accruing during pendency of association foreclosure, even beyond six months, because subsection (c) would allow repetitive actions every six months).

The JEBURPA recommended that the ULC prepare amendments to § 3-116, both to clarify the interpretational issues reflected in this pending litigation and to provide adequate protection for the ability of common interest community associations to collect

budgeted common expense assessments during distressed real estate markets typical of those that have existed since 2007.

Proposed Amendments. For the reasons discussed above, the JEBURPA proposes that the text and comments of UCIOA § 3-116 should be amended as reflected in the attached proposal. A summary of the proposed changes follows:

1. Subsection (c) would be amended to establish that the association's lien priority is not limited to only six months of unpaid common expense assessments regardless of the length of the delay involved in a foreclosure of a mortgage on the unit. Instead, the association's lien is entitled to priority under subsection (c) in amount equal to the unpaid common expense assessments, up to six months per year, based on each year's periodic budget as adopted by the association for the applicable year. Thus, if a mortgage lender does not complete a foreclosure sale on its mortgage on a defaulted unit for a period of two years, and the unit owner does not pay any assessments during that two year period, the association lien would be entitled to priority to the extent of an amount equal to six months worth of assessments in each budget year. As amended, Comment 2 provides three illustrations indicating the intended application of subsection (c).

2. Subsection (b) would be amended to clarify that the association's lien has true priority over the lien of an otherwise first mortgage lender to the extent of the amount described above. Thus, if the association conducts a foreclosure sale of its association lien and the otherwise first mortgagee does not act to redeem its interest by satisfying the association's limited priority lien, the mortgagee's lien would be extinguished by the sale. This amendment is not intended to effect a substantive change, but merely to clarify that section 3-116 was intended to create a true lien priority for the association's lien to the extent of the priority granted by subsection (c).

3. Subsections (j) and (n) would be amended to provide that once a unit owner is in default in payment of assessments for more than three months, the association is entitled to recover possession of the unit pursuant to the state's forcible entry and detainer procedures.

In its present form, Section 3-116(j) provides this remedy only for cooperative associations. As the comments to the 2008 text explain, the typical cooperative association has 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 goes toward payment of that particular unit's proportionate share of the mortgage. If the unit owner fails to pay his assessment on time, the cooperative 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. For this reason, UCIOA has provided that the cooperative association could evict a unit owner in default of assessments. This remedy would permit the association to re-let the premises

and apply collected rents toward the unpaid assessments pending completion of the association's lien foreclosure.

As originally promulgated, subsection (j) did not extend such a possessory remedy to an association in a condominium or planned community, based upon the presumption that a unit owner's failure to pay assessments on a timely basis would have less significant consequences and that the association's foreclosure remedy was sufficient. This presumption has proven questionable as common interest unit values have declined during the recent economic recession and real estate crisis.

By contrast, Illinois has adopted procedures that allow a condominium association to use forcible entry and detainer to obtain possession of a unit from a defaulting owner, and to lease the unit to a tenant and apply the rents toward the satisfaction of unpaid assessments. 735 ILCS 5/9-111. Upon recovering possession of the unit, the association has the power (though not the obligation) to lease the unit to a tenant for a period not to exceed 13 months; if the association so leases the property, the association must apply rents collected to unpaid assessments, fines, and ongoing assessments as they come due, with any surplus returned to the unit owner. 735 ILCS 5/9-111.1. Once the unit owner has paid off the unpaid assessments and becomes current on its obligations to the association, the unit owner may obtain an order vacating the judgment; if the premises are being leased by the association as described above, the judgment would be vacated effective at the end of the lease term. 735 ILCS 5/9-111.

The Illinois statute discourages strategic default by underwater unit owners in possession of their units (defaults which can place a serious financial burden on the association and other unit owners). The potential benefit of such a remedy is additionally magnified in jurisdictions (such as Illinois) that permit only judicial foreclosure. In those states in which a year or longer might elapse before an association could complete a judicial foreclosure of its assessment lien, and there is a viable market for rental of such units, this possessory remedy would enhance the ability of the association to reduce the assessment delinquency (and thereby help meet its budgeted expenses) pending completion of the foreclosure of the association lien.

Based upon this model, subsection (j) would be amended to extend a comparable remedy to all associations. Subsection (n) would also be amended to make clear that the association could not pursue this remedy until the unit owner has been in default for nonpayment of assessments for a minimum of three (3) months. A state that adopts amended subsection (j) may need to consider conforming amendments in its forcible entry and detainer statute that are similar in character to the provisions in the Illinois statute, 735 ILCS 5/9-111 and 9-111.1.

4. Subsection (r) would be amended to provide that the association's foreclosure does not terminate a subordinate interest unless the association provides notice of the foreclosure to the person that is the record holder of the subordinate interest.

In states that permit an association to foreclose its association lien by nonjudicial foreclosure, questions may arise regarding the finality of a sale in which a subordinate lienholder was not provided with notice of the nonjudicial sale. In some states, nonjudicial foreclosure procedures require notice to subordinate lienholders only when those lienholders have recorded a timely request for notice of sale on the real property records. There also is authority in some nonjudicial foreclosure states to the effect that a subordinate lien can be extinguished in favor of a bona fide purchaser at the sale even if the mortgagee failed to provide notice to the subordinate lienholder who had requested notice. In other states, a subordinate lienholder that was not provided with notice of a nonjudicial foreclosure sale does not have its lien extinguished by that sale. See, e.g., Wash. Rev. Code Ann. § 61.24.040(7).

The issue of notice to subordinate lienholders becomes more critical under UCIOA because § 3-116(c) gives the association lien limited priority over the otherwise-first mortgage lender. It is manifestly unfair for an association's foreclosure sale to extinguish the lien of the otherwise-first mortgage lender if the association did not in fact provide the lender with notice of that sale. For this reason, subsection (r) would be amended to provide that the association's foreclosure does not terminate a subordinate interest unless the association provides notice of the foreclosure to the person that is the record holder of the subordinate interest.

Subsection (r) would not be necessary in judicial foreclosure-only states, nor in states (such as Washington) that provide that a nonjudicial foreclosure can extinguish subordinate liens only if such lienholders were provided notice prior to the sale.

IN THE SUPREME COURT OF THE STATE OF NEVADA

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VILLA PALMS COURT 102 TRUST, Appellant, v. WILLIAM L. RILEY, an individual; 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; and any and all other persons unknown claiming any right, title, estate, lien or interest in the Property adverse to the Plaintiff's ownership, or any cloud upon Plaintiff's title thereto (DOES 1 through 10, inclusive), Respondents.	}	**CASE NO. 62528**

NOTICE OF SUPPLEMENTAL AUTHORITIES

Appellant Villa Palms Court 102 Trust ("Villa Palms") hereby submits this Notice of Supplemental Authorities pursuant to NRAP 31(e). The attached Memorandum was issued and came to Villa Palms' attention after Villa Palms' briefs were filed, but before a decision has been reached. The information

contained in the attached Memorandum is both "pertinent and significant" to this case. NRAP 31(e).

During the oral arguments in this matter, reference was made to the June 1, 2013 Report of the Joint Editorial Board for Uniform Real Property Acts ("JEB Report"). As a result of the JEB Report and subsequent guidance from the Uniform Law Commission Executive Committee, public comments were submitted to the Joint Editorial Board from a range of industry groups and academics and a series of meetings were held. (*See* Memorandum at p. 1, attached hereto as Exhibit 1.) These public comments and meetings culminated in a set of proposed amendments to Section 3-116 of the Uniform Common Interest Ownership Act and are set forth in the Memorandum with commentary from the Joint Editorial Board . (*See id.*)

The Memorandum speaks directly to the two issues before the Court in this appeal—(1) whether the "super priority lien" creates a true lien priority, the foreclosure of which extinguishes a first security interest that failed to protect its interest, and (2) whether a homeowners association must judicially foreclose its

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super priority lien. (*See id.* at pp. 4-6 (Proposed Amendments 2 and 5).) Because the Memorandum addresses the central questions posed in this appeal, it should be considered by the Court.

DATED this 25th day of July, 2014.

/s/ Zachary P. Takos

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CERTIFICATE OF SERVICE

I certify that on the 25th day of July, 2014, I served a copy of this **NOTICE OF SUPPLEMENTAL AUTHORITIES** upon all counsel of record:

☐ By personally serving it upon him/her; or

☒ By mailing it by first class mail with sufficient postage prepaid to the following address(es): (NOTE: If all names and addresses cannot fit below, please list names below and attach a separate sheet with the addresses.)

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Dated this 25th day of July, 2014.

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