



## **Housing Recovery in Community Associations: Priority Lien Statutes are the Reasonable Solution to Abandoned Property, Community Blight, and Zombie Foreclosures**

### **Background**

Economists attribute the cause of the U.S. housing crisis of 2008, in part, to widespread use of high-cost, unsuitable loans that triggered a large decline in home prices after the collapse of the housing bubble. This led to mortgage delinquencies, foreclosures and the devaluation of housing-related securities.

The depression-like conditions caused by the housing crisis caused serious disruption to American families, including: displacement, financial insecurity and extreme economic hardship. Additionally, communities experienced declining property values, physical deterioration, crime, population turnover and financial stress on local government and community associations. Community associations, also known as condominiums, homeowners associations, and housing cooperatives, witnessed record foreclosures and were left with abandoned properties and community blight.

Recovery in community associations has been further negatively affected by prolonged foreclosures- also known as zombie foreclosures. These foreclosures occur when a lender begins the foreclosure process and makes the owner believe they no longer own the home. The homeowners abandon the property but the lender does not complete the foreclosure process for many months or even years. In this situation, nobody is paying community association assessments.

Community associations, governed by volunteers – residents living in the community – are forced to create a response strategy to help local neighborhoods recover from the crisis. One tool community associations use to recover financial losses from homeowners who fail to pay their assessments are long-standing priority lien statutes. Without priority lien statutes in place, lenders have no incentive to take responsibility of properties and foreclose in a timely manner.

### **Recommendation**

In recognition of the inequitable burden on residents living in community associations, state legislatures should adopt or strengthen priority lien statutes. CAI encourages, at a minimum, for states to adopt the 2014 revised version of the Uniform Common Interest Ownership Act (UCIOA)

Section 3-116 priority lien language. Priority lien statutes serve to effectively preserve property values and balance the interests of homeowners in community associations and lenders.

## **Introduction**

Community associations all require homeowners to pay assessments to the association to carry out critical services. These critical services include maintenance of common elements, maintenance of community infrastructure (roads, bridges, and storm water systems), obtaining insurance coverage, and providing for utility services. Community association boards also ensure that funds are set aside in capital replacement reserves so owners are protected from large, unanticipated special assessments. To ensure these community functions are met, all homeowners pay regular assessments, which are lien-based. An association's financial obligations rely on consistent payment of assessments to operate and do not change when assessments are not paid.

When a homeowner stops paying assessments this forces the burden on responsible, non-defaulting homeowners and the community suffers. Community associations are often forced to reduce services, raise assessments or fund a special assessment. In most cases unit owners who stop paying their assessments also stop making their mortgage payments.

Communities' ability to collect delinquent assessments affects the homeowners and all of the other mortgage lenders in the community. The impact of recurring nonpayment of assessments goes beyond the resulting increase in costs which may be incurred by owners. Continuing non-payment threatens the viability of the community itself, forcing down property values within and around the community. This, in turn, affects the interests of residents and mortgage lenders.

In order to recover their losses, lenders and associations attach liens to the property and compete in a foreclosure sale for the debts owed. Generally, liens are prioritized by the common law principle, "first in time, first in right." Under this principle, the mortgage lender who properly records a mortgage always has priority over any association claim. When foreclosure proceedings are instituted, mortgagees are typically always winning bidders of the sale. In turn, this leads to the extinguishment of the association lien and leaves the association without any recourse to recover delinquent assessments.

"First in time, first in right" places all of the burdens on the association during a foreclosure. Priority lien statutes embody a careful balance of the interests of homeowners and lenders in community associations.

## **The Case for Priority Lien**

For more than 100 years, priority liens have been used for mechanic and tax liens. Today, approximately 22 states plus the District of Columbia and Puerto Rico have adopted a variation of priority lien language to allow community associations to collect delinquent assessments. State statutes are modeled after uniform codes which provide an association a lien priority over the first mortgage or deed of trust for a modest six (6) months of delinquent assessments. Meaning, when a

home is foreclosed upon, the community association would be first in line to be paid out of the proceeds of the foreclosure sale before any other creditor.

### **Associations protect the value of lenders properties.**

Priority lien statutes allow for a more equitable and fair balance of the burdens of foreclosure between mortgagees, associations and homeowners. The rationale behind these statutes is that banks should share in the financial responsibility when assessments go unpaid, because they have other loans in the community and their properties benefit from a stable association providing essential functions and services. Associations maintain infrastructure, building components and systems, ensure common improvements, enforce restrictions, preserve architectural design, and perform related services, all of which directly benefit mortgagees by protecting the value of the property securing the loan. Mortgagees should have a strong interest in supporting the ability of associations to be financially stable through priority lien statutes.

### **Community associations are involuntary creditors and lenders are in a better position to protect against foreclosure.**

Community associations must advance services in exchange for the homeowner's promise to pay assessments. On the other hand, lenders have the ability to evaluate a homeowner's creditworthiness in advance. Additionally, lenders can opt to further protect their security by requiring an escrow of certain assessments and property taxes, a larger down payment, obtaining mortgage insurance, as well as diversifying investments.

### **Mortgagees consented to lien priorities and are provided notice of foreclosure.**

The statutory language in states that have priority lien statutes is for the most part, consistent with the well-balanced, non-partisan language drafted by the Uniform Law Commission to address all stakeholder interests. Mortgagees and loan servicers consented to the priority lien language in UCIOA and the Uniform Condominium Act (UCA), but have failed to comply with their own guidelines obligating them to protect the asset securing the mortgage loan. Both Fannie Mae and Freddie Mac served on the UCA advisory committee when the comments were adopted in 1980. Their seller's guides have directed loan servicers to protect the property securing the loan, meaning they are responsible for paying monthly assessments. Loan servicers must protect the asset securing the loan and may recover any payments made to associations from the borrower.

Further, when a party seeks to foreclose on a home it must notify all parties that have an interest in the property. This notice provides them with an opportunity to either foreclose first or to bid at the foreclosure sale to protect their interest in the property. If the mortgage holder fails to act, the community association has no choice, but to continue the community association recovery process and pursue the foreclosure of the property.

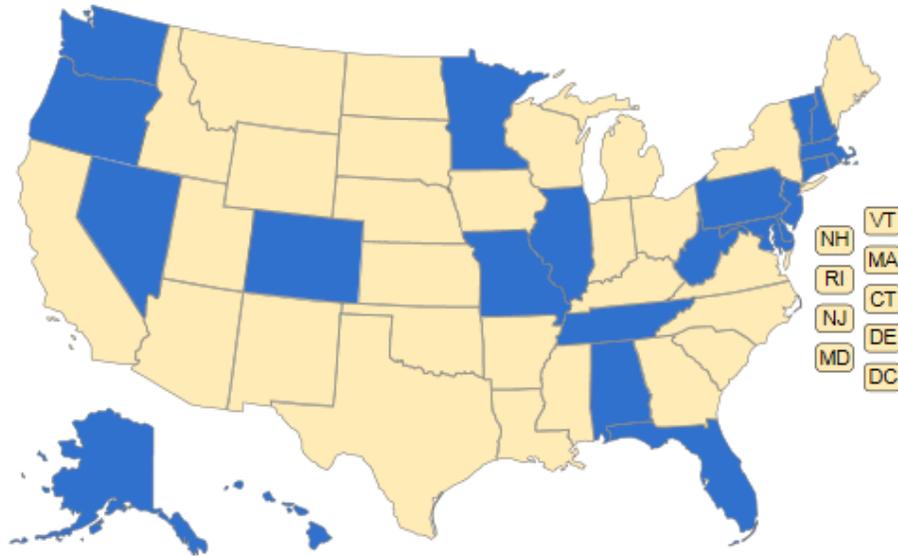
### **Conclusion**

States should adopt, or opt to strengthen, priority lien statutes to enable community associations to perform their role in maintaining critical services. CAI encourages at a minimum for states to adopt the 2014 revised version of UCIOA Section 3-116 priority lien language. Statutes that do not reflect the UCIOA language may be strengthened by increasing the period of time for which

associations are given a lien, explicitly stating priority lien is a priority in right and not merely a priority to payment, and including in the priority lien, reasonable attorney’s fees and costs associated with collection.

**States with Assessment Priority Lien Statutes**

Currently 22 states, the District of Columbia and Puerto Rico have assessment priority lien statutes (blue states):



[AL](#), [AK](#), [CO](#), [CT](#), [DE](#), [DC](#), [FL](#), [HI](#), [IL](#), [MD](#), [MA](#), [MN](#), [MO](#), [NV](#), [NH](#), [NJ](#), [OR](#), [PA](#), [PR](#), [RI](#), [TN](#), [VT](#), [WA](#), [WV](#)

<b>Alabama:</b> 6 months Judicial and Non-Judicial	<b>Delaware:</b> 6 months Judicial	<b>Maryland:</b> 4 months; \$1200 Judicial	<b>New Jersey:</b> 6 months Judicial	<b>Tennessee:</b> 6 months Non-Judicial
<b>Alaska:</b> 6 months Judicial and Non-Judicial	<b>DC:</b> 6 months Non-Judicial	<b>Massachusetts:</b> 6 months Judicial	<b>Oregon:</b> Unlimited Judicial and Non-Judicial	<b>Vermont:</b> 6 months Judicial
<b>Colorado:</b> 6 months Judicial and Non-Judicial	<b>Florida:</b> 12 months Judicial	<b>Minnesota:</b> 6 months Judicial and Non-Judicial	<b>Pennsylvania:</b> 6 months Judicial	<b>Washington:</b> 6 months Judicial and Non-Judicial
<b>Connecticut:</b> 9 months Judicial	<b>Hawaii:</b> 6 months Judicial and Non-Judicial	<b>Missouri:</b> 6 months Judicial and Non-Judicial	<b>Puerto Rico:</b> 6 months Judicial	<b>West Virginia:</b> 6 months Non-Judicial
	<b>Illinois:</b> 6 months Judicial	<b>Nevada:</b> 9 months Judicial and Non-Judicial	<b>Rhode Island:</b> 6 months; \$7500 Judicial and Non-Judicial	
		<b>New Hampshire:</b> 6 months Non-Judicial		

## Appendix

### **Uniform Common Interest Ownership Act (As Amended in 2014) Section 3-116, Comment 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 provided additional safeguards governing foreclosure of liens for unpaid common charges. These procedures may be summarized as follows::

First, Section 3–116(n) bars foreclosure for sums that are less than 3 months of common charges. Likewise, subsection (n) also bars the association from pursuing a possessory remedy against a defaulting unit owner unless more than 3 months of common charges are unpaid.:

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 associations directors with a fiduciary responsibility to maintain the property.

[Click here to view the full UCIOA Section 3-116 language.](#)