



Mortgage Bankers vs. Local Communities: Protecting Homeowners and America's Neighborhoods

Executive Summary

The Nevada Supreme Court recently ruled that community associations can exercise their right of foreclosure as permitted by law in Nevada, 21 other states and the District of Columbia. This is a fair and practical decision for mortgage bankers, community associations and homeowners. (*Nevada Supreme Court ruling SFR Investments Pool 1, LLC. v. U.S. Bank, N.A.*)

The more than 60 million Americans who make their homes in homeowners associations, condominium communities and cooperatives rely on reasonable government decisions to preserve the financial stability of their communities. That imperative should not be sacrificed because mortgage bankers prefer to avoid their financial obligations.

Many mortgage bankers have dragged their feet on foreclosures for years, delaying the process that would give them legal responsibility for the properties they own. This delay—often many months or years, even when the property has been abandoned—enables the lender to avoid paying assessments that fund the utilities and other essential services provided to residents by their community association. For all practical purposes, the lender holds the title to the property, but doesn't pay its fair share.

When that happens, responsible homeowners in the community are forced to bridge gaps in association budgets through reduced services, pay higher regular assessments and/or fund special assessments. That's why some community associations have taken the step of foreclosing without the cooperation of the lender, which results in the first deed of trust—the mortgage being extinguished. —an action that was upheld by the Nevada Supreme Court.

An association's financial obligations do not change when assessments aren't paid, either by delinquent owners or lenders. Association services must be provided; bills must be paid. With each delinquency that goes unresolved for many months, an association's financial position can become increasingly precarious. When homeowners abandon their properties or fail to make mortgage payments for a period of time, the lender has a practical and ethical responsibility to proceed with a loan modification or the foreclosure process in a timely manner. The lender can then take legal ownership of the home and fulfill its obligation to pay the community association assessments that are required by the law—and should be paid as a matter of principle.

Instead, the mortgage bankers are claiming they are trying to help the consumers by not foreclosing too quickly. Truth is, many of these homeowners have already abandoned their homes, which unmaintained become a blight to the community and drain on property values. If there are 10 lender-delayed foreclosures in a 500-home community, the burden falls not to the lender, but to the 490 neighbors bear the financial brunt of the mortgage lender's tactics.

And now big mortgage bankers—the very lenders who made these loans—are trying to suggest that the community associations are the culprit for this untenable situation. That's incredulous and disingenuous. The associations are simply sustaining their communities, protecting property values and

meeting the established expectations their homeowners. That's why a recent national survey found the 90 percent of community association residents rate their overall community association experience as positive or neutral. We wonder how the mortgage bankers would fare do in a national survey of Americans.

This is at its core a fairness issue. The owner of a home, whether an individual or a mortgage banker, has a contractual obligation—to the association and the other homeowners—to pay assessments. That's why many mortgage bankers delay the foreclosure process—even when the delinquent owner has already abandoned the home.

When the leader shirks its financial obligation, and the association and its homeowner members are left holding an empty bag. Community associations put in this situation take the only viable course of action available—to foreclose on the bank-owned property and sell it to an owner who will maintain the property and meet his or her financial obligations to the community.

NOTE: Since the Nevada Supreme Court decision, some mortgage lenders in Nevada on moving more quickly to finalize foreclosure and more lenders are paying community association assessments.

Some Facts about Mortgage Bankers

Nobody questions the fact that reckless and sometimes predatory practices by bankers and other mortgage lenders were directly responsible for the U.S. housing crisis and resulting economic downturn. The U.S. economy was sent into a prolonged tailspin. These issues were not caused by homeowners associations, condominium communities and housing cooperatives, but tens of thousands of associations—and their homeowners—had to make hard and sometimes painful choices to weather the storm. Most of these communities have recovered, but many have had to defer critical maintenance and repairs for streets, roofs, lighting, elevators and other common elements.

A little background is important. The Federal Housing Finance Agency filed law suits against 17 U.S. and overseas banks related to nearly \$200 billion in mortgage-backed securities sold to Fannie Mae and Freddie Mac during the years preceding the financial crisis. That's in addition to a nationwide, \$25 billion civil settlement for noncompliance with federal and state mortgage regulations. In August of 2014, Bank of America paid a record \$16.65 billion penalty to resolve allegations that it sold to mortgage-backed securities.

But the mortgage bankers now claim—with straight faces, no less—that they are trying to protect consumers.

The Practice of Priority Lien

For more than 100 years, the practice of priority lien has been used by law for mechanics liens, tax liens and others. Community associations have the legal right to recover delinquent assessments through a lengthy due process that provides the right to a put a lien on a property and, as a last resort, take that property to foreclosure. Banks have the same right and responsibility. If a bank chooses not to exercise that right, they leave no other choice but for other lien holders to foreclose.

Community associations are nonprofit entities. Banks are for-profit, multi-billion dollar entities. Community association boards report to their homeowner members; banking executives answer to their investors. Is there any question which group focuses on the best interests of homeowners?

The indisputable fact is that the mortgage bankers have purposely dragged their feet on foreclosures for years. They have done so—in Florida, New Jersey, New York and other states—so they can avoid taking

responsibility to pay associations the monthly assessments that fund the utilities, maintenance and other essential services provided to residents by their community association.

An association's financial obligations do not change when assessments aren't paid, either by delinquent owners or self-serving lenders. Association services must be provided; bills must be paid. With each additional delinquency, an association's financial position can become increasingly precarious, a situation that is exacerbated in a depressed housing and economic climate. Non-profit associations operate with a financial model that depends on collecting assessments from each homeowner to fund necessary services, maintenance and capital improvements.

As the banks drag their feet on foreclosure, association homeowners are called upon to make up the financial deficit created by the banks' delay. Many associations were forced to levy special assessments during the mortgage foreclosure crisis, and many more are now repaying loans that helped them sustain their communities during the downturn.

The Fallout for Homeowners and Communities

All of this puts communities and many homeowners at a great disadvantage, especially those who live on fixed incomes and struggle to pay—or literally can't pay—higher assessments or special assessments. In many cases, these owners are unable to sell their homes because they owe more than the depressed value of their homes. These homeowners are stuck—and the banks are trying to blame the associations.

When homeowners can no longer afford to pay their mortgages, they typically stop paying their community association assessments. The law provides for a foreclosure process so banks can foreclose and recoup their money through a foreclosure sale. The law allows community associations to follow a similar process. Importantly, however, community associations attempt to work with the appropriate bank before the final step of foreclosure is taken. Further, the law requires community associations to provide notice to the banks before foreclosure. Therefore, the lenders are warned of a foreclosure and given an opportunity to foreclose first.

Foreclosure is an unfortunate—and expensive— ordeal. Community associations would rather have homeowners living in the community than see a neighbor lose a home to foreclosure. By the time a community association forecloses, the homeowner has usually left the home and the association is left to maintain the property to avoid community degradation that can diminish the community's appearance, hinder home sales and perhaps lead to declining property values.

Associations would much rather have a lender foreclose on a home in a timely manner than delay a foreclosure so the bank doesn't have to pay the community association assessments. Who bears the financial burden of this all-too-common banking practice? The non-profit community association and its homeowners! The spin used by the banks to argue otherwise is blatantly disingenuous.

Bankers Working the System

The foreclosure process provides for a law-based due process so homeowners are encouraged to stay in their homes. When it is clear that a homeowner is not going to pay the mortgage, banks have a practical and ethical responsibility to proceed with the foreclosure process in a timely manner, take legal ownership of the home and fulfill their obligation to pay the community association assessments that are required by the law—and should be paid as a matter of principle.

The owner of a home—whether an individual or a bank—has a contractual obligation to pay assessments to the association. That's why many lenders delay the actual foreclosure process—even when the owner has already left the community. The bank shirks its financial obligation; the association and its homeowner members are left holding an empty bag.

The Reasonable Solution

At least 22 states provide priority for association liens to ensure a fixed amount of delinquent assessments and related expenses are recoverable through foreclosure. This means that homeowners, lenders and loan servicers share the burden and expense of a foreclosure in the community.

Priority lien is a solution that has been used for decades in mechanics liens, tax liens and other liens. The practice is not new for community associations and is a fair, equitable and reasonable solution that protects homeowners who live in a community association.

Priority lien statutes are an equitable and reasonable solution because:

- Associations are not involved in an originator's decision to extend credit.
- Remaining homeowners aren't forced to bridge gaps in association budgets through reduced services, higher regular assessments and/or special assessments.
- Lenders and loan servicers directly benefit from association policies that protect communities from blight that can depress property values.
- If foreclosure is unavoidable, lenders and servicers have a financial incentive to move expeditiously to return the property to commerce, which benefits local housing markets.
- Community associations are permitted to recover a portion of lost revenues, which affects the financial stability of the association and protects the investment made by owners in that community.
- State and local governments have a clear public policy interest in discouraging risky lending practices and promoting the financial viability of community associations. Priority lien is an established, reasonable and equitable means of achieving these public policy goals.

State statutes that give community associations priority lien status support homeowners, their community associations, municipalities, the real estate industry, and the local economy and housing market.

About Community Associations

Community associations are governed by homeowner directors who are elected by their neighbors to serve the best interests of the community. Many of them hire professionals to manage their communities and provide expert advice and service for accounting, insurance, legal and other needs. Community association boards have a fiduciary duty to protect and preserve the financial integrity of their communities. Beyond a duty, that's what their homeowner members expect them to do.

About Community Associations Institute

With more than 33,000 members dedicated to building better communities, Community Associations Institute works in partnership with 60 chapters to provide information, education and resources to those involved in community association governance and management. CAI also advocates on behalf of common-interest communities before legislatures, regulatory bodies and the courts. We believe homeowners and condominium associations should strive to exceed the expectations of their residents. Our mission is to inspire professionalism, effective leadership and responsible citizenship—ideals reflected in communities that are preferred places to call home. Visit www.caionline.org or call (888) 224-4321.

Government affairs contact: Dawn Bauman, CAE, (dbauman@caionline.org, 703-970-9224)

Media contact: Frank Rathbun (frathbun@caionline.org, 703-970-9239)