THE Superlien Dilemma

— by ANDREA LEE NEGRONI, STEVEN VONBERG AND DERRICK PITTS —

Who pays delinquent dues when it comes to shared-interest communities governed by homeowner associations? This is a growing problem that is nowhere close to being solved. Lenders stand to lose big unless the issue is addressed.

VIEW-ONLY REPRINT WITH PERMISSION FROM THE MORTGAGE BANKERS ASSOCIATION (MBA)

More and more Americans live in planned communities, condominiums, cooperatives and other types of shared-interest communities governed by homeowner associations (HOAs). According to the Falls Church, Virginia–based Community Associations Institute (CAI), fewer than 10 million Americans lived in communities governed by an association in 1980, but by 2012 that number had surged to more than 63 million—an increase of more than 600 percent. ¶ One immutable feature of shared-interest communities is the homeowner's obligation for periodic dues and assessments. Dues are usually collected monthly, quarterly or annually, in amounts ranging from a few dollars to thousands of dollars a month. ¶ Prompt dues payment enables associations to maintain properties and leads to financially sound communities. Delinquent dues have the opposite result, leaving associations short of maintenance and repair funds, and making communities less desirable for existing owners and potential buyers. ¶ Under state "superlien" laws, mortgage lenders can become liable for a property owner's unpaid dues. In states with superlien laws, an owners association's lien for unpaid dues is a priority claim on mortgage foreclosure sales proceeds. The super-priority of association liens means mortgage lenders need procedures for handling unpaid dues in superlien states.

With unpaid dues increasing as a result of the mortgage crisis, distressed shared-interest communities are seeking to transfer more responsibility for unpaid dues to lenders. This article summarizes legal controversies swirling around superlien laws and potential adverse consequences of recent efforts to amend them.

Understanding superliens

Common-interest community superlien laws go back more than 30 years. They spring from laws such as the Uniform Condominium Act, Uniform Planned Community Act and Uniform Common Interest Ownership Act (UCIOA).

Superlien laws exist in almost half the states—specifically, 21 states as of year-end 2013. More superlien laws, coupled with an explosion in the number of association-governed homes, makes superliens increasingly important to the financial lives of homeowners, the solvency of community associations, and the lending policies of mortgage companies and investors.

Litigation involving superliens is increasing as homeowners, community associations and mortgage lenders ask courts to balance the equities between the need to collect unpaid dues and the need to protect the priority of mortgage loans.

State laws take various approaches to superliens. Ten states and the District of Columbia grant a limited priority only for condominium assessments, while nine states grant priority to both condominium and homeowners association assessment liens. Vermont law grants priority to homeowner association liens but not condominium liens.

The lien priority amount also varies from state to state. Fifteen states and the District of Columbia limit lien priority to six months' worth of unpaid assessments. Maryland law limits superlien priority to the lesser of four months' assessments or $1,200. Oregon does not cap the priority amount.

The source of many state priority amounts is Section 3-116 of the UCIOA, which provides a priority lien for six months of regular dues. Unpaid dues protected by the superlien are paid from foreclosure sales proceeds, but foreclosures often take longer than six months.

Foreclosure mediation, workouts and modification efforts delay foreclosures. Moreover, lenders may be in no hurry to foreclose underwater mortgages.

Foreclosure delays usually lead to long periods of unpaid assessments and increasingly strained community budgets.

These problems are most acute in states with high delinquency rates, many common-interest communities, and long foreclosure timetables. States such as Florida and Nevada tick all three of those boxes.

To minimize the financial threat unpaid dues pose to community associations, some states are increasing the amounts entitled to super-priority. Nevada and Connecticut increased their superliens from six to nine months' assessments in 2013 and Florida went from six to 12 months in 2010.

Other states may follow suit. There have also been calls for amending superlien laws from the legal profession and common-interest communities.

The Chicago-based Uniform Law Commission's Joint Editorial Board for Uniform Real Property Acts is expediting an effort to amend UCIOA to increase assessments entitled to super-priority. A more draconian proposal urged by CAI would give assessment liens "complete priority" over unit mortgages.

Mortgage companies "choose" to extend credit to borrowers, says CAI, but homeowners associations are "unwilling creditors." CAI also likens some HOA duties, such as road maintenance and storm water management, to traditional municipal services, arguing that because municipal taxes have complete priority over unit mortgages, homeowner dues should, too.

The mortgage industry opposes supersizing the superlien. Fannie Mae says increases would restrict credit options for homebuyers in common-interest communities, increase the price of loans in those communities and inhibit refinancing by unit owners—or all three.

Fannie also claims expanded lender liability for unpaid dues might "force" it to require that dues be escrowed, a complex and expensive procedural change for both owners associations and loan servicers.

Common-interest community superlien laws go back more than 30 years.

Unresolved superlien issues

Although uniform common ownership acts are the primary legal source of assessment superliens, superlien laws are not as uniform as their titles suggest. A burgeoning amount of litigation involving the scope and effect of superliens is complicating a once-dormant issue.

The basic premise of superlien priority is simple, but as the saying goes, the devil is in the details. Most superlien laws don't resolve questions such as:

- Can penalties, fees, interest and collection costs be included in an assessment lien?
- Does a superlien achieve one-time priority over a specific unit mortgage or do superliens create rolling priority for unpaid assessments (i.e., does lien priority arise again if cured delinquencies are followed by later delinquencies)?
- How does foreclosure of an association's superior lien affect the lender's interest?
- Can an association amend its declaration or bylaws to create a superlien that "relates back" to the recording of the declaration?

One of the most pressing questions for both community associations and mortgage lenders is whether attorneys' fees, costs and expenses can be included in the superlien. Some laws specifically authorize these, while others expressly prohibit them.

For example, Massachusetts allows "reasonable" attorneys' fees in the superlien, and Rhode Island allows costs and attorneys' fees up to $2,500. Conversely, Maryland law specifically excludes attorneys' fees and other collection costs. Other state laws are silent, leading to litigation and inconsistent outcomes.

The Arkansas Supreme Court held an attorney's collection fee could be included in a judgment for unpaid assessments in *Damron v. University Estates* (1988). Last year, Minnesota considered amending its Common-Interest Community Act to exclude from the superlien fines, penalties and interest on unpaid dues, requiring them to be recovered by separate civil action, but the law did not pass.

Putting aside attorneys' fees, an association that folds fees into assessment liens may face legal challenges. Associations add fees and interest to delinquent dues to encourage timely payment, and because collection can be expensive and unprofitable without the additional fees. For example, a community with modest dues of $25 a month ($150 for six months) may incur collection and lien-enforcement costs much higher than the unpaid dues.

But states take contrary positions on whether fees and costs can be included in the superlien. New Hampshire's superlien law allows collection costs but disallows late charges, interest, fines and penalties. New Jersey's strict superlien law disallows late charges, fines, interest and collection costs.

Another open superlien issue involves ambiguity about rolling superliens. Legal interpretations are emerging on whether superlien laws grant "one-time" priority or are "perpetually renewing." Certain states address this issue by statute, but many do not.

New Jersey allows an association's lien for unpaid assessments priority over a particular mortgage only once every five years. Connecticut takes the opposite approach: An association's assessment lien can achieve priority over the same mortgage repeatedly. More commonly, the question of rolling priority is not settled by statute and is ripe for litigation.

Industry response to superlien issues

Superlien priority advances a homeowner association's interest over the lender's, up to the statutory amount. Consequently, a lender has a vested interest in ensuring that the association does not foreclose its assessment lien, which the lender generally protects by paying the dues subject to the superlien.

Recognizing that an assessment lien foreclosure can threaten a first mortgage, Freddie Mac announced in Bulletin No. 2013-15 that beginning Aug. 1, 2013, servicers would be "required to pay any condominium, HOA and PUD [planned unit development] regular assessments prior to the foreclosure sale date if they are, or may become, a first-lien priority on the mortgaged premises or that if not paid, would result in the subordination" of Freddie Mac's lien. The amount is not limited to six months' assessments, but is the lesser of the actual, statutory or priority assessment amounts established by the community declaration or bylaws.

In attempting to clarify handling of unpaid assessments, Freddie may have opened Pandora's Box. Reference to priority assessment amounts in declarations or bylaws suggests that servicers or their attorneys should review documents that may be hard to find, interpret, or both. A servicer handling mortgages in hundreds or thousands of common-interest communities is unlikely to have community declarations or bylaws handy; moreover, these may have been amended without notice to noteholders.

Further, assessment lien provisions in recorded declarations might contradict statutory law, leading to the question, "Which source controls?" While courts have occasionally decided which source controls—for example, a Colorado court in *BA Mortgage LLC v. Quail Creek Condominium Association* (2008) decided that a statutory superlien controlled a contradictory declaration—most states have not considered this dilemma.

Piling on to the problems of unavailability and complexity of common-interest community documents, homeowner associations have occasionally amended their documents to declare that assessment liens "relate back" to the filing of the declaration. In this way, associations seek retroactive lien priority for unpaid assessments. Sometimes they are successful, but not always.

A 1991 Wyoming case, *American Holidays v. Foxtail Owners Association,* held that a condominium association's assessment lien related back to the recording of the declaration. A 2008 statutory amendment to the Florida homeowners association act allows relation back, but *Coral Lakes Community Association v. Busey Bank* (2010) held this amendment unenforceable on the grounds it benefited the homeowner association to the disadvantage of lenders in the community.

Other state laws expressly prohibit relation back of assessment liens, including those in Indiana and Nebraska. State-by-state variations in these and other superlien-related legal issues create a compliance patchwork for lenders making mortgages in common-interest communities.

Summing up

The growing number of households in common-interest communities combined with the housing crisis has focused attention on the question of unpaid assessments and who should pay them. Delinquent mortgages and unpaid homeowners' dues usually go hand-in-hand. Whether and to what extent unpaid dues are returned to communities before lenders get their foreclosure sales proceeds is a question that will face courts and lawmakers for the foreseeable future.

Possible industry approaches include escrowing the total amount of the superlien at loan closing; requiring associations to subordinate their claims above a fixed dollar amount or fixed number of months' dues (with or without attorneys' fees, interest and costs); or requiring borrowers to pay dues into lender-held escrow accounts, along with their property taxes and insurance.

While these options could reduce lender liability for dues subject to superliens, changes to loan closing and escrow procedures are labor- and resource-intensive, and might discourage buyers from buying in shared-interest communities.

Mortgage lenders and servicers will face greater liability for unpaid homeowner dues if superlien laws are expanded. Adopting policies to limit the impact of superliens will involve implementation and compliance costs, and could dampen homebuyer interest in community living.

A passive approach to superlien priority matters may ultimately be very expensive, but proactive steps to minimize the effect of superlien priority will have their own costs and consequences. **MB**

Andrea Lee Negroni, Steven vonBerg and **Derrick Pitts** are attorneys with the Washington, D.C., office of BuckleySandler LLP, where they advise residential mortgage lenders, loan servicers and vendors to the mortgage industry on regulatory compliance with state and federal laws. They can be reached at alnegroni@buckleysandler.com, svonberg@buckleysandler.com and dpitts@buckleysandler.com.