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FOR CONDO AND HOA BOARDS: A FORECLOSURE/COLLECTION PRIMER

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A condo or HOA board encounters a unit owner default in paying various common charges; perhaps there are quite a number of these defaults. Some action beyond obvious letters and revocation of privileges will often be needed to elicit payment. But what precisely are the powers available; what steps can be taken?

Tales abound of liens and foreclosures being difficult to understand. Banks and mortgages seem to be involved, law and procedure are obscure and the whole process is either a mystery or just confusing. While some details can be left to professionals, the board may not be appropriately armed to give direction and make decisions if the process is not fathomed. In any event, boards most effectively serve themselves and their constituents by understanding how everything works and how ultimately goals can be achieved. To be sure, there can be nuance and complication to all this, but understanding the basics – what a board can do and how everything works – can be efficiently outlined. It is worth knowing and can be readily grasped.

Some of the concepts relevant to this review were explored in a somewhat different context in two earlier articles in these pages: "Don't Wait For the Bank's Foreclosure", Issue 21 Community Associations Institute – Long Island Chapter, 1 (Summer 2013); and "Don't Wait For the Bank's Foreclosure II", Issue 24 Community Associations Institute – Long Island Chapter, 1 (Spring 2014). So, attention is also invited to those explorations as we approach the issues.

ROLE OF THE DECLARATION AND BY-LAWS

Although there is plenty of statute and case law affecting collection and foreclosure, some of the actual powers are set forth in the declaration and the by-laws: recouping legal expense, late charges, accrual of interest on default, authority of the board, among others. Therefore, it may be necessary to consult those documents although generally they are similar. The board's general counsel or special foreclosure counsel, if engaged, will know these provisions and should proceed accordingly.

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FILING A LIEN

When a unit owner defaults, whatever the amount due, it is for the moment merely a bookkeeping entry, something in a sense just theoretical. In the face of continued non-payment, that debt, that obligation, needs to be memorialized of record, for the world to have notice. That is accomplished by the filing of a lien with the county clerk. So if the question is asked, "can we file a lien?", the answer is assuredly "yes". (For condos it is a matter of statute, for HOA's the authority is less precise, but such is a detail which need not be examined here.)

All the board needs to do is decide that it is time to file the lien. Supply counsel with the address, the unit number, the unit owner's name and a breakdown of the sums due. The attorney prepares the lien and submits it for filing. Shortly thereafter (the time can vary from county to county), the lien is of record and burdens the property. This is the first demonstration to the unit owner that the board is in earnest.

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LIEN IS A CONTINUING LIEN

This is an important and comforting concept to appreciate. Suppose at the time the lien is prepared, the unit owner owes $2,000. (It could be less or it could be much more depending upon the level, category and computation of charges and the duration of the delinquency until the decision was made to file the lien.) Whatever the amount at that moment, it appears to become stale the very next month when additional sums, late charges and interest come due – with a similar scenario monthly thereafter.

This is not a problem, though, because the lien is deemed at law to encompass all subsequent amounts, hence, the denomination a "continuing lien". This benefit continues through the foreclosure process should that be necessary.

WHEN TO FILE THE LIEN

This is mostly a business decision, but there are factors to consider. First, the by-laws might require a certain notice or waiting period before a lien can be filed so adherence to that is, of course, required. Once any possible constraints have expired is when it becomes a judgment call.

For the unit owner who didn't pay because of a lengthy hospital stay, which has or is about to conclude, compassion is typically in order. Likewise, the board may not take an aggressive stance for the owner who was out of work for a few months, has gotten a new job and is amenable to a payment plan.

But for those who simply cannot pay, or those who game the system and choose not to pay, experience suggests that waiting and hoping will fail. There cannot be a foreclosure by the board without a filed lien and so proceeding with dispatch is recommended. Because the board's legal expense is most often the responsibility of the defaulting owner, being repaid the modest fee to file the lien will be a part of any unit owner's remittance of arrears. Thus, the board suffers no monetary loss through diligence in filing the lien. It should strongly consider that.

SUING ON THE DEBT INSTEAD OF FORECLOSING

If the question is asked, this can be done. The board could simply sue for the arrears. This would usually be faster than foreclosing, but its efficacy is questionable. Even when a judgment is obtained, the owner needs to have readily available assets to collect upon. And if he does not, finding those assets (if they exist) can be time-consuming and expensive and may not yield results.

The pros and cons of pursuing the monetary obligation instead of foreclosing is a more detailed examination than is merited here. Suffice it to say for our purposes, usually (but not always) foreclosure is the more productive path.

FORECLOSURE – THE BOARD'S MAIN REMEDY

Let's immediately answer this elemental question: Can there be a foreclosure of the lien by the board? Answer: Yes.

This promptly leads to wonderment about the bank and any mortgages it holds on the unit, in particular, the interplay between a condo or HOA foreclosure and a foreclosure by a bank holding a mortgage. This is a bit more nuanced and will be reviewed later, but the central point to understand is that unless and until a senior bank may have actually completed a foreclosure on the unit, the board is absolutely free to pursue its own foreclosure, unfettered by what the bank does or does not do. Whether it is a good strategy to foreclose is a different contemplation – to also be discussed. But the key aspect bears repetition: any condo or HOA foreclosure is independent of a bank foreclosure.

HOW A FORECLOSURE WORKS AND WHAT IT ACCOMPLISHES

This is a legal proceeding with various distinct plateaus (most of the minutiae is best left to counsel), which consumes roughly between one and two years, somewhat less with exceptional diligence by counsel and luck, more when the courts are bogged down and when a unit owner chooses to contest. In the latter instance it becomes a litigated case and candidly, the system is made to be abused. Unit owners who want to lie (and it surely happens) can add detainment to the action. But these same people never would have paid anyway and the condo or HOA can expect to prevail in the end. The crazy cases are a minority, but it would be imprudent for a board member to dismiss the possibility of litigation.

The board is the plaintiff in an action to foreclose its lien. The unit owner and anyone having an inferior lien on the property is a defendant. (Judgment creditors, junior mortgage holders and other lien holders are in this category.)

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During the course of the foreclosure, until the moment of the court decreed foreclosure sale, the unit owner has the absolute right to satisfy the lien – in full. The condo or HOA need not accept a penny less than everything due it and that includes all interest, late charges, legal fees and court costs. This is a powerful weapon. If the unit owner is chastened by the action and feels the pressure of imminent loss of title, he may offer a payment plan. If that is truly the best he can do (it may or may not be) and the board is amenable to it, that can be accepted. The foreclosure holds in place as a sword in the event of a default on the plan which is hardly uncommon.

If the obligation is not paid, the lien foreclosure action eventually elicits from the court a judgment of foreclosure and sale which, in turn, authorizes the final event: the foreclosure sale. At the courthouse or a town hall (depending upon the county where the property is located), a judicial sale is conducted under the direction of a court appointed Referee. The sale is an auction and anyone can bid. The end result is either that a third party buys the property and the condo or HOA will have been paid all the money due it, or some lesser sum it was willing to accept, or, the condo/HOA gets the property back, free to resell it to a new owner who will pay, or to rent it out (until some day that a bank may complete a foreclosure of its mortgage).

LOOKING AT THE NUMBERS AT A FORECLOSURE SALE

When a foreclosure sale arrives, counsel will ask the board for bidding instructions. Both to better understand the end result of a foreclosure, and to arm the board to wisely give those bidding instructions, we look at some numeric examples to elucidate.

Suppose for example that the sum due on the lien by the time of the foreclosure sale is $25,000. (We understand, of course, that there are many variables and that amount could be $12,000 or $80,000 or anything below, above or in between.) Also assume for the purpose of example that there is a bank with an unpaid $100,000 mortgage (senior to the sums due under the lien), and that the property – the unit – is worth $200,000.

Mechanically, this means that anyone who bids at the foreclosure sale, and bids up to the $25,000 due to the condo or HOA, will buy the property subject to the $100,000 bank mortgage and the obligation to pay that mortgage. This aggregates, of course, an investment by the foreclosure sale bidder of $125,000. Would a person prudently pay $125,000 to own a property worth $200,000? The answer should be "yes" and this would suggest that a foreclosure sale in this scenario would lead to a third party buyer and would give full payment to the condo/HOA of the sums due to it. Indeed, the bidding might go above the $25,000, although the foreclosing party (here the condo/HOA) can never get more than the sum due to it – in our example, $25,000. Given this set of facts, the bidding instructions will be to bid up to the full debt and the end result should be a happy one.

Now assume an alternate circumstance where the sum due is the same $25,000, the senior bank mortgage is the same $100,000, but the value of the unit is $90,000. If the question is asked again, would someone pay $25,000 at the foreclosure sale, thereby creating an investment of $125,000 (the aggregate of what was paid at the sale and what must be paid on the senior bank mortgage)?, the answer would likely be "no". Aside from not expecting to pay retail at a judicial sale, here the bidder would be, in essence, paying $125,000 for a property worth only $90,000; it typically does not make sense. Even if the condo/HOA was willing to accept $5,000 at the sale for the benefit of getting a new owner who would pay in the future, the investment would still be $105,000 for a property worth $90,000 and so a bidder would still be unlikely. You can see, though, that as the numbers change, different scenarios eventuate. One point to understand is that the condo/HOA could elect to have the property sold at the foreclosure for something less than what it is actually due. That is a business decision.

In this second example, the likelihood that any third party would bid is slim and, therefore, the condo/HOA would be the successful bidder at the sale, would take the unit back, and would be well-advised to rent it and collect the income until some day when the senior bank might complete its own foreclosure.

PAYING THE BANK?

A further concept here to emphasize is that should the condo/HOA become the owner of the property, it has no obligation whatsoever to pay the bank the $100,000 due on the unit owner's mortgage. The unit owner was bound to pay that (and is still liable) because he had signed a promissory note or a

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mortgage note. It is a personal obligation. If the condo/HOA wanted to pay the bank, and it would still be profitable to rent for all the years to come, it could elect to do so. But the only penalty of not paying the bank is that someday (perhaps years from now) the bank will complete its own foreclosure because the unit owner never paid the mortgage. That will extinguish the condo/HOA title, but again, this is not an affirmative obligation on the part of the condo/HOA.

TAXES?

Another closely related issue is who pays the real estate taxes on the unit? Typically, a bank needs to protect its mortgage because if taxes are not paid, the taxing authority will ultimately take title and that will extinguish the mortgage. Therefore, banks most often continue to pay those taxes and add them to the mortgage debt – not really the problem of the condo or HOA. Most often, therefore, worrying about the real estate taxes is not for the attention of the condo or HOA.

INTERPLAY BETWEEN BANK MORTGAGE AND CONDO/HOA LIEN

Generally speaking, the condo/HOA lien is senior to all other liens except a first mortgage. Many units, likely most, will have been purchased with a mortgage so that such mortgage is senior and superior to the condo or HOA lien. (Please note, though, that a second mortgage such as a home-equity loan, will be junior and inferior to a condo/HOA lien.) The paramount nature of a first mortgage (usually, but not always held by a bank) is that when the condo/HOA lien is foreclosed, anyone who gets the title at the foreclosure sale (the condo or a third party) takes the property subject to that paramount bank mortgage. They need not pay the bank mortgage but eventually, someday, the bank will foreclose its mortgage and that will extinguish the title purchased at the condo/HOA lien foreclosure sale.

Once that concept is understood, then the primary focus becomes an analysis of how quickly the bank is enforcing its rights. As it turns out, banks suffer heavy burdens in endeavoring to foreclose their mortgages; public relations compulsions, pressure to settle from regulators among others, a general desire not to foreclose, and heavy delays imposed by statutes designed to protect mortgage borrowers. Banks must go through a settlement process and need to send various notices, all of which leads to the actuality that banks tend to move very slowly in enforcing their rights and often consume many years in the process. All this was discussed at further length in the prior articles we mentioned earlier in this piece (and attention is invited to those articles). Tersely stated, the condo or HOA which refrains from enforcing its own foreclosure rights, does so by abdicating its fate to banks that do not have the interests of the condo or HOA at heart. The mortgage lenders will lumber through the foreclosure process – or not – at a typically slow pace, during which common charges and/or HOA fees incessantly continue to accrue to the detriment of all the other. unit owners. In short, the better strategy is usually for the condo or HOA to vigorously enforce its own rights. Either it will be paid by the unit owner facing loss of title, or some new owner will buy at the foreclosure sale and begin paying the common charges and/or HOA fees, or the condo/HOA will become the owner and can rent it out for all those years that the banks are delaying in prosecuting their own foreclosures.

EVICTION AFTER FORECLOSURE

If it is the condo or HOA which has taken back the property at the foreclosure sale, the question is asked: What happens to the unit owner or other tenants who may still be there? In some instances,

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they actually do depart when notified that the foreclosure is over and that their rights have been extinguished. On other occasions though, they simply remain, knowing that they can live for free until legal process actually ousts them.

There are, of course, legal procedures to evict after foreclosure, although they are not nearly as neat and rapid as would be preferred. In the absence of vigorous opposition or unusual delay by the sheriff (or marshal), the procedure to evict consumes roughly three months although, as always, it could be a bit less or somewhat more.

Where the unit owner or tenant wishes to litigate the matter, many more months can be added to the process. While this may seem daunting, it is something which must be faced, knowing that the final result will be success and that it is something which must be pursued.

CONCLUSION - It is apparent that there is a fair amount to know when examining remedies to assure that condo and HOA charges are to be paid. But having an overall sense of what can be done will only serve to aid in making decisions and working with counsel to accomplish an ultimate goal. The thoughts expressed here can be an initial guide. ■

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