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## We Aren't Getting Paid?

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After years of exploding real estate prices, it appears that the market in the DC metro area is now heading in the opposite direction. As you may have recently heard, foreclosure rates are at historic highs. Many people who purchased or refinanced their homes within the last two years, are now faced with these declining values and are unable to sell their homes. As a result, we have seen a dramatic increase in the number of foreclosures by the mortgage holders. Unfortunately, these foreclosures often have a significant impact upon both condominium and homeowners associations for the simple reason that owners who do not pay their mortgages typically do not pay their assessments.

In the not too distant past, a first trust foreclosure usually resulted in the property being sold to a third part at a price significantly higher than the balance due on the mortgage. As a result, any unpaid assessments, legal fees and costs were paid from the excess proceeds of the foreclosure. Now, however, we have noticed that several of these properties aren't selling at the foreclosure sale, and the mortgage holder is taking title to the property.

When a property is foreclosed by the mortgage holder, all other claims against the property are either paid in the order of priority or extinguished. In other words, if there are no

proceeds from the foreclosure to payoff an association's liens, those liens are extinguished and the association's claim against the property is wiped out. At that point, the association's only option to collect the debt is to pursue a personal judgment against the former owner. Otherwise, the account will have to be reclassified by the Board of Directors as bad debt.

Once the mortgage holder begins the foreclosure process, there isn't anything the association can do to stop the process. At a minimum, the association and management should take extra care in ensuring that accounts are promptly referred for collection and that liens are being executed and returned for recordation as quickly as possible. That way, the debt will at least be secured in the event that there are excess proceeds available or the owner files for bankruptcy in an effort to stop or postpone the foreclosure.

From time to time, clients inform us that they are interested in attending a sale and bidding on a particular property that is scheduled for foreclosure. Board members may certainly bid on their own behalf, but the Board should carefully consider this course of action if it is interested in purchasing the unit on behalf of the association. The association's documents may require the Board to allocate specific funds in its

budget for this purpose or pass a special resolution authorizing the Board to purchase the property. In addition, the purchase may require a significant investment of association funds in not only purchasing the property, but also preparing it for sale or rent.

If a property is foreclosed and mortgage holder takes title to the property, the association and management need to “split” the account and begin billing the bank for any assessments that come due from the date of foreclosure. Unfortunately, the trustees who regularly conduct the foreclosure sales generally do not promptly record deeds reflecting the change in ownership of the foreclosed unit or lot. Obviously, this makes it difficult to ascertain the identity of the new owner or obtain its contact information. In many cases, the bank will neglect to pay the assessments as they come due, which will require the Association to record another lien against the property. Typically, the bank will look to make payment arrangements shortly before it sells the property, which means that months may pass before the account is paid. If the first trust is backed by the Department of Veteran’s Affairs or HUD, the process becomes even more difficult.

As you might imagine, there can be several layers of bureaucracy that must be navigated in order to simply inform the appropriate person of the association’s claim. If a property within your association has been foreclosed, the Board and management should pay particular attention to any requests for resale disclosure packages for the foreclosed unit or lot..

Financial experts predict that the number of foreclosures may increase before they begin to decline. While this region’s real estate market has proven over the years to be more stable than other areas of the country, associations should still take whatever precautions they can. If you have any questions regarding what your association can do to protect itself, please contact any one of our community association attorneys.