Community Collateral Damage: A Question of Priorities

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Today's soaring mortgage default rate and the uncertainty and delay associated with mortgage foreclosure proceedings threaten to cause financial tragedies of the commons in condominiums and homeowner associations across the country. Assessment defaults in privately governed communities result in an inequitable allocation of upkeep costs—a phenomenon that current law has failed to prevent. But the collateral damage caused by delayed foreclosures and insufficient recoveries can be minimized by increasing the payment priority of the association lien.

In a majority of states, association liens are completely subordinate to the first mortgage lien. At foreclosure of the mortgage lien, the junior priority assessment lien will be extinguished whether or not there are sufficient proceeds to reimburse for community charges. Assessment delinquencies grow over time, so the longer it takes to complete foreclosure, the greater the costs to the neighborhood. Although several states have adopted a limited lien priority for up to six months' worth of unpaid assessments, foreclosures today take far longer than six months, and the amount ultimately owed to a community can be significant and far exceed that cap. Federal housing policy affects the resolution of the issue because the Federal Housing Administration ("FHA"), Fannie Mae and Freddie Mac only permit qualifying mortgages to be subject to a six-month assessment lien priority. The decelerating pace of foreclosure further exacerbates the already unjustifiable financial impact borne by non-defaulting neighbors. The lien priority status quo fails to adequately protect communities in today's context of widespread, delayed foreclosures and

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under-collateralized mortgage loans. Decreasing the first mortgage lien's priority during a foreclosure delay would mitigate the harm.

Lien priority statutory changes could protect association finances in the future, and such provisions might be applied retroactively as well. In other contexts, states have held that changes to a lien priority regime could apply to existing associations and existing mortgages without unconstitutionally impairing contract or property rights. This has been particularly true where the association's lien was deemed to have been created on the date the community's organizational documents were recorded (prior to any unit's mortgage). Historically, bank lobbyists have opposed any enhanced assessment lien priority. However, supporting property upkeep and making assessments more predictable and collectible would actually benefit lenders by shoring up the value of their collateral. Moreover, increased certainty with respect to homeowner payment obligations would enable more responsible credit underwriting and contribute to economic recovery. Shoring up assessment lien priority would not only ensure a fair allocation of community costs, but also would help to contain the current housing market decline.

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INTRODUCTION

Culpable parties in today's housing crisis are legion,[1] but innocent bystanders are directly and tangibly harmed by the fallout. Nonpayment of upkeep charges by financially strapped owners forces guiltless neighbors to fund the community budget revenue gap. The problem is exacerbated by foreclosure delay, since a property conveyance would replace an insolvent owner with a solvent one. Whether a foreclosure delay results from mortgage lenders' strategic behavior[2] or from procedural missteps by servicers,[3] the result is the same—hard-working,

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1. Mortgage brokers pushed unrealistic loans. Steven Krystofiak, President, Mortgage Brokers Ass'n for Responsible Lending, Statement at the Federal Reserve (Aug. 1, 2006), *available at* http://www.federalreserve.gov/secrs/2006/august/20060801/op-1253/op-1253_3_1.pdf. Appraisers validated unrealistic prices. *See* Jonathan R. Laing, *The Bubble's New Home*, BARRON'S ONLINE (June 20, 2005), http://online.barrons.com/article/SB111905372884363176.html (discussing economist Robert Shiller's forecast of the housing market). Homeowners borrowed money they could not repay, and lenders lent funds while ignoring credit and market risks. Ben Steverman & David Bogoslaw, *The Financial Crisis Blame Game*, BLOOMBERG BUSINESSWEEK (Oct. 18, 2008, 12:01 AM), http://www.businessweek.com/investor/content/oct2008/pi20081017_950382.htm. Secondary market purchasers and investors overly relied on securitization, and regulators and credit rating agencies blessed the entire system in error, negligence, or both. *See, e.g.*, Carol Ann Frost, *Credit Rating Agencies in Capital Markets: A Review of Research Evidence on Selected Criticisms of the Agencies*, J. ACCT., AUDITING, & FIN. (forthcoming 2006), *available at* http://ssrn.com/abstract=941861 (analyzing the criticism of the credit rating agencies); John Patrick Hunt, *Credit Rating Agencies and the "Worldwide Credit Crisis": The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement*, 1 COLUM. BUS. L. REV. 109, 114 (2009) ("It is not plausible to argue that rating agencies have a valuable reputation for rating instruments they have never rated before."); Robert T. Miller, *Morals in a Market Bubble*, 35 U. DAYTON L. REV. 113, 136 (2009) ("Alan Greenspan and his colleagues on the Federal Open Market Committee made some mistakes in the early years of this decade by keeping interest rates very low for a very long time."); Randolph C. Thompson, *Mortgage Backed Securities, Wall Street, and the Making of a Global Financial Crisis*, 5 AM. U. BUS. L. BRIEF 51, 53 (2008) (providing an overview of the "misguided confidence in these debt instruments."); Jeff Madrick, *How We Were Ruined & What We Can Do*, N.Y. REV. OF BOOKS, Feb. 12, 2009, *available at* http://www.nybooks.com/articles/archives/2009/feb/12/how-we-were-ruined-what-we-can-do/ (providing an overview of the securitization and the financial crisis); Ronald Colombo, *A Crisis of Character*, HUFFINGTON POST (May 12, 2009, 4:58 PM), www.huffingtonpost.com/ronald-j-colombo/a-crisis-of-character_b_202562.html (lamenting the erosion of morals in the modern economy).

2. In a normal housing market, pushing foreclosures through quickly is in a lender's best interest. But in a depressed market, lenders have discovered that a foreclosure with a low prospect of a quick resale actually causes them to lose money. In 2009, lenders canceled up to 50% of foreclosure sales in some parts of the country, and many of these delays were inspired by the desire to avoid upkeep costs (maintenance, community assessments, and property taxes) while awaiting a market rebound. Todd Ruger, *Lenders' Latest Foreclosure Strategy: Waiting*, HERALD TRIB., July 12, 2009, at A1.

3. In early October 2010, three of the largest mortgage lenders in the United States—Bank of America, J.P. Morgan Chase, and Ally Financial—announced moratoriums in the twenty-three states that require court-ordered sales to foreclose on mortgages. This was in reaction to

financially responsible homeowners are forced to pay significant, additional amounts of money merely because of their neighbors' payment defaults, and in the many cases where foreclosure sale proceeds do not even cover the loan,[4] such amounts may never be recovered. The additional burden on the non-defaulting neighbors possibly forces such homeowners into their own financial distress. Allocating the cost of a delinquent owner's upkeep share to the paying neighbors is inefficient and unfair.[5] Furthermore, inequitable cost allocation will ultimately lead to additional owner defaults and further impairment of collateral value for every lender.

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increased judicial scrutiny of sloppy—or even fraudulent—servicer foreclosure procedures. *See* Ariana Eunjung Cha & Brady Dennis, *Judges Revisiting Foreclosure Cases May Help Owners but Clog Market*, WASH. POST, Oct. 5, 2010, at A9 (referencing a Florida case). Within a week of the initial announcements of these servicer-initiated moratoriums, Bank of America expanded its freeze on foreclosures nationwide, and attorneys general in all fifty states begun investigative probes into the extent of servicer misconduct in foreclosure procedures. *See* Ariana Eunjung Cha, Steven Mufson & Jia Lynn Yang, *Momentum Builds for Full Moratorium on Foreclosures*, WASH. POST, Oct. 9, 2010, at A11 (reporting that national civil rights groups had called for a government-mandated national moratorium on foreclosures); Jia Lynn Yang & Ariana Eunjung Cha, *Obama Vetoes Foreclosure Bill as Anger Grows*, WASH. POST, Oct. 8, 2010, at A1 (reporting that federal legislation intended to streamline foreclosure proceedings had been vetoed by President Obama, further lengthening the foreclosure process). While moratoriums have now been lifted, the concern that prompted them hangs over foreclosure proceedings, and the increased servicer scrutiny operates to lengthen the foreclosure timeline. *See* Carrie Bay, *Self-Evident Truth in Market Variables: Longer Foreclosure Timelines*, DSNNEWS.COM (Apr. 12, 2011), http://www.dsnews.com/articles/self-evident-truth-in-market-variables-longer-foreclosure-timelines-2011-04-12 (stating that the time period from default to foreclosure continues to increase across the country).

4. According to the Rasmussen Report, 31% of U.S. homeowners with a mortgage owed more on their homes than their homes were worth at the end of 2010. Peter Schroeder, *Poll: Nearly One-Third of Homeowners Underwater on Mortgage*, THE HILL (Mar. 21, 2011, 1:29 PM), http://thehill.com/blogs/on-the-money/801-economy/151039-poll-nearly-one-third-of-homeowners-underwater-on-mortgages. Deutsche Bank predicts that 48% of American homes could have negative equity by the end of 2011. Mortimer B. Zuckerman, *Housing Crisis Represents the Greatest Threat to Recovery*, U.S. NEWS & WORLD REP. (Jan. 27, 2011), http://www.usnews.com/opinion/mzuckerman/articles/2011/01/27/housing-crisis-represents-the-greatest-threat-to-the-recovery.

5. The concept that an unfair enjoyment of benefits by parties not bearing associated costs (free-riding) is inequitable and "wrong" was articulated by H.L.A. Hart in 1955 and was termed the "principle of fairness." H.L.A. Hart, *Are There Any Natural Rights?*, 64 PHIL. REV. 175, 185–86 (1955). This concept has been favorably cited by John Rawls. JOHN RAWLS, A THEORY OF JUSTICE 96 (rev. ed. 1971). Fair allocation of cost demands that all beneficiaries of a cooperative enterprise bear pro rata responsibility for the costs of such enterprise. This formulation of fair allocation is well-suited to the case of upkeep expenses of a common interest community such as a homeowner association or condominium. Unfair cost allocation in communities creates neighborhood contention and lowers quality of life for members of an association. Michelle Conlin & Tamara Lush, *Neighbor vs. Neighbor as Homeowner Fights Get Ugly*, ASSOCIATED PRESS, July 10, 2011, *available at* http://finance.yahoo.com/news/Neighbor-vs-neighbor-as-apf-2524543580.html?x=0.

Today, defaulting neighbors cause millions of blameless homeowners around the country to face such inequitable and unexpected financial burdens.[6] An increasing number of new developments nationwide have adopted a private governance model.[7] Approximately 62,000,000 people in the United States (20% of the country's population) live in one of the 309,600 privately governed common interest communities ("CICs").[8] Nationally, home loan delinquency rates are now between 10% and 13% of all mortgages.[9] Mortgage defaults are concentrated in certain geographic areas, however, so the mortgage delinquency rate in

6. Numerous media accounts have highlighted the stories of suffering by such non-delinquent neighbors. *See, e.g.*, Christine Dunn, *'Nightmare' Condo Fees After Foreclosure*, PROVIDENCE J., July 6, 2008, at G1 (discussing a Rhode Island foreclosure); Christine Haughney, *Collateral Foreclosure Damage*, N.Y. TIMES, May 15, 2008, at C1 (examining the plight of a Miami woman); Sarah Ryley, *New Manhattan Condos See Rise in Foreclosures*, THEREALDEAL.COM (Mar. 8, 2010, 11:00 AM), http://therealdeal.com/newyork/articles/new-manhattan-condos-see-rise-in-foreclosures--2 (reporting on New York foreclosures); David Sutta, *Condos Demanding Foreclosure On Abandoned Units*, MFI-MIAMI (Apr. 28, 2010), http://www.mfi-miami.com/2010/04/condos-demanding-foreclosure-on-abandoned-units/ (discussing the predicament of a Florida woman).

7. More than 80% of newly built homes across the country are in a CIC. Conlin & Lush, *supra* note 5. The prevalence of condominiums increased markedly over the decade ending in 2005. However, since the housing crisis began, the percentage of occupied housing stock within a condominium has notably declined. *See* JENNIFER COMNEY, CHRIS NARDUCI & PETER TATIAN, URBAN INST., STATE OF WASHINGTON, D.C.'S NEIGHBORHOOD 2010 26–29 (Nov. 2010) (showing how Washington, D.C.'s housing stock has followed the national trend).

8. "Common interest community" is defined by the Restatement (Third) of Property to be a "development or neighborhood in which individually owned lots or units are burdened by a servitude" that cannot be avoided by nonuse or withdrawal. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 6.2 (2000). Common interest communities include condominiums and homeowner associations—also known as planned unit developments ("P.U.D.s"). Data regarding the number of U.S. common interest communities and their residents is tracked by the Community Associations Institute ("CAI"). *Industry Data*, CMTY. ASS'NS INST., http://www.caionline.org/info/research/Pages/default.aspx (last visited Aug. 16, 2011) [hereinafter CAI Industry Data]. CAI's data indicate that the number of residents of common interest communities has increased from 2.1 million in 1970 to 62.0 million in 2010. This figure represents 20.2% of the population of the United States, estimated by the U.S. Census Bureau to be 307 million in 2009. *Population Finder*, U.S. CENSUS BUREAU, http://factfinder.census.gov/servlet/SAFFPopulation (last visited Aug. 16, 2011).

9. Based on figures provided by Lender Processing Services, as reported at PR Newswire, Press Release, Lending Process Services, Inc., LPS September 'First Look' Mortgage Report: August Month-End Data Shows More Delinquent Loans Entering Foreclosure Process (Sept. 15, 2010*), available at* www.reuters.com/article/idUS224331+15-Sep-2010+PRN20100915. Another article reporting these figures calculates that this rate indicates more than 7.2 million mortgage loans are behind on their payments. Carrie Bay, *Residential Mortgage Delinquency Rate Surpasses 10%: LPS*, DSNEWS.COM (Feb. 4, 2010), http://www.dsnews.com/articles/mortgage-delinquency-rate-surpasses-10-lps-2010-02-04. The foreclosure rate is ten times pre-crisis levels, and the aggregate number of foreclosure sales in one month (around 100,000 nationwide) is now similar to the number of pre-crisis foreclosure sales for an entire year. Alex Viega, *Foreclosure Rate: Americans on Pace for 1 Million Foreclosures in 2010*, HUFFINGTON POST (July 15, 2010, 5:07 PM), http://www.huffingtonpost.com/2010/07/15/foreclosure-rate-american_n_647130.html.

those areas is much higher.[10] The states with recent growth booms are the ones dealing with the steepest mortgage default rate.[11] Notably, these states also have the highest percentage of citizens residing in privately governed CICs.[12] People who have stopped paying their mortgages have, almost invariably, previously stopped paying their community association assessments.[13] The precipitous rise in mortgage

10. *See* Shayna M. Olesiuk & Kathy R. Kalser, *The 2009 Economic Landscape, The Sand States: Anatomy of a Perfect Housing-Market Storm*, 3 FDIC Q., no. 3, 2009 at 26, *available at* http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_1/Quarterly_Vol3No1_entire_issue_FINAL.pdf (discussing the acute nature of the housing downturn in Arizona, California, Nevada, and Florida); *see also* Dina ElBoghdady, *Foreclosure Activity Rises in Most Major Metropolitan Areas*, WASH. POST, July 30, 2010, at A14 ("The 20 regions with the worst foreclosure rates were in the four states—Florida, California, Nevada and Arizona."); Brad Heath, *Most Foreclosures Pack into Few Counties*, USA TODAY (Mar. 6, 2009, 7:13 PM), http://www.usatoday.com/money/economy/housing/2009-03-05-foreclosure_N.htm (explaining that properties concentrated in a mere thirty-five counties accounted for half of the country's foreclosure actions, and eight counties in Arizona, California, Florida, and Nevada were the source of a quarter of the nation's foreclosures in 2008). As of July 2010, 1 in 200 households in California were in foreclosure; 1 in 171 households in Florida were in foreclosure; 1 in 167 households in Arizona were in foreclosure; and 1 in 82 households in Nevada were in foreclosure. *States with Highest Foreclosure Rates*, CNBC.COM, http://www.cnbc.com/id/29655038/States_with_the_Highest_Foreclosure_Rates (last visited Aug. 16, 2011) (citing data from RealtyTrac's U.S. Foreclosure Market Report).

11. In the last decade, many cities in Arizona, California, Florida, and Nevada have experienced both a double-digit rise in prices as well as a double-digit decline in prices. *See House Price Index*, FED. HOUS. FIN. AGENCY, http://www.fhfa.gov/Default.aspx?Page=87 (last visited Aug. 16, 2011) (providing an index of housing transactions by state); S&P/CASE-SHILLER, HOME PRICE INDICES 2009, A YEAR IN REVIEW 5 (Jan. 2010), *available at* http://www.standardandpoors.com/ (follow "S&P/Case-Shiller Home Price Indices" hyperlink; then follow "S&P/Case-Shiller Home Price Indices: 2009 A Year In Review" hyperlink) (reporting on 2009). Conversely, cities such as Boston, Charlotte, Cleveland, Dallas, and Denver never experienced double-digit price rises nor have they experienced double-digit declines. *See* Heath, *supra* note 10 (explaining that in some parts of the country, "the foreclosure wave was barely a ripple").

12. For example, an estimated 25% or more of Californians reside in a condominium or homeowner association. *See* Carol Lloyd, *Condominium Homeowners Face Rising Condo Fees and Special Assessments*, SFGATE.COM (Aug. 3, 2007), http://articles.sfgate.com/2007-08-03/entertainment/17255445_1_affordable-housing-new-homeownership-inclusionary (reporting on increases in special assessments). Tomas Musil, director of the Shenehon Center for Real Estate at the Opus College of Business at the University of St. Thomas in St. Paul, Minnesota, explains that while "the problem is national in scope, it is more pronounced in Florida, California, Texas, and Colorado," where CIC developments were more popular. Tom Bayles, *After Foreclosure, It's Time for Neighbors to Pay*, HERALD TRIB. (Sept. 23, 2008, 1:26 AM), http://www.heraldtribune.com/article/20080923/ARTICLE/809230372/2055/NEWS?Title=When_foreclosure_is_finished__it_s_time_for_neighbors_to_pay (quoting Musil). The Policy Institute of California asserts that 38% of the housing units in California's "Inland Empire" exist in homeowner association communities. Jim Wasserman, *HOAs Struggle with Gotchas*, ASSOCIATED PRESS, http://www.calhomelaw.org/doc.asp?id=463 (last visited Aug. 16, 2011). Wasserman also points out that more than half of the nation's CIC housing is in five states (California, Florida, Texas, Arizona, and Nevada). Jim Wasserman, *California Eyes HOA Changes*, ASSOCIATED PRESS, (July 8, 2004), *available at* http://www.democraticunderground.com/discuss/duboard.php?az=view_all&address=141x2045calhomelaw.org/doc.asp?id=646.

13. Trevor G. Pinkerton, *Escaping the Death Spiral of Dues and Debt: Bankruptcy and*

default rates therefore indicates an even steeper rise in assessment delinquencies, which will continue until solvent owners replace delinquent owners.[14]

All types of CICs, from high-rise residential condominiums to multiple-zip-code single-home developments, share the same essential service and payment structure: homeowner-elected directors manage common upkeep, and all homeowners contribute their pro rata portion of the common costs.[15] The CIC structure enables more community amenities and upkeep, permitting neighborhoods to self-fund and allowing local governments to avoid raising taxes in response to more housing developments.[16]

Owners in condominiums and homeowner associations expect to be financially independent of their neighbors.[17] Architects of CIC-enabling legislation did not intend to create financial co-dependence nor cause significant financial entanglement because default in a well-functioning market would lead expeditiously to foreclosure and title transfer to a successive solvent homeowner. If a credit-worthy party quickly takes over a defaulting owner's share of upkeep obligations and begins to pay allocated assessments, the community would suffer only limited financial loss due to a member's mortgage default. But it often does not work that way in today's market. Now, contrary to original

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Condominium Association Debtors, 26 EMORY BANKR. DEV. J. 125, 142–43 (2009); Monica Hatcher, *Mediators Foresee Gloom, Doom in Condo Industry*, MIAMI HERALD, Jan. 4, 2009, at 1H; Press Release, PR.com, Concerned Homeowners Association Members Coalition Forms (Feb. 18, 2011), *available at* http://www.pr.com/press-release/299084; Donna Gehrke-White, *Homeowner Associations Step Up Foreclosure Filings*, MIAMI HERALD (Feb. 20, 2011), http://www.miamiherald.com/2011/02/20/2062656/homeowner-associations-step-up.html; Daniel Vasquez, *Should Delinquent Condo Owners Lose Internet, TV Service?*, SUN SENTINEL, Mar. 1, 2011, http://articles.sun-sentinel.com/2011-03-01/business/fl-cable-tv-condocol-20110301_1_delinquent-condo-owners-associations-maintenance-fees.

14. *See infra* notes 80–84 and accompanying text (illustrating that because assessments are the primary source of funding for community associations, delinquent payments usually cause increases in the assessments of all other homeowners to offset this financial imbalance).

15. *See* WAYNE S. HYATT & SUSAN F. FRENCH, COMMUNITY ASSOCIATION LAW: CASES AND MATERIALS ON COMMON INTEREST COMMUNITIES 11 (2d ed. 2008) (discussing the power of an elected board of directors); WAYNE S. HYATT, CONDOMINIUM AND HOMEOWNER ASSOCIATION PRACTICE: COMMUNITY ASSOCIATION LAW 105, 121 (3d ed. 2000) (discussing assessments and other collection devices).

16. *See generally* CLIFFORD TREESE, ROBERT DIAMOND & KATHERINE ROSENBERRY, RESEARCH INST. FOR HOUS. AM., CHANGING PERSPECTIVES ON COMMUNITY ASSOCIATION MORTGAGE UNDERWRITING AND CREDIT ANALYSIS 3 (Nov. 2001), *available at* http://www.housingamerica.org/RIHA/RIHA/Publications/48502_ChangingPerspectivesonCommunityAssociationMortgageUnderwriting.pdf (discussing methods that communities utilize to minimize taxes); CAI Industry Data, *supra* note 8 (indicating the number of residents of common interest communities).

17. *See infra* notes 97–100 and accompanying text (discussing the negative aspects of economic entanglement).

intent and expectations, foreclosure is slow in coming and sometimes deliberately or negligently delayed, and community assessments can accrue and remain unpaid for months or years.[18] Furthermore, the sheer number of owners who are currently in default on their payment obligations—some ten times higher than pre-crisis—means that an association could be suffering from widespread assessment delinquency, both increasing its budgetary shortfall and decreasing the number of owners shouldering the burden of bridging that gap.[19] Paying additional upkeep costs harms homeowners. Furthermore, uncertainty in association funding threatens the viability of the community itself.

In the context of today's lengthy mortgage foreclosure timelines, neighbors in CICs have become truly financially interdependent, and the failure of some owners to pay their fair share of common costs requires a greater financial contribution by the others.[20] During the months or years that mortgage foreclosure on a unit is threatened or pending, the association still must pay for upkeep, utilities and necessary repairs; its only source of revenue is increased assessment payments by those owners who are still able to pay.[21] Increased assessments, triggered by chronic non-payments, essentially result in forced inter-neighbor loans. Because foreclosure of the first mortgage wipes away the association's junior lien for assessments,[22] these forced loans typically end up being forced inter-neighbor permanent subsidies.

Requiring owners to pay their neighbors' debts is wrong, inefficient, and destabilizing for the hundreds of thousands of CICs in the United

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18. Shuang Zhu & R. Kelley Pace, The Influence of Foreclosure Delays on Borrower's Default Behavior 3 (Apr. 19, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=1717127; *see also* Brent Ambrose, Richard Buttimer, Jr. & Charles Capone, *Pricing Mortgage Default and Foreclosure Delay*, 29 J. OF MONEY, CREDIT & BANKING 314, 319–20 (1997) (providing an overview of foreclosure delay).

19. RealtyTrac's Year-End 2010 U.S. Foreclosure Market Report shows a total of 3,825,637 foreclosure filings (including default notices, scheduled auctions, and bank repossessions) reported on a record 2,871,891 U.S. properties in 2010, an increase of nearly 2% from 2009 and an increase of 23% from 2008. Press Release, RealtyTrac, Record 2.9 Million U.S. Properties Receive Foreclosure Filings in 2010 Despite 30-Month Low in December (Jan. 12, 2011), *available at* http://www.realtytrac.com/content/press-releases/2010-year-end-foreclosure-report-6309. The report also shows that nearly 2.23% of all U.S. housing units (1 in 45) received at least one foreclosure filing during the year, up from 2.21% in 2009, 1.84% in 2008, 1.03% in 2007, and 0.58% in 2006. *Id.* Today, at least 8 million Americans are behind on their mortgage payments, and the threat of further housing price decline (the so-called "double dip") has been called the "greatest strategic threat to the recovery of the economy." Zuckerman, *supra* note 4.

20. *See infra* Part I.B.2 (discussing the communal burden of assessment default in a CIC).

21. *See infra* notes 80–84 and accompanying text (discussing the importance of assessment payments to meet an association's budgetary needs).

22. *See infra* notes 187–97 and accompanying text (explaining the treatment of an assessment lien during first mortgage foreclosure).

States and the millions of homeowners who live in them.[23] The current system forces people who completely lacked the ability to foresee, control, or avoid their neighbors' defaults to bear increasing costs due to irresponsible mortgage lending. These same owners end up effectively subsidizing their neighbors' mortgage lenders whose collateral they pay to maintain, insure, and protect through association expenditures. Current laws fail to protect innocent, non-defaulting owners from being forced to provide their own private mortgage lender and neighbor bailouts. These bailouts are not ultimately reimbursed by the federal government or paid back by the home's foreclosing lender or foreclosure buyer. If neighbors refuse to privately fund deficiencies, lack of association funding for maintenance, insurance, and management of common property will eventually lead to a deterioration of the housing stock.[24]

Several states have responded to the dual problem of under-funded associations and inequitable cost allocation by providing for a capped amount of assessment deficiency (typically six months of unpaid assessments) to be repaid at or after foreclosure of the first mortgage on defaulting homes.[25] Often, this is not enough. Such limited obligations fail to adequately protect associations and their paying members from the costs of neighbor delinquency, in terms of both short-term uncertainty and ultimate association recoveries.[26] Changing the lien priority regime—to allow the first mortgagee's priority to decrease as foreclosure is delayed—is a better solution. Freeing post-foreclosure assessment claims from a dollar-capped limit would permit an association to ultimately recover the lenders' share of upkeep costs.

Decreasing a lender's priority based on the interval between mortgage default and foreclosure would likely incentivize more expeditious foreclosure sales. At first glance, this seems to run against conventional wisdom and current politics. Although lenders could choose to delay foreclosure and pay collateral carrying costs, increased lender costs pre-foreclosure could lead to faster foreclosures and faster home loss for defaulting borrowers. Even so, making lenders bear the costs of maintaining their collateral and encouraging transfer of title to

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23. Hart, *supra* note 5, at 185–86; CAI Industry Data, *supra* note 8; *see also infra* Parts I.B & II.B.1 (illustrating how assesement deliquencies can lead to housing devaluation).

24. For example, one Florida CIC was a "dreamy little spot" with affordable amenities before the foreclosure crisis and before "the rats started chewing through the toilet seats in vacant units and sewage started seeping from the ceiling." Conlin & Lush, *supra* note 5; *see also infra* Parts I.B.2–3 (discussing how some states have adopted the Uniform Common Interest Ownership Act, which gives assessment liens a limited priority upon foreclosure).

25. *See infra* Part II.A.1.a (describing the six-month limited priority lien).

26. *See infra* Part II.A.1.d (discussing the inadequacy of limited priority liens).

solvent owners is the only way to contain a community's financial distress.[27] Whether foreclosure delays are caused by default volume, inadequate lender documentation, faulty procedure, predictions regarding resale, or the lender's desire to retain the defaulted loans as performing on the balance sheet, equity demands that the procrastination costs be allocated to the mortgagee rather than to the community as a whole. Lender funding of the upkeep of their own collateral avoids unjust enrichment and places costs on the parties who could have reasonably foreseen and prevented the assessment delinquencies in the first place—the lenders who should have been underwriting their potential borrowers.[28] Creating a legal means for ultimate recovery and reimbursement of neighbor-funded budget deficiencies will shore up the finances of communities and non-defaulting homeowners and help stabilize the housing market.

Part I of this Article explains the negative externalities of foreclosures and defaults in the context of CICs, as well as the limited remedies currently available to community associations under disparate state statutes. Part II.A discusses some attempted and proposed solutions to the problem of assessment nonpayment and foreclosure delay, including judicial attempts to resolve the issue through application of equity and legislative efforts to increase limited lien priority coverage. Finally, Part II.B advocates a more nuanced and targeted approach to solving the problem: capping the community's losses by allowing the first mortgage lien's priority to gradually erode during the assessment default period.

While foreclosure procedure must be closely monitored and stringently followed to protect mortgage borrowers, promoting foreclosure sales within such procedural limits helps combat negative externalities created by defaulting community members. Laws that incentivize prompt, procedurally perfect foreclosures and allow for open-ended assessment lien priority would ultimately benefit homeowners, communities, and mortgage lenders. Systematic erosion

27. *See infra* Part II.B.2 (explaing how a community stands to benefit from an expedited foreclosure process). Furthermore, foreclosure delays result in a "free ride" for mortgagors and their lenders during the time that assessment obligations are not paid on behalf of the defaulted property. *See* Hart, *supra* note 5, at 182 (articulating the idea of "moral property"). While public policy might justify giving defaulting homeowners reasonable time to relocate, economically and philosophically, there is no justification for substantial foreclosure delays that create "collateral damage" on the surrounding community, due to upkeep costs being allocated inequitably. There is no equitable reason to give either cost-free occupancy to borrowers or cost-free collateral preservation to their lenders. In fact, the very definition of "fair allocation" would demand otherwise. *See* RAWLS, *supra* note 5, at 96 (articulating moral principles).

28. *See infra* notes 378–79 and accompanying text (discussing why shifting the financial burden to the lender would be beneficial to individuals and the economy as a whole).

of mortgage priority during foreclosure delay promotes equitable allocation of upkeep costs and efficient property transfers, and keeps lenders from getting a free ride. Compared to other potential solutions, first mortgage lien priority erosion is the best way to remedy the inequitable and community-destabilizing status quo.

I. THE PROBLEM OF PRIVATE GOVERNANCE AND MEMBER DEFAULTS

A. Negative Externalities of Default

A property owner's failure to meet assessment payment obligations creates significant negative externalities.[29] Widespread payment defaults destabilize communities, depress property values, lower local property tax revenue, and impose additional costs on public agencies that provide municipal services.[30] Although the problem of contagious declines in property values and neighborhood upkeep is often couched in terms of the spillover effect of foreclosures,[31] the most significant external harm arises not from the foreclosure sale itself, but from the default in homeowner payment obligations that preceded it.[32] Below-market foreclosure sales may temporarily reduce real estate market pricing of real estate in the immediate vicinity of the foreclosed parcel.[33] But the adverse neighborhood effect of a property in limbo (foreclosure is pending while upkeep is lacking) is both more tangible and longer-lasting.[34] The true risk of contagion, therefore, comes from default and delay rather than from the ultimate property transfer.

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29. *See, e.g.*, ALLAN MALLACH, BROOKINGS INST., METRO. POL'Y PROGRAM, ADDRESSING OHIO'S FORECLOSURE CRISIS: TAKING THE NEXT STEPS 35 (June 2009), *available at* http://www2.safeguardproperties.com/pub/Alan_Mallach.pdf (reporting on the consequences of Ohio foreclosures).

30. *See* City of Cleveland v. Ameriquest Mortg. Sec., Inc., 621 F. Supp. 2d 513, 536 (N.D. Ohio 2009) (involving a lawsuit brought by the City of Cleveland against several lending institutions), *aff'd en banc*, 615 F.3d 496 (6th Cir. 2010), *cert. denied*, 131 S. Ct. 1685 (2011); *see also* JOINT CTR. FOR HOUS. STUDIES HARV. U., AMERICA'S RENTAL HOUSING: THE KEY TO A BALANCED NATIONAL POLICY 3 (2008), *available at* http://www.jchs.harvard.edu/publications/rental/rh08_americas_rental_housing/rh08_americas_rental_housing.pdf (describing the destabilization of certain communities).

31. In a May 5, 2008 speech, for example, Chairman of the Federal Reserve Ben Bernanke warned that "high rates of delinquency and foreclosure can have substantial spillover effects on the housing market, the financial markets, and the broader economy." Ben S. Bernanke, Chairman, Fed. Reserve, Speech at Columbia Business School 32nd Annual Dinner (May 5, 2008) (transcript available at http://www.federalreserve.gov/newsevents/speech/Bernanke20080505a.htm).

32. *See infra* Part I.A.2 (discussing constructive abandonment).

33. *See infra* notes 38–39 and accompanying text.

34. *See infra* Part II.A.2 (describing the effects of a prolonged foreclosure).

1. Lower Comparable Sales Valuation

In general, property sells at foreclosure for a significant amount below an arm's-length market transaction.[35] Because the market traditionally prices homes based on comparable sales within the same community, any below-market sale creates a drag on neighboring values and sale prices.[36] In addition, mortgage default and foreclosure increases the supply of homes for sale in the given neighborhood, and increasing supply with static demand lowers market prices as well. Research published by Fannie Mae in 2006, focusing on the effect of subprime foreclosures, estimated that 41 million properties in the United States faced declining property values due to foreclosure of nearby parcels, resulting in an aggregate loss of $200 billion in value.[37] The study found that homes within one-eighth of a mile of a foreclosed property experience a 0.9% decline in value after the foreclosure sale.[38] More recent empirical studies have questioned this figure—particularly in terms of the geographic scope and duration of the foreclosure effect—arguing that the depreciation is closer to 0.5%, can quickly rebound, and that the farther away a "good standing" home resides from a foreclosed home, the smaller the psychological and market pricing impact of the foreclosure sale.[39]

Interestingly, while neighboring homeowners may decry falling property values, the downward price pressure of foreclosure sales may actually help rather than hurt the housing market as a whole. Housing prices in this country are likely still inflated above market

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35. *See* John Y. Campbell, Stefano Giglio & Parag Pathak, *Forced Sales and House Prices* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 14866, 2009), *available at* http://econ-www.mit.edu/files/3914 (showing that foreclosure sales prices averaged 27% lower than the appraised value for the home). The depressed purchase price at foreclosure, however, is almost never cause to avoid the sale. *See, e.g.*, B.F.P. v. Resolution Trust, 511 U.S. 531, 545 (1994) ("We deem, as the law has always deemed, that a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with.").

36. *See* John Harding, Eric Rosenblatt & Vincent Yao, *The Contagion Effect of Foreclosed Properties*, 66 J. URB. ECON. 164, 172 (2009) (providing statistics). For a description of comparative sales methodology, see James Kimmons, *The Sales Comparison Method of Real Estate Appraisal and Valuation*, ABOUT.COM, http://realestate.about.com/od/appraisaland valuation/p/compare_method.htm (last visited Aug. 16, 2011) (discussing factors to consider in comparing properties).

37. Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single Family Mortgage Foreclosures on Property Values*, 17 HOUS. POL'Y DEBATE 57, 57 (2006).

38. *Id.*; *see also Chart of the Day: Foreclosure Contagion*, PORTFOLIO.COM (Jul. 18, 2008, 12:00 AM), http://www.portfolio.com/views/blogs/odd-numbers/2008/07/18/chart-of-the-day-foreclosure-contagion/#ixzz10I33 (discussing the effects of foreclosure on neighboring property values).

39. Harding et al., *supra* note 36, at 164–65.

"equilibrium"—meaning that the ratio of a home's value based on rental income is well below the comparable sale value of a given home.[40] Even though rents have gone up and prices have gone down, in many cases rents still cannot cover purchase-money mortgage payments, suggesting that real property prices have not yet decreased sufficiently to reach a stable, rent-neutral level.[41] There is, therefore, a systemic (market stability-based) upside to this particular aspect of foreclosure "contagion."

2. Constructive Abandonment

Comparable sales values of homes are notoriously finicky and fragile, and the foreclosure-related value losses likely represent unsustainable prior gains due to housing speculation.[42] Far more long-lasting and tangible costs arise from homeowners defaulting on their property upkeep obligations. Our system of homeownership involves both rights and responsibilities of homeowners,[43] and when owners abandon their homes, either literally, by ceasing to reside there, or figuratively, by ceasing to maintain the property, the community suffers tangible and permanent losses in value,[44] homes and neighborhoods deteriorate, and

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40. *See* Suzanne Stewart & Ike Brannon, *A Collapsing Housing Bubble?*, 29 REG. 15, 16 (2006) ("A reading well below or above 100 indicates a market that is out of equilibrium: if the reading is below 100, renting is a bargain."). In 2005, the average rental value of homes was only 70% of the purchase price nationwide and was the lowest since the Office of Federal Housing Enterprise Oversight ("OFHEO") began the index in 1985—with the next-lowest annual ratio (1989) being roughly 91%. *Id.* The rental-sale price disequilibrium was far more pronounced in certain areas of the country, such as California, Nevada, Arizona, and Florida, where home prices in the prior decade had increased by over 99%. *See* OLESIUK & KALSER, *supra* note 10 (providing statistics); s*ee also* Anthony Sanders, *The Subprime Crisis and its Role in the Financial Crisis*, 17 J. HOUS. ECON. 254, 254 (2008) (providing statistics).

41. *See, e.g.*, Emma L. Carew, *To Woo A Renter: Homeowners Who Punt on Selling Face Challenge as Tenants Get Choosier*, WASH. POST, Aug. 15, 2009, at E1 (providing an example from the Washington, D.C. area); *see also* Stewart & Brannon, *supra* note 40, at 16.

42. *See* Andrea J. Boyack, *Lessons in Price Stability from the U.S. Real Estate Market Collapse*, 2010 MICH. ST. L. REV. 925, 933–34 (2010) (discussing speculation and overpricing).

43. Owners of real property are obligated to pay property taxes, are required to protect against hazards and nuisance on their properties, and face liabilities related to environmental hazards thereon. Real property cannot be abandoned. *See* RESTATEMENT (FIRST) OF PROP. § 504 cmt. a (1944) (explaining why easements may be abandoned more easily than other land interests); *see also, e.g.*, Pocono Springs Civic Ass'n v. MacKenzie, 667 A.2d 233, 235 (Pa. Super. Ct. 1995) (discussing the law of abandonment in Pennsylvania). Property law requires that some entity always hold seisin, because the holder of seisin is the gatekeeper, or responsible party, with respect to that parcel of realty. *See* THOMAS W. MERRILL & HENRY E. SMITH, PROPERTY: PRINCIPLES AND POLICIES 201 (2007) (discussing the role of gatekeeper as it relates to adverse possession).

44. *See* Ivana Kottasova, *A House Dies and a Block Sinks*, BROOK. INK (Mar. 9, 2011), http://thebrooklynink.com/2011/03/09/23899-a-house-dies-and-a-block-sinks/ ("Vacant properties are often not maintained properly and show signs of physical distress . . . . That itself causes property values to go down—and then the area becomes less attractive for residents." (quoting Josiah

the absence of a vigilant gatekeeper for the property allows vandalism and other crime to increase.[45] A defaulting homeowner facing imminent or even eventual mortgage foreclosure has little incentive to invest anything in the home and, thus, will forego many socially desirable activities: painting shutters, cleaning gutters, mowing the lawn, or fixing broken appliances or cabinets.[46]

The mere drop in home value itself can start the trend toward owner constructive abandonment because once a property is "upside-down" or "underwater" (more is owed on a mortgage loan than the property is worth), any improvements or maintenance made on a home effectively becomes "sweat debt" (value created for the lender) rather than "sweat equity" (value created for the owner). Some commentators have suggested that a typical borrower will consider walking away from a mortgage when the home value falls below 75% of the amount owed on the mortgage.[47] More than 5 million homeowners in the United States

Madar)). The negative externalities caused by failure of an owner to exercise adequate property oversight are among the many justifications for the doctrine of adverse possession. *See* John G. Sprankling, *An Environmental Critique of Adverse Possession*, 79 CORNELL L. REV. 816, 816 (1994) (advocating an environmental reform of the adverse possession doctrine).

45. *See, e.g.*, John Cutts, *Neighborhood Cleanup Might Improve Cheap Houses for Sale Numbers*, REAL ESTATE PRO ARTICLES (July 7, 2010, 10:15 AM), http://www.realestate proarticles.com/Art/19024/278/Neighborhood-Cleanup-Might-Improve-Cheap-Houses-for-Sale-Numbers.html (discussing foreclosures in San Antonio); Seth Slabaugh, *High Vacancy Rates in Inner-City Muncie*, STAR PRESS (Feb. 26, 2011), http://pqasb.pqarchiver.com/thestarpress/ access/2276988201.html?FMT=ABS&FMTS=ABS:FT&date=Feb+26%2C+2011 (reporting on the numerous vacancies in Muncie, Indiana); Yepoka Yeebo, *Coping With Chicago's Foreclosure 'War Zones,'* HUFFINGTONPOST.COM (Mar. 2, 2011, 9:49 AM), http://www.huffingtonpost.com/2011/03/02/chicago-vacant-reo-property_n_829343.html (lamenting vacancies in Chicago).

46. *See* Steve Vitali, *HOA's are Important to Our Valley Communities*, LAS VEGAS REV. J. (Mar. 12, 2011), http://www.lvrj.com/real_estate/hoas-are-important-to-our-valley-communities-117848853.html?ref=853 (describing efforts by the Nevada legislature); Tammy Leonard, Home Appreciation, Default Risk and Neighborhood Upkeep 3 (June 10, 2009) (unpublished manuscript), *available at* http://www.utdallas.edu/~murdoch/NeighborhoodChange/Tammy/ Appreciation_Default_Upkeep_v11.pdf (examining the relationship between houshold maintenance expenditures and default risk). Some homeowners who have defaulted on their mortgages and know that they will ultimately lose their home in foreclosure affirmatively and permissively create waste—some homeowners rip out fixtures and actively destroy improvements on the real property. *See Report: Owners of Foreclosed Homes Steal Appliances, Leave Houses in Disarray*, FOXNEWS.COM (Feb. 4, 2009), http://www.foxnews.com/story/0,2933,487884,00 .html (reporting that some homeowners retaliate against lenders by damaging and looting their homes prior to foreclosure sales); James Thorner, *In home foreclosure, if it's not nailed down…*, ST. PETERSBURG TIMES (Feb. 19, 2008), http://www.sptimes.com/2008/02/19/Business/In_home _foreclosure__.shtml (reporting that, in Florida, 20% of owners strip their houses prior to foreclosure); James Walsh, *Monsey, NY—House Demolished Just Before Auction for Mortgage Default*, VOS IZ NEIAS? (Feb. 4, 2009, 8:41 AM), http://www.vosizneias.com/26875/2009/02/04/ monsey-ny-house-demolished-just-before-auction-for-mortgage-default/ (reporting a situation where homeowners destroyed their entire house before a foreclosure sale).

47. David Streitfeld, *No Aid or Rebound in Sight: More Homeowners Just Walk Away*, N.Y.

reached this "tipping point" of underwater valuation by the third quarter of 2009.[48]

According to the Rassmussen Report, 31% of U.S. homeowners with a mortgage owed more on their homes than their homes were worth as of the end of 2010.[49] Deutsche Bank predicted that 48% of American homes could have negative equity by the end of 2011.[50] Along with the numerous defaults on home mortgages caused by the inability to pay, more and more borrowers who are financially able to pay are strategically defaulting on their mortgages.[51] When the lender holds 100% (or more) of the current value of a home, many homeowners feel that there is no financial incentive to continue to pay the mortgage or, for that matter, the community association assessments.[52]

3. Government Rescue Efforts

The negative externalities of homeowner constructive abandonment have been cited to justify policies and programs aimed at helping homeowners facing foreclosure.[53] Many of these programs create additional incentives for lenders to pursue loan modifications or permit

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TIMES, Feb. 3, 2010, at A1.

48. *Id.*; *see also* Thompson, *supra* note 1, at 55 ("Housing prices peaked in the United States in early 2005 and began declining in 2007. Foreclosures then increased in the United States at record levels throughout 2006, continuing throughout 2008."); *Negative Equity Report for Q3*, CALCULATED RISK (Nov. 24, 2009, 4:00 PM), http://www.calculatedriskblog.com/2009/11/negative-equity-report-for-q3.html ("Nearly 10.7 million, or 23 percent, of all residential properties with mortgages were in negative equity as of September, 2009.").

49. Peter Schroeder, *Poll: Nearly One-Third of Homeowners Underwater on Mortgage*, THE HILL (Mar. 21, 2011, 1:29 PM), http://thehill.com/blogs/on-the-money/801-economy/151039-poll-nearly-one-third-of-homeowners-underwater-on-mortgages. Previously, in the first quarter of 2010, Zillow.com had estimated that 23% of homes in the United States were worth less than mortgage loan amounts secured by the property. Brian Louis, *U.S. Mortgage Holders Owing More Than Homes Are Worth Rise to 23% of Total*, BLOOMBERG (May 10, 2010, 3:31 AM), http://www.bloomberg.com/news/2010-05-10/u-s-mortgage-holders-owing-more-than-homes-are-worth-rise-to-23-of-total.html.

50. Zuckerman, *supra* note 4.

51. *See* Gail Marks-Jarvis, *Ethics of Strategic Default are Really Hitting Home*, CHI. TRIB., Oct. 7, 2010, at 7.1 ("Morgan Stanley recently estimated that about 18 percent of defaults will be strategic.").

52. Underwater homeowners have no incentive to pay property taxes either, but counties are always first in line to collect unpaid tax amounts from foreclosure proceeds. There is no cap on the amount of unpaid property taxes that a county can collect from the purchase price at a foreclosure sale.

53. *See* CONGRESSIONAL OVERSIGHT PANEL, EVALUATING PROGRESS ON TARP FORECLOSURE MITIGATION PROGRAMS, APRIL OVERSIGHT REPORT (2010) [hereinafter APRIL OVERSIGHT REPORT] (discussing the Home Affordable Modification Program ("HAMP") and its successes and failures over the first year); *see also* David Streitfeld, *Program to Pay Homeowners to Sell at a Loss*, N.Y. TIMES, Mar. 7, 2010, at A1 (stating that the Obama Administration's latest program "will allow owners to sell for less than they owe and will give them a little cash to speed them on their way").

short sales in lieu of foreclosure.[54] To the extent that loan modifications create true incentives for owners to remain invested in their property by reassuming the gatekeeper role and paying upkeep costs and the like, such modifications would help eliminate the property value losses discussed above and should be promoted as sound policy. To the extent that short sales would streamline the process of replacing insolvent owners with financially capable "gatekeepers," short sale incentives would also benefit the community and deserve to be encouraged.[55] Unfortunately, however, these government efforts have mostly failed to create viable mortgages and ensure homes are held by owners able to meet their assessment obligations. Even with payment reductions and government assistance, more than three-quarters of the mortgage loans that were modified under the Home Affordable Modification Program ("HAMP") remained underwater in April 2010.[56] The initiative for expedited short sales likewise has been mostly unsuccessful.[57]

One obstacle to greater success through loan modifications and/or short sales is the problem of junior liens.[58] Not only do many financially imperiled homes today have subordinate liens from second mortgages and home equity lines, but the community association in any CIC will have a lien securing its rights to recover unpaid assessments.[59] Junior lienors, including community associations, can stymie modification plans by withholding consent to proposed changes to the senior loan.[60] A community association's board might lack the

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54. Short sales are tri-party agreements amongst a defaulting mortgage borrower, the mortgage lender, and a third-party purchaser, whereby the purchaser agrees to buy the property for less than the outstanding loan amount, and the lender agrees to accept payment of the buyer's purchase price in full satisfaction of the borrower's mortgage loan.

55. Streitfeld, *supra* note 53, at A1.

56. APRIL OVERSIGHT REPORT, *supra* note 53, at 39.

57. Andrew Jeffrey, *Housing Market: Foreclosure Relief Programs Under Fire*, MINYANVILLE (Mar. 14, 2011, 10:00 AM), http://www.minyanville.com/businessmarkets/articles/foreclosure-forelcosure-relief-program-homeowners-loan/3/14/2011/id/33322.

58. Loan modifications without junior lienor consent can result in a complete loss of priority for the senior lienholder. Short sales are made subject to all junior liens, if these are not paid off or voluntarily released, as part of the sale. *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 871–76 (5th ed. 2007) (discussing the relationship between junior and senior liens); s*ee also* Robert Kratovil & Raymond J. Werner, *Mortgage Extensions & Modifications*, 8 CREIGHTON L. REV. 595, 610 (1975) (stating that an original clause in the record granting the senior lienor the ability to increase the interest rate on the giving of any extension will not be sufficient for priority for that increased interest over junior lienors, due to prejudice).

59. Many properties in default have other junior lienors as well, including second purchase money mortgages or home equity lines of credit. In many, but not all, states, second mortgages are junior in priority to the association's lien.

60. Loan modifications occurring without the consent of junior lienors are vulnerable to priority loss should a court determine that the modification adversely impacts the secured position of the junior lienor. Many loan modifications, however, have been upheld as non-prejudicial to a

authority to engage in debt forgiveness with respect to delinquent assessments, since this effectively imposes more costs on the remainder of the community and violates the payment allocation provisions of the CIC's governing documents.[61] The argument that in a bad mortgage debt situation, both a borrower and a lender should compromise by giving up value (in terms of lost equity and lost loan proceeds) is compelling.[62] But no similar logic supports a claim that non-party neighbors should be forced to bear losses due to other people's poorly conceived loans. This is one reason the "Helping Families Save their Homes Act of 2009" was voted down in the U.S. Senate: the proposed law would have given bankruptcy judges the ability to mandate massive write-downs on unpaid assessment liens, essentially blocking the already limited ability of associations to collect delinquent assessments and continue to perform their essential functions.[63] If the government truly wants to encourage short sales or modifications in privately governed communities, it must ensure that the workout (a) ultimately stabilizes the community and (b) is not forcibly financed by the non-delinquent neighbors.

Government programs that encourage property to be efficiently conveyed to solvent and responsible owners ameliorate the harm caused

community association. *See, e.g.*, Dime Sav. Bank of N.Y., F.S.B. v. Levy, 615 N.Y.S.2d 218, 220 (Sup. Ct. 1994) (holding that a modification extending the first mortgage loan term remained a first priority lien, and short sales required cooperation of junior lienors (or full repayment of such obligations) to transfer unencumbered title to the proposed buyer).

61. *See* ROBERT G. NATELSON, LAW OF PROPERTY OWNERS ASSOCIATIONS 437 (1989) (discussing the impact of association conduct on the value individual condominium units); *see also* HYATT & FRENCH, *supra* note 15, at 319, 567–68 (stating that homemakers of a community generally rely on uniform enforcement of covenants that are in furtherance of the original developmental scheme).

62. This argument is often used to promote modifications and short sales. *See* David Benoit, *Bank Of America Begins Mortgage Principal Reduction Program in Arizona*, FOX BUS. (Mar. 2, 2011), http://www.foxbusiness.com/industries/2011/03/02/bank-america-begins-mortgage principal-reduction-program-arizona/ (discussing Arizona's program "using federal money to get Bank of America to lower the amount borrowers owe on their mortgages"); Dave Clarke, *U.S. Regulators Strike Deal on Mortgage Risk Rule*, REUTERS, Mar. 1, 2011, *available at* http://www.reuters.com/article/2011/03/01/financial-regulation-qrm-idUSN0113980220110301 (examining banking regulator's provision forcing services to modify loans if it would save the lenders and borrowers money); Abigail Field, *What the Mortgage Mess Settlement Proposal Really Means*, DAILY FIN. (Mar. 9, 2011, 12:20 AM), http://www.dailyfinance.com/story/credit/what-the-mortgage-mess-settlement-proposal-really-means/19872233/ ("Servicers have to show their math when announcing if a modification is denied."); David McLaughlin & Lorraine Woellert, *Attorney Generals Push for Loan Reductions, Seek Bank Accord*, BLOOMBERG (Mar. 8, 2011, 12:01 AM), http://www.bloomberg.com/news/2011-03-07/foreclosure-settlement-said-to-be-sought-by-states-u-s-within-two-months.html (discussing how state attorneys general are pushing for reduced balance settlements between lenders and borrowers).

63. H.R. 1106, 111th Cong. §§ 202–03, 532 (2009) (defeated in a Senate vote on April 30, 2009).

by owner payment defaults.[64] But most government attempts to mitigate the damage caused by mortgage defaults have failed to adequately address the problems caused by upkeep reduction, and, in fact, some have exacerbated the spillover effects of default. For example, although purporting to help homeowners, foreclosure moratoriums can perpetuate the constructive abandonment maintenance problem.[65] Forced loan modifications—to the extent they merely postpone the inevitable and leave a borrower unable (or unwilling) to pay assessments—do the same.[66] Any government interference that slows foreclosure may (at least in the short-run) help an individual defaulting mortgagor and might, in a temporarily "down" market, even help the mortgage holder ultimately recover more on its loan, but in CICs, these benefits are funded by the neighbors. Keeping an ultimately doomed mortgage loan on this sort of life support increases current and carrying costs borne by neighboring owners, increases CIC assessment levels, and drives down property values.

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64. Unlike HAMP and the initiative promoting short sales, the Neighborhood Stabilization Program of the Department of Housing and Urban Development ("HUD") has focused on infusing money into communities directly, buying abandoned homes, renovating them, and contributing to the community's upkeep and property values. This HUD program is effectively the antithesis of foreclosure moratoriums: it encourages sales of constructively abandoned properties to prevent communities from bearing the negative externalities such properties cause. HUD provided $6 billion in two rounds of Neighborhood Stabilization Program funding, some of which was supplemented by state funds to create successful and effective localized programs. For example, $5.6 million in federal funds combined with $30 million in resources from the Twin Cities Community Land Bank created an entity able to buy up 250 blighted and defaulting properties in targeted neighborhoods. These properties were rehabilitated (updated to green standards) and sold to "responsible homeowners." Shaun Donovan, *Fighting Foreclosures and Strengthening Neighborhoods*, U.S. DEP'T OF HOUS. AND URBAN DEV. BLOG (Sept. 3, 2010), http://portal.Hud.gov/portal/page/portal/HUD/press/blog/ (discussing the effectiveness of The Neighborhood Stabilization Program as an example of a fairer and more forward-looking approach to the contagion effects of mortgage defaults in communities).

65. Moratoriums can perpetuate the tenure of owners who are unwilling or unable to bear the costs of ownership, including paying community assessments, property taxes, and basic property upkeep costs, delaying the conveyance of property owning responsibilities to an owner willing to assume such responsibilities. *See, e.g.*, Jennifer Slosar, *Chicago Coupe Deals with Toxic Mold, Unresponsive Bank*, CHI. J. (Oct. 6, 2010), http://www.chicagojournal.com/News/10-06-2010/Chicago_couple_deals_with_toxic_mold,_unresponsive_bank ("As the foreclosure process stretches past the two-year mark, they are struggling to maintain the empty unit and stanch the bleeding in their homeowners association fund from lost assessments."); *see also* Zhu & Pace, *supra* note 18, at 12–17 (stating that foreclosure delays encourage mortgage default and lack of owner upkeep and investment in the property, all of which drives down the value of homes and drives up costs of financing and "may impede the recovery of the housing market").

66. This is because the longer a non-payment problem persists in a community, the more costs are inequitably borne by paying neighbors. If a modification merely delays an ultimate, inevitable foreclosure, it is unlikely that a neighbor will bring his or her association assessments current in the interim, and the threat of permissive and affirmative waste remains.

Foreclosure rescue efforts have mostly failed to create viable long-term mortgage loans, and the most worrisome contagious effects of homeowner defaults remain, since true losses arise not from foreclosure sales themselves, but from a chronic reduction in neighborhood upkeep and inequitable upkeep costs.[67] This fact reinforces the main contention of this Article: delaying foreclosure and allowing property to deteriorate is a lose-lose scenario, avoidable only by ensuring that properties are owned by people who are able and willing to maintain the property and pay association assessments. This is particularly true in CICs where there are additional, direct and compelling cost externalities with respect to payment defaults, so the contagion effect is more pronounced.[68]

B. Financial Entanglement

1. The CIC Ownership, Assessment, and Services Model

The CIC structure is a privatized governance solution to the collective action and free-rider problems often termed the "tragedy of the commons."[69] Widespread private property ownership in the United States has minimized the number of publicly maintained "commons,"[70] and until recently, federal, state, or local governments maintained most of those areas that could not be divided and privatized.[71] In the past

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67. Harding et al., *supra* note 36, at 165, 172, 178; s*ee also supra* Part I.A.2 (discussing the notion of constructive abandonment).

68. *See infra notes* 83–88 and accompanying text (describing why delayed foreclosure is particularly harmful in CICs).

69. Garret Hardin, *The Tragedy of the Commons*, 162 SCI. 1243, 1244–45 (1968); *see also* Thrainn Eggertsson, *Open Access versus Common Property*, in TERRY L. ANDERSON & FRED S. MCCHESNEY, PROPERTY RIGHTS: COOPERATION, CONFLICT AND LAW, 74–82, 84–85 (2003) (discussing the tragedy of subsequent empirical studies as a result of Garret Hardin's *The Tragedy of the Commons*); James E. Krier, *The Tragedy of the Commons, Part II*, 15 HARV. J.L. & PUB. POL'Y 325, 325 (1992) (acknowledging Garret Hardin as having addressed the problem of coordinating human behavior as it affects environmental quality); Mark A. Lemley, *Property, Intellectual Property and Free Riding*, 83 TEX. L. REV. 1031, 1037 (2005) ("The tragedy of the commons is a specific example of the more general preoccupation of the economic literature on real property with the internalization of externalities and with the use of property law to achieve that end.").

70. Throughout U.S. history, the government has aggressively sought to sell land to private owners. This was the impetus behind Thomas Jefferson's Land Ordinance Act, for example. *Land Ordinance of 1785*, *in* DOCUMENTS OF AMERICAN HISTORY 123–24 (Henry S. Commager ed., 1940); *see* Richard P. McCormick, *The "Ordinance" of 1784?*, 50 WM. & MARY Q. 112, 116–17 (1993) (discussing the scheme for selling and disposing of land acquired under the Ordinance as a reason why it was not adopted in its original form).

71. *See, e.g.*, 39 AM. JUR. 2D *Highways, Streets, and Bridges* § 212 (2011) (discussing usage rights for public property adjacent to private property); 59 AM. JUR. 2D *Parks, Squares, and Playgrounds* § 23 (2011) (discussing the proper use of property such as parks and squares); *see also* Lemley, *supra* note 69, at 1038 (discussing government regulation of property rights due to

century, courts began to routinely hold that community covenants creating payment obligations for common area upkeep were servitudes running with the land.[72] This judicial interpretation enabled the rise of private governance and assessment systems across the United States. In privately governed neighborhoods, common space and amenities are maintained by an association, which assesses each owner a share of the upkeep costs.[73] The association provides sufficient governance to solve the tragedy of the commons by controlling overuse and creating a mechanism for maintenance and shared costs,[74] which in turn permits communities to avoid the economic downside of public goods, meaning that a neighborhood can enjoy better amenities at lower prices.[75] The association is essentially a mini-government, performing public functions: upkeep of common areas and amenities, rule-making, and dispute resolution.[76] Association assessments are therefore, to some extent, the equivalent of property taxes, a mechanism to fund common

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negative externalities).

72. Neponsit Prop. Owners Ass'n, Inc. v. Emigrant Indus. Sav. Bank, 15 N.E.2d 793, 797 (N.Y. 1938). Prior to *Neponsit*, covenants to pay money were viewed as personal, not running with the land because they did not adequately "touch and concern" real property. The *Neponsit* characterization of this covenant as creating a real property servitude, however, spurred the growth of suburban communities across the country. Enforcing payment obligations as servitudes on real property is now *de rigueur*. *See, e.g.*, Regency Homes Ass'n v. Egermayer, 498 N.W.2d 783, 788–93 (Neb. 1993) (holding that a covenant to pay dues to a community association to maintain recreational facilities is a real covenant that runs with the land).

73. Most associations' governing documents explicitly provide for assessment funding of association obligations. HYATT, *supra* note 15, at 108 ("Generally, covenants in the declaration provide authority for the association to collect assessments from each owner."). Even in situations where governing documents for community associations have failed to provide for assessments, courts find the power to assess implicit in the structure of a CIC. *See, e.g.*, Fogarty v. Hemlock Farms Cmty. Ass'n, 685 A.2d 241, 244 (Pa. Commw. Ct. 1996) ("[A]bsent language in the deed covenant prohibiting HFCA from levying special assessments for capital improvements, the [property owners] may be assessed their proportionate costs to construct the new improvements."); Meadow Run & Mountain Lane Park Ass'n v. Berkel, 598 A.2d 1024, 1027 (Pa. Super. Ct. 1991) (finding that inherent in the duty to provide maintenance is the power to assess costs to property owners). *But see, e.g.*, Bd. of Dirs. of Carriage Way Prop. Owners Ass'n v. W. Nat'l Bank of Cicero, 487 N.E.2d 974, 978–79 (Ill. App. Ct. 1985) ("[T]he [association] cho[o]s[ing] to continue to maintain the common areas does not render the [property owners] unjustly enriched."); Wendover Road Prop. Owners Ass'n v. Kornicks, 502 N.E.2d 226, 231 (Ohio Ct. App. 1985) (declining to apply quasi-contract or unjust enrichment theories to require a property owner to pay assessments when the deed conveying the property did not provide for such an assessment).

74. *See* HYATT, *supra* note 15, at 29–32 ("The community association allows innovation, provides for responsibility and obligation, and provides the necessary power to meet these responsibilities.").

75. CAI INDUSTRY DATA, *supra* note 7; *see* TREESE ET AL., *supra* note 16, at 6 (noting that common upkeep also allows a community to take advantage of cost savings from economies of scale).

76. *See* TREESE ET AL., *supra* note 16, at 6 (discussing the municipal responsibilities the associations now assume).

costs, and are treated as such by the income tax laws of at least two states.[77]

For condominiums, a private governance and assessment system is not only beneficial, it is essential. Once states passed statutes allowing fee simple ownership of a three-dimensional "box" of space,[78] multiple individuals could become owners of distinct units within one building. But having many owners within one building mandates certain jointly-held property: the roof, lobby, elevators, hallways, laundry rooms and, in some buildings, water, sewer, trash, electricity, and gas, as well as hazard insurance on the building itself. The mechanism of private community governance provides and pays for all such commons equitably and efficiently.[79]

Typically, CIC governing documents explicitly vest the association with broad authority to assess members according to budgetary needs,[80] and courts have found that even when an association's documents lack explicit authorization, assessment power is implied.[81] As long as the assessments are authorized, it is clear that the obligation to pay assessments is both an *in personam* obligation of a homeowner and an *in rem* affirmative covenant that runs with the land and is binding on all successor owners of the property.[82] The obligation to pay assessments is the most vital obligation in a privately governed community because

77. In New Jersey, the correlation of community assessments and property taxes has been acknowledged by the legislature, which now permits a portion of community assessment payments to offset local property tax assessments. N.J. STAT. ANN. §§ 40:67-23.2-23.3 (West 1993); *see also* K. Kennedy & B. Lambert, *New Developments in Municipal Services Equalization*, 3 J. CMTY. ASS'N L. 1 (2000) (illustrating that the New Jersey Municipal Services Act, which requires a municipality to provide certain public services to private communities, provides a framework for the eradication of the double taxation of these communities). Recently, Pennsylvania's legislature followed suit, passing a law that allows a unit owner in a CIC to deduct 75% of association assessments from state income taxes. H.R. 675, 2009 Gen. Assemb. Reg. Sess. (Pa. 2009). On the other hand, many of the community-provided services supplement local governmental functions rather than replace them and instead operate to replace individual upkeep costs. The trend toward municipal services equalization legislation—refunding members of a CIC local government taxes for items paid for by the association—is discussed in TREESE ET AL., *supra* note 16, at 3.

78. Under the common law, real property is owned in a column of space defined with respect to a two-dimensional real property mapping description, indicating a closed figure on the face of the earth.

79. *See* Robert C. Ellickson, *Cities and Homeowner Associations*, 130 U. PA. L. REV. 1519, 1522–23 (1982) (discussing the method of assessments and distribution of costs amongst property owners).

80. Associations meet their budget requirements through a combination of regular assessments, special assessments, and transfer fees.

81. HYATT, s*upra* note 15, at 105–09. *See, e.g.*, *supra* note 73 (discussing whether an association has the authority to demand assessments from its members).

82. HYATT, *supra* note 15, at 105–17.

assessments are a community's "lifeblood" and its primary (and sometimes only) funding source.[83] As Wayne Hyatt, author of the seminal treatise on CICs, explains, "when one member of the community chooses not to pay the assessments, everyone in the community pays the price through increased assessments, decreased services, and declining community appearance and quality of living."[84]

Two aspects of association assessments are important for purposes of this discussion: their collectability and their durability. The ability to collect delinquent assessments is of crucial importance in a context—such as today—where increasing mortgage defaults indicate an even steeper increase in assessment delinquency.[85] In addition to the ability to assess charges, associations have the power to place a lien on a member's real property to secure the assessment payment obligation.[86] In some states, such liens arise and are perfected on the date the association's documents are recorded in the land records.[87] In other states, the lien arises and is perfected automatically at the time an assessment comes due.[88] Still, in other states, perfection of an assessment lien requires filing a notice of the lien in the appropriate land records.[89] Whether this lien has payment priority over a first mortgage can determine whether an association will be able to ultimately collect. Assessment liens are generally junior in priority to first mortgage liens on the units,[90] and junior interests are extinguished upon the foreclosure of a senior priority lien.[91]

83. *Id.* at 105, 121.

84. *Id.* at 121.

85. Association assessment defaults are usually well in advance of loan payment delinquencies. *See* Pinkerton, *supra* note 12, at 142–43 (discussing how dues and debts create a "death spiral").

86. HYATT, *supra* note 15, at 120–21.

87. For example, in Colorado, a perfected association lien exists as of the date of filing the declaration. COLO. REV. STAT. § 38-33.3-316 (2009). Although this perfected lien could be essentially an "empty bucket" securing no indebtedness, it has statutory priority relating back to the date the community was created. First mortgages on units in such states, however, enjoy a special statutory super-priority over the pre-existing association lien.

88. Under the Uniform Common Interest Ownership Act § 3-116 (1994) (amended 2008), recording of the declaration creating a common interest community constitutes record notice and perfection of the lien for all future assessments. *See also infra* note 190 and accompanying text (explaining that the Uniform Common Interest Ownership Act takes the position that assessment liens are considered automatically perfected with the date of perfection relating back to the date the association was formed).

89. *See, e.g.*, F.N. Realty Servs., Inc. v. Or. Shores Recreational Club, Inc., 891 P.2d 671, 674 (Or. Ct. App. 1995) (finding that an association lien arises only upon recordation of notice of lien).

90. *See infra* Part I.C.2 (noting that liens on real property enjoy a priority based on the order in which they were perfected).

91. NELSON & WHITMAN, *supra* note 58, at 872–73 ("[I]f a junior lienor is forced to satisfy

CICs are contractually bound to maintain the property and provide other services mandated by the documents creating the servitude regime.[92] State and local laws may mandate the provision of other services and/or a certain level of association reserves, in addition to document-based requirements.[93] The FHA will only insure loans secured by units in communities with sufficient reserve funding.[94] Although reserve requirements support an association's future financial health, increasing the required reserves means that the association must collect additional funds today. Raising the reserve requirement can exacerbate the problem of increasing assessments for paying members in an environment of widespread payment defaults.[95] The upkeep and reserve funding obligations of the association are not contingent on the condition of the economy or the payment participation of all members, and assessments are the association's sole source of income.[96]

2. Tragedy of the Financial Commons

The legal structure of CICs was an attempt to solve the tragedy of the commons by establishing a government that could manage common resources, preventing overuse and under-maintenance.[97] Such a private consortium democracy with governance obligations and powers theoretically can create a better neighborhood for all. But since the homeowners in CICs jointly bear funding responsibilities for essential

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the senior mortgage in order to protect his or her position, the amount required for such satisfaction will be more than could have been contemplated at the time the junior interest was acquired.").

92. HYATT, *supra* note 14, at 43.

93. States require reserve studies by condominiums and homeowner associations to ensure adequate reserves are collected. *See, e.g.*, VA. CODE ANN. § 55-514.1 (2002) and § 55-79.83.1 (1993) (requiring a condominium's executive organ or a homeowner association's board of directors to conduct a study to determine the necessity and amount of reserves required at least once every five years and review the results of that study at least annually).

94. Reserve requirements are 60% of the annual budget for established condominiums and 100% of the budget for new projects. Letter from Brian D. Montgomery, Assistant Sec'y for Hous., Fed. Hous. Comm'r, to All Appr. Mortgagees and All FHA Roster Appraisers (June 12, 2009) (on file with author).

95. *See, e.g.*, Josh Brown, *Condo Assessments are the Breaking Point for Some*, VA. PILOT (Sept. 20, 2009), http://hamptonroads.com/2009/09/condo-assessments-are-breaking-point-some (explaining that a homeowner faced loss of home through association foreclosure because of an inability to pay an assessment increase to fund the increased reserve requirement mandated by statute).

96. Some associations charge user fees, but most association costs are covered exclusively by assessments paid by unit owners. *See* HYATT & FRENCH, *supra* note 14, at 319 (stating that the most common approach to financing the operations of community associations is the assessment of a share of common expense); HYATT, *supra* note 14, at 121 (noting that assessments are generally the primary funding source).

97. MERRILL & SMITH, *supra* note 43, at 772.

commons upkeep, the fiscal fortunes of the members of a community are intertwined. A change in the economic fortunes of one owner can therefore impact the other owners. Defaults of members on payment obligations cause a direct and devastating impact on the other members of the community who must fund the difference. Sam Chandan, chief economist at the real estate research firm Reis, explained the connection between the upside of joint maintenance and the downside of economic entanglement:

> What motivated people to go into the condo market in a way that led to overbuilding was the expectation that it would be easier than owning a home on a maintenance basis. The downside is that your fate is tied to 50 to 100 other people who may stop making their condo payments.[98]

Although the possibility of member assessment default had long been understood, before 2006, no one anticipated that so many highly leveraged mortgages taking so long to foreclose would eventually put a huge strain on community associations.[99] But today's delinquency rate for assessments has caused many of these associations to fail.[100] Their failure leaves the community without its expected amenities and upkeep and leaves the commons to its natural economic "tragedy" because local municipalities need not provide public services that were previously left to private associations to fund and provide.

Most courts have held that CIC associations cannot declare bankruptcy as long as they retain the power to assess for budgetary shortfalls.[101] Thus, solvent owners must fund their delinquent neighbors' deficiencies. Delinquency levels in some parts of the country have seen astronomical increases since 2005. One management firm in the Boston area reported a 150% increase in delinquent assessments from 2006 to 2007.[102] Vulnerability to increased assessments to fund neighbor shortfalls and the inability of an

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98. Haughney, *supra* note 6, at C1 (quoting Chandan).

99. The closest precedent is New England in the late 1980s and early 1990s when many associations were left with debilitating budgetary shortfalls as many owners defaulted on their mortgages and other payment obligations. It was this regional crisis among CICs that led Massachusetts to adopt a six-month lien priority for CIC association liens. *See infra* note 213 (explaining that the six-month super priority in UCIOA was meant to solve this same issue, but the authors of that model legislation did not foresee that in today's climate of extensive and long-delayed foreclosure, six months would generally be inadequate).

100. *See* Pinkerton, *supra* note 12, at 125 (discussing the "crushing" nature of association debt).

101. *See infra* Part I.B.4 (explaining why it is unfeasible for condominium associations to file for bankruptcy).

102. Sacha Pfeiffer, *Delinquencies at Condos Can Cost Neighbors*, BOS. GLOBE, Oct. 16, 2007, at C1.

association to perform contractually required maintenance in the face of member default causes a significant adverse impact on the value of properties within a CIC.[103]

Where available, statistics regarding the problem of assessment delinquencies underscore the magnitude of the problem. According to a study cited by *The Miami Herald*, more than 60% of Florida condominiums and homeowner associations reported in March 2010 that at least half of their units were at least two months behind in paying their assessments.[104] Losing half of the required revenue completely hamstrings the operation of these associations. For example, Parkview Point Condominium in Miami Beach suffered a large enough loss of assessment revenue that it was unable to pay water bills for the building, and the unit owners nearly had their water cut off before solvent owners were able to raise funds to pay the arrearage.[105] The lobby ceiling repairs, however, were stopped mid-repair, leaving wiring and ducts exposed.[106] On the nation's other coast, Gas Lamp City Square in downtown San Diego awaits pending foreclosure sales on multiple units in the building while the association struggles with a $115,000 budgetary shortfall because of unpaid dues.[107] In Union City, California, a special assessment for roof repairs in Alvarado Village ended up costing each paying owner $18,494.27.[108] A couple in San Francisco reports that over the past three years, their special assessments have exceeded $100,000.[109]

Pervasive assessment default unfairly impacts the paying neighbors financially and psychologically, and anecdotal evidence underscores the reality behind the troubling statistics of unpaid community dues. Ana Martinez, for example, reported that she no longer felt safe living in her own home—a unit within a South Florida condominium that was deteriorating in the face of the association's inability to pay for

103. *See, e.g.*, Bd. of Dirs v. Wachovia Bank, N.A., 581 S.E.2d 201, 206 (Va. 2003) (Lacy, J., dissenting) ("Part of the value of a condominium unit comes from the ability of the condominium association to maintain the common areas of the development . . . . The ability to maintain these elements is directly related to the association's ability to secure payment of assessments from the individual unit owners.").

104. Rachael Lee Coleman, *Desperate Condos Thrown a Lifeline*, MIAMI HERALD, Mar. 7, 2010, at 1A.

105. Haughney, *supra* note 6, at C8.

106. *Id.*

107. *Id.*

108. James Temple, *Neighborhood Fees Go Through the Roof*, CONTRA COSTA TIMES (May 29, 2006), http://www.calhomelaw.org/doc.asp?id=487. The Alvarado Village association also blamed the large special assessment on the property developer who they claim failed to adequately fund reserves. *Id.*

109. Lloyd, *supra* note 11.

maintenance.[110] Some of Ana's neighbors had literally abandoned their units, leaving behind not only unpaid and underwater mortgage loans, but also months of unpaid condominium assessments.[111] Ana's monthly assessment tripled in response to the condominium's budget shortfall, and her property's value fell and continues to plummet in the face of lower occupancy, higher crime, and substandard common area maintenance.[112]

In a modest, low-income area of Providence, Rhode Island, Debra McGarry was forced to take out a $4800 personal credit card loan to keep water, gas, and electricity from being cut off in the eight-unit condominium building in which she lives.[113] Two of the owners in the building stopped paying dues and abandoned their homes, nearly bankrupting the small condominium.[114] Even doubling the condominium fees that the remaining six paying owners were assessed failed to generate enough capital to keep the building afloat.[115] The "affordable" unit Debra and her husband Bernard, a disabled veteran, bought in 2006 ended up being their financial "nightmare" since Debra and her solvent neighbors were left to personally pick up the tab left by lenders who failed to foreclose on strategically defaulted mortgages.[116]

The problem of assessment delinquencies is not confined to lower income owners. Many owners of ritzy Manhattan condominiums that come with top-flight amenities (gym membership, butler and maid service, billiards room, and library) can no longer afford the cost of such services because of a rash of unit owner assessment defaults.[117] In the past year, foreclosure filings for Manhattan condominiums doubled, and now, one in every thirteen units are in some stage of foreclosure.[118] Foreclosures in New York take longer than in any other state, and at the current pace, it would take lenders sixty-two years to complete foreclosure on the 213,000 homes now in severe default.[119] During the

110. Sutta, *supra* note 6.

111. *Id.*

112. *Id.*

113. Dunn, *supra* note 6, at G1.

114. *Id.*

115. *Id.*

116. *Id.*

117. Ryley, *supra* note 6.

118. *Id.*

119. David Streitfeld, *Backlog of Cases Gives a Reprieve on Foreclosures*, N.Y. TIMES, June 19, 2011, at A1 (citing calculations by LPS Applied Analytics, a real estate data firm). Even before the housing crisis, it took up to two years for property to be sold at a foreclosure sale under New York law. In the first half of 2011, the average time to complete a foreclosure in New York was 966 days, and the average time to foreclose in Florida was 676 days. While the number of foreclosure sales dropped dramatically in the first half of 2011, this does not indicate a market

several years foreclosure is pending in the current market, the non-defaulting owners in these glamorous buildings will see their own assessments increase to close the association's budgetary gap while the building services and amenities simultaneously disappear. In one Manhattan condominium, the nonpayment of just one investor—who held title to a dozen units in the building—caused the remaining members' monthly charges to jump by 15%.[120]

3. Barriers to Market Recovery

The housing market continues to implode in many localities. Sustainable home pricing and the expeditious placement of owners willing and able to meet a property's upkeep obligations are the only way out.[121] But predictable credit costs and upkeep charges are a prerequisite to stable home pricing and residential real estate investment.[122] Volatile CIC assessments stymie economic recovery. Would-be buyers, faced with uncertain future assessment increases due to financial entanglement in a CIC, are unwilling and unable to manage certain risks. Loan modifications for overburdened borrowers do not

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recovery, but is rather further testament to rampant processing delays and lender strategic delays. Les Christie, *Foreclosures Plunge in First Half of 2011*, CNN MONEY (July 14, 2011), http://money.cnn.com/2011/07/14/real_estate/housing_market_foreclosures/index.htm.

120. Ryley, *supra* note 6. The situation is different for cooperative buildings because assessment payments are characterized as rent. Thus, the cooperative can evict a defaulting owner and need not wait for the owner's lender to foreclose. In condominiums, however, the association lien is subordinate to the first mortgage lien, and typically, the association's assessment will not be paid upon foreclosure.

121. *See* BEN BERNANKE, CHAIRMAN, U.S. FED. RESERVE, SEMIANNUAL MONETARY POLICY REPORT TO THE CONGRESS 2 (July 13, 2011), *available at* http://www.federalreserve.gov/newsevents/testimony/bernanke20110713a1.pdf (opining that one key roadblock to economic recovery is "the continuing depressed condition of the housing sector"); Steven Pearlstein, *To Sort this Mess, Both Banks and Borrowers Must Own Their Mistakes*, WASH. POST, Oct. 10, 2010, at A09 (explaining that "the longer the foreclosure process goes on, the longer it will take for the excess supply of houses to be absorbed, for prices to stabilize and for the real estate market to return to something closer to a normal equilibrium"); Alexander Eichler, *Foreclosure Processing Time Has Doubled Since 2007, Backlogging Housing Market*, HUFFINGTON POST (July 1, 2011), http://www.huffingtonpost.com/2011/07/01/home-foreclosure-backlog_n_888655.html (citing *The Atlantic*'s Daniel Indiviglio's opinion that "the more foreclosures pile up, the longer it will take for the housing market to hit bottom and begin recovering").

122. While the costs of real estate investment are usually cited as high transaction costs and illiquidity, predictability of future costs and returns is often cited as one of the benefits of real estate investment. It therefore stands to reason that eroding this benefit will decrease the attractiveness of investment in the real property sector. *See* Christian Rehring, *Real Estate in a Mixed-Asset Portfolio: The Role of the Investment Horizon*, REAL ESTATE ECON., June 30, 2011, at 22 (finding that return predictability is very important to attracting real estate investors); *cf.* JOINT CTR. FOR HOUS. STUDIES HARV. U., THE STATE OF THE NATION'S HOUSING 4–5 (2011) (chronicling the declining confidence and investment in the housing sector of the economy as prices remain uncertain).

work when assessments rise so quickly that borrowers still cannot meet their reduced mortgage debt obligations while also paying association assessments. Lenders resist financing and refinancing in communities where assessment levels and the fiscal health of the association are both uncertain.[123] The possibility (or reality) of steeply rising assessments makes investors hesitant to purchase a unit when rents may not cover additional increases. As one example: the common charge for a 601 square foot studio in one Manhattan CIC is now $1095 per month, and this substantial cost has discouraged investor purchasers and financiers, even when the purchase price for the unit is set at a tremendous discount.[124] When rents will not cover assessments, ownership of a unit generates a monthly financial loss.

Lenders are as wary of the uncertain financial future of CIC properties as are would-be buyers. Mortgage financing or refinancing of a unit in a condominium or a house in a privately governed community has become vastly more difficult as banks seek information not only about the creditworthiness of their borrower, but the credit of the other members of the financially linked community.[125] Lenders have started to scrutinize a community's reserve amounts and assessment delinquency levels in an attempt to quantify the risk of assessments materially increasing.[126] A buyer of a new condominium unit in New York reported that Bank of America denied her application to refinance because the condominium association's reserve account was depleted, and 17% of the owners in her building were delinquent in paying their assessments.[127] Most lenders require that reserves be sufficiently funded and that no more than 15% of homeowners be more than thirty days delinquent on homeowner assessments before they will agree to lend on any property located in the community.[128]

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123. *See* Dina ElBoghdady, *New Condo Loan Rules Put More Scrutiny on Neighbors*, WASH. POST, Apr. 25, 2009, at A01 (noting that financing availability depends on the credit of neighboring owners in a condominium); *infra* Part II.A.1.b (discussing lending policies and risk assessment).

124. Ryley, *supra* note 6. Ryley also gives the example of a Manhattan studio that rents for $3000 a month costing $5750 a month in mortgage payments, taxes, and common charges.

125. *See, e.g.*, Lorraine Ash, *People Facing Foreclosure Should Seek Help Early*, DAILY RECORD (Mar. 19, 2011, 6:35 PM), http://www.dailyrecord.com/article/CN/20110319/NJNEWS/103190343/People-facing-foreclosure-should-seek-help-early (noting that banks look at the association finances); Matt Tomsic, *Homeowners Associations Stepping Up Legal Pressures with Foreclosures*, STARNEWS (Mar. 5, 2011, 5:01 PM), http://www.starnewsonline.com/article/20110305/ARTICLES/110309754 (noting that lenders look at the financial help of associations).

126. Ryley, *supra* note 6.

127. *Id.*

128. *HOA Delinquinces in Condos*, FREE ADVICE (Apr. 14, 2010), http://forum.freeadvice.com/buying-selling-home-40/hoa-delinquencies-condos-512763.html. *See also infra* notes 129–32 and accompanying text.

The two giants of the secondary residential mortgage market—the government-sponsored enterprises ("GSEs") Fannie Mae and Freddie Mac—likewise demand certain thresholds of reserves and non-delinquencies for CICs in which their prospective mortgage loan purchases are located.[129] For example, Freddie Mac's Condominium Unit Mortgages Project Analysis requires a budget and certification of a working capital fund, appropriate assessments levied with a minimum of 10% of the budget designated for replacement reserves and deferred maintenance, a working capital fund in an amount consistent with the remaining life of the common elements, and no more than 15% of assessments delinquent more than thirty days.[130] Freddie Mac also mandates that common elements be consistent with the nature of the project and competitive with the local market, and it requires the community to be in good financial and physical condition.[131]

The lack of financing alternatives and the threat of instability that would result if assessment delinquencies reach 15% have chilled investment in condominium properties.[132] Some investors report that they will pay only cents on the dollar because of the possibility that neighboring owners will default in paying their pro rata share of maintenance costs, rendering all units in the CIC unfinanceable.[133] Before he would agree to buy, one investor from Italy reportedly demanded a "written guarantee" from the association that he would not

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129. Fannie Mae (formerly the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation) were chartered by Congress and regulated by federal agencies. Although technically still owned by private shareholders, in September 2008, the Treasury Department placed Fannie Mae and Freddie Mac into conservatorship, reorganizing the enterprises and infusing them with new capital. At the time, this was the largest state rescue in history, to the tune of $100 billion. *See* Herbert M. Allison, Jr., President and CEO, Fannie Mae, Oversight Hearing to Examine Recent Treasury and FHFA Actions Regarding the GSEs (Sept. 25, 2008) (addressing how Freddie Mac pursued its mission to support the mortgage market, provide liquidity, and prevent foreclosures since the conservatorship began); James Lockhardt, Acting Dir., Office of Fed. Hous. Enter. Oversight (OFHEO), Testimony Before the Financial Crisis Inquiry Commission (Apr. 9, 2010), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0409-Lockhart.pdf (explaining the Freddie Mac remediation process). *See generally* Press Release, Fed. Hous. Fin. Agency, Questions and Answers on Conservatorship, http://www.fhfa.gov/webfiles/35/FHFACONSERVQA.pdf (explaining conservatorship and how it will affect the Federal Housing Finance Agency).

130. FREDDIE MAC, FREDDIE MAC CONDOMINIUM UNIT MORTGAGES 1, 3 (Apr. 2011), *available at* http://www.freddiemac.com/learn/pdfs/uw/condo.pdf.

131. *Id.*

132. Some areas of the country—New England and Manhattan in particular—faced a breakdown in the early 1990s. There is anecdotal evidence of New Yorkers during that crisis "handing over their Fifth Avenue apartments for $1 because they could not afford the maintenance fees." Haughney, *supra* note 6, at C1.

133. *Id.*

have to pay larger fees in the future (although such a guarantee is likely not enforceable against the association).[134] The fact that no one—neither banks nor buyers—willingly takes on this uncontrollable risk is more evidence that the current system is broken.[135]

Some associations have responded to their community's budgetary crisis by in-sourcing all possible costs.[136] For example, homeowners may be required to take turns mowing common area lawns, caring for common area maintenance, or even staying up all night to serve as a doorman or security guard. While these efforts may reduce the dollar contributions associations need to function, in-sourced upkeep actually replicates the very same collective action and free-rider problems that community governance was designed to eliminate: some people will contribute more than others, and others will be unjustly enriched by their efforts. In-sourcing just replaces the problem of increased assessments of money with the problem of increased "assessments" made in kind, and it is equally inequitable. Either way, the non-defaulting homeowners pick up the costs of the defaulting owners mortgage lenders' free ride.[137]

As an alternative to increasing assessments, associations may reduce the level of services offered to members of the community by decreasing maintenance, closing amenities, or starting to charge amenity user fees. In 2008, the Community Associations Institute conducted an informal poll and found that nearly 40% of the associations nationwide had delayed capital expenditures, and nearly 35% had raised assessments—in each case because of an increase in delinquent assessments.[138] Three years later, these numbers are likely even higher. The end result of the efforts to cut services and impose

134. *Id.* Associations cannot guarantee limitations on future assessments unless the documents so permit because any limitation to one unit owner's obligations necessarily burdens other owners with greater costs should the association's revenue requirements increase.

135. Condominiums as a real estate product type have incurred the biggest losses in terms of market value and transactional volume. CLIFFORD TREESE, METRICS FOR THE DEPRESSED (May 2011), *available at* https://spreadsheets.google.com/spreadsheet/pub?hl=en_US&hl=en_US&key=0Apv0sov_B8cSdGpwVTd4TEwybGJFd2J3QUQ2ZnRFbXc&output=html. According to statistics compiled by LM Funding from the Hillsborough Property Appraiser's Office and Zillow.com, average values for condominiums have dropped 34% from the peak in 2005 to 2009. *Id*.

136. *Housing Associations*, DUE NORTH, http://www.due-north.com/Industries/housing-associations.aspx (last visited Mar. 21, 2011); Michelle Rindels, *Nevada Legislators Considering Reform for HOAs*, ASSOCIATED PRESS, Feb. 25, 2011, *available at* http://www.kolotv.com/home/headlines/Nevada_Legislators_Considering_Reform_for_HOAs_116980213.html; Vitali, *supra* note 46.

137. *See* Lemley, *supra* note 69, at 1057 (discussing the consequences of free riding); *infra* Part II.B.1 (discussing how lenders benefit from upkeep pre-foreclosure).

138. Bayles, *supra* note 11.

more costs on owners is the same: significant decline in a community's property values and a community government that ceases to function effectively.[139]

4. Association Bankruptcy

Community associations cannot seek relief from their financial obligations in bankruptcy, even if their obligations outpace their revenues. Condominium associations typically have no assets of their own,[140] and homeowner associations are prohibited by their governing documents from selling their assets or otherwise seeking to raise revenues in ways not foreseen and explicitly authorized in their covenants.[141] These entities perform primarily (or exclusively) governance and maintenance roles. Although it is nearly impossible to file bankruptcy as a pass-through entity, it is also practically impossible for an association to function if a significant amount of the units are in arrears. Once more than 15% of unit owners are delinquent in their assessment payments, FHA insurance and Fannie Mae loan qualification becomes unavailable for purchaser mortgages on units in that community.[142] At that level of delinquency, neither associations nor their member owners can obtain financing.

Bankruptcy law currently offers no good solution.[143] Courts generally disallow bankruptcy filings by community associations

139. *See* HYATT, *supra* note 14, at 121 (stating that cutting services and charging user fees for amenities may cause disrepair of the common and recreational facilities, resulting in a decline in property values within the community). A similar fate befell Alaskan condominiums when workers abandoned their units and moved away after the completion of the Alaska pipeline. *See* MIN DIXON, WHAT HAPPENED TO FAIRBANKS? THE EFFECTS OF THE TRANS-ALASKA OIL PIPELINE ON THE COMMUNITY OF FAIRBANKS, ALASKA 295–96 (1980) (explaining that a housing shortage resulted from a lack of certainty regarding the housing that an industry was to supply its employees and the disposition of that housing after the construction period had terminated).

140. In condominium ownership, the unit owners hold title to all common areas as tenants-in-common, and the association's role is purely one of governance.

141. HYATT, *supra* note 14, at 109–12.

142. U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-19, CONDOMINIUM APPROVAL PROCESSS—SINGLE FAMILY HOUSING (June 12, 2009), *available at* http://www.hud .gov/offices/adm/hudclips/letters/mortgagee/files/09-19ml.doc; U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-46 A, TEMPORARY GUIDANCE FOR CONDOMINIUM POLICY (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46aml.pdf; U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2009-46 B, CONDOMINIUM APPROVAL PROCESS FOR SINGLE FAMILY HOUSING (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46bml.pdf.

143. Professor Evan McKenzie calls association bankruptcy attempts "disaster[s]" that accomplish nothing. Joseph Dobrian, *Condominium Associations Hard Hit by Foreclosures Consider Bankruptcy*, J. PROP. MGMT., May/June 2010, at 32 (quoting McKenzie). Recently, scholars have called for reformation of the Bankruptcy Code to offer some relief to beleaguered condominium associations. Pinkerton, *supra* note 13, at 142–46 (citing the inescapable "death

because the associations have assessment powers, and courts can force associations to levy assessments on unit owners to pay for association debt.[144] Because an association can theoretically make special assessments to make up any budgetary shortfall, an association's inability to pay its obligations is seen as a revenue problem rather than as a debt or asset problem. Only if all the members of the association are themselves insolvent does the actual ability of an association to meet its debts become imperiled.[145]

There have been very few exceptions to this general rule, and each has presented an atypical case. For example, in the recent bankruptcy case filed in Florida by Maison Grande Condominium, the association entered into a long-term recreation lease with an escalation clause and faced inability to meet this obligation when 25% of its units became delinquent while lease fees rose astronomically.[146] The association filed a petition for Chapter 11 bankruptcy seeking to reject the lease, and the bankruptcy judge in that case permitted the lease rejection.[147] The court noted that the board of directors had concluded that further increases of assessments would be unavailing because unit owners had advised the board that they lacked the ability or willingness to pay.[148]

spiral" of association unpaid dues and debt).

144. *See* White v. Cox, 95 Cal. Rptr. 259, 263 n.3 (Cal. Ct. App. 1971) (stating that a condomium owner may satisfy his portion of any liability arising from the association by the payment of his proportionate share of the liability); HYATT & FRENCH, *supra* note 14, at 591; NATELSON, *supra* note 61, at 328–31; Donald L. Schreifer, *Judicial Action and Condominium Unit Owner Liability: Public Interest Considerations*, 1986 U. ILL. L. REV. 255, 262–65 (1986) (explaining that at least a share of the debt may be collected from any member who has been named and served in the absence of a statute to the contrary); Jessica Meyers, *HOA Bills Start to Get Spotlight*, DALL. NEWS (Mar. 7, 2011, 10:05 AM), http://trailblazersblog.dallasnews.com/archives/2011/03/hoa-bills-start-to-get-spotlig.html; *cf. In re* Rivera, 256 B.R. 828, 830–36 (Bankr. M.D. Fla. 2000) (denying as moot and unnecessary a homeowner association's "Motion for Reconsideration of Order denying Motion to Compel Debtor to Reaffirm, to Redeem, or to Surrender, and to Withhold Entry of the Discharge Pending Consideration of this Motion or Alternately to Dismiss," because post-petition homeowner association assessments survived a Chapter 7 discharge as a condition of continued ownership of a lot subject to such assessment), *superseded by statute*, 11 U.S.C. § 523(a)(16) (2006).

145. *See* Pinkerton, *supra* note 13, at 147–64 (discussing the insolvency and condominium association debtors).

146. *In re* Maison Grande Condo. Ass'n, 425 B.R. 684, 687–88 (Bankr. S.D. Fla. 2010).

147. *Id.* at 689, 707.

148. *Id.* at 688 ("Some owners advised members of the Board that they lacked the financial resources to pay additional assessments. Others advised the Board that they would refuse to pay additional assessments that were only necessitated by other owners not paying their fair share. The Board also took into consideration the demographics of the unit owners, including the fact that many [were] elderly and on fixed incomes." (citation omitted)). Chapter 11 Bankruptcy offers an association the only hope of bankruptcy relief, but even that avenue is uncertain and perilous. *See* Pinkerton, *supra* note 12, at 155–65 (asserting that Chapter 7 is "not a good option for condominium associations" and that while Chapter 11 "might work," the association faces many problems with that route as well); *see also* Kristen L. Davidson, *Bankruptcy Protection for*

This case, however, is an anomaly and upon closer reading, seems to be predicated on a finding that the subject lease's escalation clause was unenforceable in Florida as against public policy.[149]

More typical is the approach of another Florida bankruptcy case, in which the court adamantly rejected the association's proposed Chapter 7 bankruptcy.[150] In this case, the association sought to dissolve and reform to avoid payment obligations to a roofing vender that it could not meet without significant increases to assessments.[151] The court rejected this plan, calling the association's attempt to avail itself of bankruptcy protection bad faith.[152] Carla Barrow, counsel to the roofing company, noted that at least eight other condominiums had also filed for some sort of bankruptcy protection in South Florida, attempting to avoid paying for roof repairs,[153] but such attempts are unlikely to be successful. In 2010, Florida passed the Distressed Condominium Relief Act, which, among other things, specifically empowers associations to take stronger measures to recover revenues from non-paying owners and permits "bulk assignees" and "bulk buyers" to take over unsold developer condominium inventory, assuming assessment obligations but not other liabilities of the original developer.[154]

Without bankruptcy as a potential escape from financial obligations in excess of collected funds, associations with assessment delinquencies are left with only one alternative: increase assessment amounts and hope the paying members will make up the shortfall. Charging paying members more to make up for neighbor defaults is not only unfair,[155] but it is unlikely to actually save the community from de facto insolvency. As the court in *Maison Grande* noted, increased assessments will likely increase delinquencies.[156] Increased delinquencies lead to increased assessments that can further increase delinquencies, requiring still greater increases of assessments (*ad infinitum*). Barring some ability to actually recover from non-paying

Community Associations as Debtors, 20 EMORY BANKR. DEV. J. 583, 616–25 (2004) (discussing the difficulty that courts have in applying bankruptcy laws to community associations).

149. *In re Maison Grande*, 425 B.R. at 702.

150. *In re* Boca Village Ass'n, 422 B.R. 318, 327 (Bankr. S.D. Fla. 2009).

151. *Id.* at 325.

152. *Id.* at 321–25.

153. Dobrian, *supra* note 143, at 33.

154. S.B. 1196, 2010 Sess. (Fla. 2010) (adding new Sections 718.701–708 to the Florida Statutes through the "Distressed Condominium Relief Act").

155. *See* Hart, *supra* note 5, at 185 ("[W]hen a number of persons conduct any joint enterprise according to rules and thus restrict their liberty, those who have submitted to these restrictions when required have a right to a similar submission from those who have benefited by their submission.").

156. *In re* Maison Grande Condo. Ass'n, 425 B.R. 684, 688 (Bankr. S.D. Fla. 2010).

owners or properties, the only remaining solution is to have a public (state, local, federal) government step in and bail out communities that are unable to collect sufficient revenues from their members.[157] Private government failure mirrors local government failure (when tax revenues are insufficient to maintain the community), but unlike community associations, municipalities can, in fact, declare bankruptcy.[158]

C. Payment Collection and Lien Priority

1. Association Collection Efforts

Because of the difficulty of enforcing payment obligations in privately governed communities, conventional wisdom holds that an association board should act quickly in response to nonpayment of assessments. An association with delinquent members has the ability to enforce its payment obligation in several ways. Associations may be able to use self-help by denying a delinquent owner the right to use common elements or by suspending the owner's voting rights.[159] For example, a nonpaying unit owner may be barred from using a community amenity such as a swimming pool or health club. The

157. *See* Dobrian, *supra* note 143, at 34 ("The main burden of dealing with troubled condo associations will fall on local governments, which are seldom experienced in such matters.") (quoting Professor Evan McKenzie).

158. 11 U.S.C. § 109(c)(1) (2006). Chapter 9 of the Bankruptcy Code provides for reorganization of municipalities, which includes cities, towns, villages, counties, taxing districts, municipal utilities, and school districts. *E.g.*, *Municipality Bankruptcy*, U.S. COURTS, http://www.uscourts.gov/federalcourts/bankruptcy/bankruptcybasics/chapter9.aspx (last visited Aug. 16, 2011). It does not, however, cover common interest communities. Municipal bankruptcy legislation has a history of constitutional fragility. *See, e.g.*, Ashton v. Cameron Cnty. Water Improvement Dist. No. 1, 298 U.S. 513, 530–32 (1936) (striking down as incompatible with the Tenth Amendment the initial attempt by Congress to craft bankruptcy protection for local governments). According to the federal government, in the more than sixty years since Congress established a constitutionally viable municipal bankruptcy procedure, there have been less than 500 governmental bankruptcy petitions filed. *Municipality Bankruptcy*, *supra*. Those filings that do occur, however, are typically extreme cases in large municipalities (e.g., Orange County, CA) and can involve many millions of dollars in municipal debt. MARK BALDASSARE, WHEN GOVERNMENT FAILS: THE ORANGE COUNTY BANKRUPTCY 7 (1998).

159. HYATT, *supra* note 14, at 121–22; *see also* How v. Mars, 513 N.W.2d 511, 516 (Neb. 1994) (holding that both the association bylaws and Nebraska's nonprofit corporations code permitted the association to deny delinquent owners the right to vote in the community). *But see* Mountain Home Props. v. Pine Mountain Lake Ass'n, 185 Cal. Rptr. 623, 630 (Cal. Ct. App. 1982) (holding that California law bars a community association from denying membership privileges to a new member because of the unpaid association debts of the new member's predecessors in interest). In most cases, private governments are able to suspend voting rights of members due to non-payment of assessments even though public governments may not suspend the right to vote based on non-payment of taxes. For example, a Florida law passed in July 2010 clarifies the availability of this type of self-help in that state. S.B. 1196, 2010 Sess. (Fla. 2010). For further discussion of how assessments in communities are similar to and yet distinct from taxes, see *infra* Part II.A.3.

extent to which services may be denied, however, depends on state law. For example, a Texas court permitted an association to turn off the utilities of a delinquent owner,[160] but few states permit the discontinuance of essential services, such as heat, water or electricity.[161]

If such efforts fail, an association can commence an action to collect a debt against the non-paying owner. Federal case law is split on the issue of whether association assessments are debts for the purposes of the 1966 Fair Debt Collection Practices Act, 15 U.S.C. § 1692 (2006), which would require certain explicit warnings and notices to be served prior to collection efforts.[162] To the extent an association complies with any such applicable laws, it can thereafter bring lawsuits against delinquent owners personally, claiming breach of contract and seeking damages equal to the unpaid assessment amounts.[163] Collection based on a judgment against the owner can proceed like any other debt collection (garnishing wages, seizing assets, enforcing a judgment lien, etc.).[164] Bringing a lawsuit, however, can be costly to the association in terms of time and attorney fees, and the paying owners—those who are already bearing the costs of their neighbors' delinquencies—will have to foot that bill unless the delinquent owner or responsible party can

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160. San Antonio Villa Del Sol Homeowners Ass'n v. Miller, 761 S.W.2d 460, 465 (Tex. App. 1988) ("Clearly, a condominium dweller who does not pay his share of the maintenance fee, admits that the other owners are in essence paying his way, and fails to respond to notice of disconnection is in violation of the meaning and intent of the [by-laws]. The Association took appropriate action to abate this condition.").

161. *See, e.g.*, N.Y. GEN. BUS. LAW § 352-eee(4) (McKinney 2011) (prohibiting a property owner who wishes to convert a building to cooperative or condominium ownership from the "interruption or discontinuance of essential services, which substantially interferes with or disturbs the comfort, repose, peace or quiet of any tenant in his use or occupancy of his dwelling unit or the facilities related thereto."). Among property managers, the belief is that the most efficient way to collect unpaid assessments is to turn off community-provided cable or satellite television services where law permits. *See* Polyana da Costa, *Associations Get Creative in Punishing Delinquencies*, MIAMI DAILY BUS. REV., Nov. 23, 2010, at A1 (discussing legal and prohibited methods of encouraging assessment compliance); *see also* Mark Leen, *Condo Utilities May Be At Mercy of Assessments*, KING CNTY. BAR ASS'N BAR BULLETIN, 2009, *available at* http://www.kcba.org/newsevents/barbulletin/archive/2009/09-07/article18.aspx (discussing why cutting services off to a unit is "particularly effective").

162. *Compare, e.g.*, Bryan v. Clayton, 698 So. 2d 1236, 1237 (Fla. Dist. Ct. App. 1997) (assessments are not covered by the Act) *with* Newman v. Boehm, Pearlstein & Bright, Ltd., 119 F.3d 477, 479 (7th Cir. 1997) (finding that a past due assessment is a "debt" under the Act).

163. *See* HYATT, *supra* note 14, at 119 (discussing a typical collection process for an association against a delinquent owner, including filing a lawsuit against the delinquent owner personally, in addition to filing a lien on the delinquent owner's unit).

164. *See infra* Part I.C.1 (discussing association collection efforts). The priority of any such judgment lien, however, will be subordinate to any mortgages or other obligations currently secured by the property, and thus, perfecting the association's assessment lien likely offers a better chance for ultimate recovery.

obtain the costs of collection.[165] Nevertheless, these sorts of collection actions are how the bulk of unpaid assessments are eventually collected.[166]

The lien on the defaulting owner's property that association covenants create for delinquent assessments is another tool for delinquency recovery.[167] The lien guarantees that the association will be paid out the proceeds of any resale, after all senior interests are satisfied. Furthermore, a lien for unpaid assessments clouds the owner's title and can be used as leverage to convince an owner who is seeking clear title (for sale or financing) to pay up. A last resort for associations is to foreclose on the property lien securing the assessment obligation.[168]

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165. *See* HYATT, *supra* note 14, at 121 (discussing the substantial amount of time it takes to foreclose on a lien and collect a judgment, the low price a sheriff's sale may generate, and that the availability of wage garnishment is dependent on the delinquent owner having an income).

166. *See, e.g.*, KATZMAN GARFINKEL & BERGER, COMMUNITY ASSOCIATION ASSESSMENT COLLECTION AND FORECLOSURE 14–15 (2011), *available at* http://www.canfl.com/pdfs/KGBcollFAQs_sm.pdf (explaining the benefits of collection actions).

167. *See* Pinkerton, *supra* note 13, at 143 ("Functionally, condominium associations only possess one remedy to recover their expenses from delinquent unit owners. They can obtain a lien on the unit for the amount owed to the association by that unit owner. The association can then foreclose on its lien if the debt remains unpaid. However, this remedy is not very useful in the face of many states' laws concerning the relative priority of mortgages."). The association lien has always been used as a practical means to induce voluntary compliance with assessment obligations rather than as a means to collect from the asset's value directly via foreclosure (although the viable threat of foreclosure can motivate payment). The problem arises in situations where a homeowner is already facing foreclosure (under the mortgage) and the owner's equity is gone. The association in such cases loses its power to motivate compliance. At this point, the only other interest holder of the property who still has a stake in its value is the first mortgagee, which is why eroding that priority position may incentivize a lender to pay, or cause a borrower to pay, assessments. A lender would be motivated to pay to preserve its own collateral value if its claim on the property would diminish should assessments remain delinquent.

168. *See, e.g.*, UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (amended 2008) (outlining enforcement of lien for sums due the association, including foreclosure); Societe Generale v. Charles & Co. Acquisition, Inc., 597 N.Y.S.2d 1004, 1009 (N.Y. Sup. Ct. 1993) ("[A] condominium's lien for unpaid common charges may be foreclosed in the same manner as a mortgage on real property . . . ."). Some state laws limit recovery for debt repayment from foreclosure of a homestead. Homestead exemptions protect a certain amount of equity from sale to satisfy a debt. In Missouri, for example, the first $15,000 of debt is exempted as the owner's homestead. MO. REV. STAT. § 513.475 (2002). Florida, Texas, Oklahoma and Colorado have virtually unlimited homestead exemptions. *See, e.g.*, TEX. PROP. CODE ANN. § 41.001 (West 2010) (providing that a homestead is "exempt from seizure for the claims of creditors except for encumbrances properly fixed on homestead property," which include: (1) purchase money; (2) taxes on the property; (3) work and material used in constructing improvements on the property; (4) an owelty of partition; (5) the refinance of a lien against the homestead; (6) an extension of credit subject to certain conditions including security by a voluntary lien; and (7) a reverse mortgage which meets certain requirements); *Id.* § 52.001 (attaching judgment liens to real property except that property exempt from seizure or forced sale under Chapter 41, the Texas Constitution, or any other law). Mortgage lenders typically require an explicit waiver of this statutory protection of borrower equity.

How useful association foreclosure is as an enforcement tool depends greatly on the perfection and priority regime of the applicable state.[169] A first mortgage loan on a particular unit in a CIC enjoys senior priority to the association's assessment lien in all states, although the first mortgage priority is subject to a capped payment priority association lien in several states.[170] In those states lacking a six-month super-priority for assessment liens, the association will only be able to recover from the sale if foreclosure proceeds exceed the senior loan amount.[171]

Depending on the jurisdiction, lien foreclosures are effected either by a sale in a court action in equity or by private power of sale granted in the security instrument.[172] Judicial foreclosure is the exclusive method of foreclosure in over one-third of the states,[173] and it is available in

Similarly, association declarations may purport to waive application of the homestead exemption for foreclosure of the association lien. Many states have passed statutes explicitly carving out CIC associations from the applicability of such limitations. The Colorado statute expressly authorizes an association to ignore the homestead exemption otherwise applicable in that state. BA Mortg., LLC v. Quail Creek Condo. Ass'n, 192 P.3d 447, 451 (Colo. App. 2008). Texas, a state with a very broad homestead exemption, allows association foreclosure to circumvent this limitation. Inwood N. Homeowners' Ass'n v. Harris, 736 S.W.2d 632, 637 (Tex. 1987). In other states, the applicability of the homestead exemption to association lien foreclosure proceedings is less clear. *See, e.g.*, Andres v. Indian Creek Phase III-B Homeowner's Ass'n, 901 So.2d 182, 182–83 (Fla. Dist. Ct. App. 2005) (expressing, in dicta, doubt that covenants purporting to waive the state's homestead exception would be effective); Knolls Condo. Ass'n v. Harms, 781 N.E.2d 261, 267–69 (Ill. 2002) (holding that the homestead exemption did not preclude the association suing for possession of a defaulting unit but not reaching the question of whether it would preclude foreclosure of the association's lien).

169. *See* HYATT, *supra* note 14, at 120–21 (discussing the practical value of an association's lien rights as dependent upon the state law authority for the lien, procedures for perfection and enforcement, and lien priority). In some states, perfection of the lien is automatic. In other states, a filing is required to perfect the lien. State law may require re-filing to maintain perfection. For example, in New Hampshire, a notice of an association's lien must be re-filed every six months to retain perfection. N.H. REV. STAT. ANN. § 356-B:46, III (LexisNexis 2010). States specifically prescribe the method of foreclosure and the process required in order to legally foreclose on real property. In addition, certain states have attempted to limit the power of associations to foreclose based on unpaid assessment liens. For example, in 2004, a bill in California that would have set a threshold of $2500 of unpaid assessments before an association could pursue foreclosure was vetoed by Governor Arnold Schwarzenegger. *See* Jim Wasserman, *Schwarzenegger Rejects Ban on Foreclosures*, ASSOCIATED PRESS, Oct. 1, 2004, *available at* http://www.calhomelaw.org/doc.asp?id=462 (discussing Governor Schwarzenegger's veto of a bill that would have required associations to use small claims courts, instead of nonjudicial foreclosure, to collect unpaid debts under $2500).

170. *See infra* Part I.C.2 (discussing assessment lien priority).

171. *See, e.g.*, Bd. of Dirs. of Olde Salem Homeowners Ass'n v. Sec'y of Veterans Affairs, 589 N.E.2d 761, 764 (Ill. App. Ct. 1992) (finding that a buyer at a mortgage foreclosure took the property free of assessments accruing prior to recording of the deed, which were extinguished by the foreclosure action); Long Island Sav. Bank, F.S.B. v. Gomez, 568 N.Y.S.2d 536, 537 (N.Y. Sup. Ct. 1991) (finding that an association's junior lien was extinguished by foreclosure of the senior priority mortgage).

172. NELSON & WHITMAN, *supra* note 58, at 600–01, 633.

173. *Id.* at 601 n.1. Judicial foreclosure is the exclusive or generally used method in

every jurisdiction.[174] Judicial foreclosures are complicated, costly, and time-consuming compared with non-judicial foreclosures pursuant to a power of sale.[175] Some states that permit a mortgage containing an explicit power of sale to be non-judicially foreclosed will likewise permit non-judicial foreclosure of association liens. Such states have a separate foreclosure statutory provision dealing solely with association liens.[176]

Most associations, as well as owners and legislatures, view the foreclosure of an assessment lien as "a last resort" for two reasons.[177] First, foreclosure proceedings—even in states permitting non-judicial foreclosure of association liens—involve significant upfront costs such as advertising, auction, and legal fees. These costs would have to be borne by the neighborhood as a whole, unless they can be recovered from the delinquent owner. Second, a buyer who purchases at an association foreclosure would take the property subject to a first priority mortgage lien unless that loan amount is paid off.[178] This vastly

Arkansas, Delaware, Florida, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Montana, Nebraska, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, South Carolina, and Wisconsin. In two other states, Connecticut and Vermont, foreclosure is judicial but is not a public sale; rather, it is a transfer of ownership to the lienor (called strict foreclosure).

174. In some states, an explicit statutory right to foreclose through the court exists. In others, judicial foreclosure is available as an incident to the jurisdiction of courts of equity. *See* Lansing v. Goelet, 9 Cow. 346, 366, 403 (N.Y. 1827) (holding that the decree for the sale of mortgaged premises was within the inherent powers of a court of equity, in addition to a statutory right to foreclose through the court).

175. STEVEN W. BENDER ET AL., MODERN REAL ESTATE FINANCE AND LAND TRANSFER 419–21 (4th ed. 2008); NELSON & WHITMAN, *supra* note 58, at 601–02.

176. *E.g.*, Property Owners' Association Act, VA. CODE. ANN. tit. 55 § 516 (2007) (titled "Lien for Assessments"); Maryland Condominium Act, MD. CODE ANN., REAL PROP. § 11-110 (West 2003), *amended by* Act of May 10, 2011, ch. 387, H.B. 1246 (effective Oct. 1, 2011).

177. Benny L. Kass, *Condo Board Can Foreclose for Delinquent Fees*, WASH. POST, Feb. 14, 2009, at F4; *see also* Baker v. Monga, 590 N.E.2d 1162, 1164–65 (Mass. App. Ct. 1992) (holding that a unit valued at $350,000 could be foreclosed for the owner's nonpayment of assessments totaling less than $3000). A recent unsuccessful bill in California attempted to place a significant cost threshold on when an association could pursue foreclosure to enforce its lien for unpaid assessments. S.B. 1682, 2003–2004 Reg. Sess. (Cal. 2004).

178. Junior priority liens are wiped out by foreclosure and, after paying amounts owed to the association, are distributed to such lienors in order of priority, but buyers at the foreclosure of a junior lien take subject to senior liens. Most courts have held, and scholars have opined, that this "subject to" means that a junior lien foreclosure transfers the property with the senior liens intact but unpaid. NELSON & WHITMAN, *supra* note 58, at 611–14; *see also, e.g.*, Shaikh v. Burwell, 412 S.E.2d 924, 926 (N.C. Ct. App. 1992) ("If the trustee is only foreclosing on the junior deed of trust, the senior lien continues with the property and the trustee must sell subject to the senior lien."). In a puzzling recent Virginia decision, however, foreclosure of an association's junior lien was misinterpreted to mandate payment of the first mortgage, rather than as a sale of property subject to a first mortgage lien. Bd. of Dirs. of the Colchester Towne Condo. Council of Co-Owners v. Wachovia Bank, N.A., 581 S.E.2d 201, 206 (Va. 2003). The Supreme Court of Virginia, over a vigorous dissent, interpreted the statutory authority to foreclose the unit "subject to prior liens" to mean that proceeds of the association's foreclosure sale must be used first to

decreases the ability of the association to find a third-party buyer at such a sale. In fact, in today's environment of underwater properties, finding an interested third-party buyer at a junior lien foreclosure would be unlikely at best.

In the absence of a third-party buyer, the association in an assessment foreclosure would be forced to take title to the unit itself. While this strategy might allow an association to rent out a unit and pay rental proceeds toward association costs, this approach is risky.[179] Once an association takes title to a unit, it becomes responsible for the assessments on that unit, which means that the unit's assessment obligations will continue to be spread among the paying owners in the community—precisely the unsatisfactory result that collection efforts against the prior owner were trying to avoid in the first place. As the owner, the association also becomes liable for property taxes, meaning that yet another cost is passed on to the community. Although the association could theoretically mitigate these costs by renting out the unit, this would entail the association becoming a landlord, exposing the community to the various risks and liabilities of assuming that role.[180] Even if an association is willing to serve as a landlord, rental properties

satisfy the lien of the first deed of trust before any delinquent assessments are reimbursed. *Id.* at 203–04. The doctrinal basis of this holding seems misconstrued. The majority cites principles of interpretation—that a statute should be read to be internally consistent—to support its conclusion. *Id.* at 203. But the asserted inconsistency seems to arise from the court's complete misunderstanding of secured transactions law. The court states that by granting first mortgage liens super priority in Virginia Code section 55-79.84(A), the Virginia Legislature implicitly required the judicial reformation of the statutory repayment waterfall in an association foreclosure, as contained in Virginia Code section 55-79.84(I)(5)(c). *Id.* at 203–04. As the dissent noted, this interpretation "is inconsistent with that phrase's well-understood and long accepted meaning." *Id.* at 205 (Lacy, J., dissenting). Justice Lacy also notes that there is nothing ambiguous or inconsistent in the statute that requires judicial re-writing of the language to reach the majority's result, chiding that "we generally do not engage in adding words to a statute." *Id.* While this decision runs contrary to nearly every other interpretation of the term "subject to," the Virginia General Assembly has thus far been unable to pass legislation correcting this judicial precedent. *See* S.B. 411, 2010 Sess. (Va. 2010) (stricken Jan. 27, 2010) (attempting to clarify the statute by adding language that states that the term "subject to" means that liens to which an association's lien is subordinate "shall survive the sale and be binding upon the purchaser at such sale").

179. *See, e.g.*, Daniel Vasquez, *Should Condo Associations Rent Units in Foreclosure?*, SUN SENTINEL (Mar. 18, 2009), http://articles.sun-sentinel.com/2009-03-18/news/0903170451_1_rent-units-condo-associations-foreclosure-action (explaining the various costs and liabilities that an association incurs when it becomes a landlord of units it acquires in assessment foreclosure proceedings).

180. *See, e.g.*, Matt Humphrey, *HOA Foreclosing to Rent Units? First Know the Risks*, HOALEADER.COM (Mar. 25, 2011), http://www.hoaleader.com/public/554.cfm (warning that an association becoming a landlord of a unit acquired in foreclosure is "very dangerous" because it "opens the association up to economic liability"). *But see* Gehrke-White, *supra* note 13 (explaining that in the context of long bank foreclosure delays, condominium association foreclosure and renting of units is the only way to obtain assessment funds from defaulting units).

that are subject to pending mortgage foreclosure—and therefore potentially terminable with little advance notice—would likely fetch rentals that are far below market. The depressed rental revenue may not be enough to pay property taxes and assessment charges on the unit.[181]

Generally, senior lienholders cannot be joined in a foreclosure action involuntarily.[182] Some dated case law supports the contention that a junior lienor may join a senior lienor in a combined foreclosure proceeding when the senior loan is also in default and is due and payable.[183] In the unlikely event that this doctrine would gain new traction, it could permit foreclosing associations to join a lender and potentially safeguard its lien in a sufficient sale or, at least, speed the process of senior lien foreclosure, giving associations the legal ability to self-protect in an environment of lender foreclosure delays. Most courts today, however, agree that a lienor has the right to choose the timing of foreclosure of its lien.[184]

2. Priority Baseline

As a general rule, liens on real property enjoy a priority based on the order in which they were perfected.[185] This first-in-time basic presumption is usually subject to a handful of exceptions under state law, including municipal real property taxes, which always enjoy the highest lien priority.[186] In addition, most states set the priority of a mechanic's lien supporting payment obligations for work done to the

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181. *See* Bruce Rogers, *Collecting Delinquent Assessments: Why the Old Ways Won't Work and How to Play the Association's Cards in the Great Recession*, LM FUNDING LLC, 1, http://www.lmfunding.com/assets/Collecting-Delinquent-Assessments-in-Todays-Market.pdf (last visited Oct. 30, 2011) (explaining that current economic reality is why only 4% of associations with delinquent assessments foreclose on their liens).

182. NELSON & WHITMAN, *supra* note 58, at 611; *see also, e.g.*, Osage Oil & Ref. Co. v. Mulber Oil Co., 43 F.2d 306, 308 (10th Cir. 1930) (holding that the junior lienor cannot enforce a sale for more than its own equity of redemption without consent of the senior lienor).

183. *See, e.g.*, Hefner v. Nw. Mut. Life Ins. Co., 123 U.S. 747, 754 (1887) (holding that when a first mortgagee's debt is due and payable, the first mortgagee may be made a party); Hagan v. Walker, 55 U.S. 29, 37 (1852) (holding that a senior lienor may be a "necessary party" to a foreclosure, when the senior lienor is also in default, so that "a sale may be made of the whole title"); Masters v. Templeton, 92 Ind. 447, 451–52 (1883) (allowing a junior mortgagee to join a senior mortgagee so that the "ultimate rights of the parties" may be determined in one action); Peabody v. Roberts, 47 Barb. 91, 102 (N.Y. 1866) (allowing a junior mortgagee to proceed with a foreclosure action despite a prior foreclosure and sale under the senior mortgage). Even as late as 1992, the court in *Shaikh v. Burwell* cited six possible "special circumstances" that would enable a junior lienor to join a senior lienor in a foreclosure action. *Shaikh*, 412 S.E.2d at 927–28.

184. NELSON & WHITMAN, *supra* note 58, at 612. This creative approach is similar to the "mortgage terminator" approach that has recently been used on occasion in Florida. *See infra* Part II.A.2 (discussing creative strategies used by attorneys in seeking recovery for their clients).

185. BENDER ET AL., *supra* note 175, at 123.

186. *Id.* at 271–73.

real property itself as relating back to the date on which such work was commenced.[187] In the absence of a statutory directive to the contrary, assessment liens follow the general first-in-time priority rule, and because mortgage loans are typically funded prior to assessment delinquencies, such first mortgage liens are senior to assessment liens.[188] The California Condominium Act, for example, explicitly follows the first-in-time rule, setting lien priority according to the time a separate "notice of delinquent assessment" is filed in the land records.[189]

In some states, assessment liens are considered automatically perfected with the date of perfection relating back to the date on which the association was formed (when the declaration was filed in the land records).[190] However, statutes defining priority in such states specifically make an exception for first mortgage liens on individual units within the community, permitting the first mortgage to always enjoy a priority senior to the association lien, even though the first-in-time rule would otherwise deem the related-back perfected association lien to be first.[191] For example, the Virginia Condominium Act provides that the assessment lien is subordinate to "sums unpaid on any first mortgages or first deeds of trust recorded prior to the perfection of said lien for assessments and securing institutional lenders."[192]

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187. *See, e.g.*, CAL. CIV. CODE §§ 3134, 3137 (West 1993) (providing that liens for site improvements have priority based on the commencement of site improvements); 770 ILL. COMP. STAT. ANN. 60/16 (West 1989) (providing that no encumbrances placed upon land shall operate before a lien in favor of work done or materials furnished has been satisfied).

188. An increasing number of states have statutorily created a limited priority for such liens. *See infra* Part II.A (discussing some attempted and proposed solutions to the problem of assessment nonpayment and foreclosure delay). Some states define the time of perfection for association liens as relating back to the date on which the assessment was due. *See infra* note 190 and accompanying text.

189. CAL. CIV. CODE § 1367.1(b), (d) (West 2011).

190. The UCIOA takes this approach. *See* UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (1994), *available at* http://www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/ucioa94. htm (stating that recording of the declaration constitutes record notice and perfection of the lien); *see also* FLA. STAT. ANN. § 718.116(15)(a) (West 2011) (providing that the lien is effective dating back to the recording of the original declaration); TEX. PROP. CODE ANN. § 82.113 (West 1997) (providing that the association's lien for assessments is created by recordation of the declaration, which constitutes perfection); *see also, e.g.*, American Holidays, Inc. v. Foxtail Owners Ass'n, 821 P.2d 577, 580 (Wyo. 1991) (deeming the date the declaration was recorded as the date of perfection for assessment lien).

191. *See, e.g.*, COLO. REV. STAT. ANN. § 38-33.3-316 (LexisNexis 2010) (providing that any security interest created before the assessment becomes delinquent has priority over the assessment lien). This way of conceptualizing the priority of association liens likely originated with the FHA Model Condominium Act of 1961. In some cases, the priority granted to first mortgage liens is subject to a capped super-priority. *See infra* Part II.A (discussing capped "super priority" liens).

192. VA. CODE ANN. § 55-79.84A (LexisNexis 2007).

Arizona's Condominium Act protects first mortgage priority even further, providing that such liens are always superior to assessment liens regardless of when they arose.[193] Maryland and North Carolina also deem an association lien completely subordinate to first mortgage liens on units within the community.[194] In states where the statute is arguably vague as to the priority position of the first mortgage, courts have clarified that even an assertion of super-priority in the declaration establishing the community will not create a priority superior to a first mortgage lien.[195] Thus, regardless of jurisdiction, first mortgages on units within a community are senior in priority to association liens for unpaid assessments. Legislatures and courts cite a policy of promoting financing availability as the motivation for this priority scheme.[196]

Holders of junior claims on the property (both liens and holders of equity) must be joined in a foreclosure proceeding to terminate their rights.[197] Because the association is a junior lienor, a foreclosing first mortgage loan is required to name the association as a necessary party to the foreclosure proceeding, and any excess sale proceeds beyond the amount owed on the first mortgage will be applied to the association's claim. However, where mortgages are under-collateralized, foreclosure sales typically do not obtain sufficient proceeds to pay off the first mortgage, let alone junior liens. Whether paid off or not, junior liens are wiped out in foreclosure of the senior lien.

Courts and legislatures in some states have attempted to limit the extent of association losses and protect community members against non-payment of assessments, even those lacking any priority protection with respect to first mortgages.[198] In New York, for example, the

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193. ARIZ. REV. STAT. ANN. § 33-1256B (West 2007) (effective through Jan. 1, 2012).

194. MD. CODE ANN., REAL PROP. § 11-110 (LexisNexis 2010); N.C. GEN STAT. ANN. § 47C-3-116 (LexisNexis 2009). Maryland recently enacted a three-month capped priority for unpaid assessments. *See infra* notes 290–92 and accompanying text.

195. *See* Holly Lake Ass'n v. Fed. Nat. Mortg. Ass'n, 660 So. 2d 266, 269 (Fla. 1995) (holding that an assessment lien relating back to the date of declaration would expose lenders to unknown risks and therefore cannot have priority); Tally Arms Condo. Ass'n, Inc. v. Breland, 854 So. 2d 28, 30 (Miss. Ct. App. 2003) (holding that a subsequent assessment lien cannot have priority over a mortgage lien); First Fed. Sav. & Loan Ass'n of Charleston v. Bailey, 450 S.E.2d 77, 81 (S.C. Ct. App. 1995) (holding that assessments fixed or determined subsequent to a mortgage lien are subordinate to the assessment lien).

196. *See, e.g*, Bd. of Dirs. of Colchester Towne Condo. Council of Co-Owners v. Wachovia Bank, N.A., et al., 581 S.E.2d 201, 202 (Va. 2003) (explaining that "the realities of the marketplace require that such lenders be encouraged to provide the desired financing for individual condominium units by granting priority to the lien of their first mortgages or first deeds of trust").

197. NELSON & WHITMAN, *supra* note 58, at 570–73, 602–08.

198. A limited priority lien for assessment liens has been proposed multiple times to the New York legislature, but lenders have lobbied against the adoption of the measure. The first year it

statutory lien securing all unpaid condominium assessments is junior in priority to first mortgage liens,[199] and New York case law has confirmed that all sums related to a first mortgage lien (including collection costs, fees, etc.) on a unit within a community take priority over an association lien.[200] If a unit is delinquent on assessments in New York, however, legislation provides that the association may obtain a court-appointed receiver to pay regular assessments to the association *prior to* making any mortgage payments, and collect rents directly from a tenant.[201] Case law clarified that this provision does not apply to special assessments that are payable by a receiver only after mortgage loan payments are made.[202]

Even without appointing a receiver or foreclosing its lien, associations in Florida, like New York, can collect rents directly from any tenants living in units owned by defaulting members.[203] The 2010 amendment to the Florida Common Interest Community Act provides that associations can collect rent payments directly from tenants when the owner of a unit is delinquent and further provides that if tenants do not pay rent to the association, the board can evict them.[204] The revised law also explicitly permits associations to suspend voting privileges for owners who are ninety days delinquent in their assessments and clarifies

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was proposed, the measure was allowed to die in committee. The next year, it was defeated on the floor. *See* Ronald A. Sher, Esq., *Habitat Board Leadership Conference Seminar: Condo Collections*, HIMMELFARB & SHER LLP, http://www.himmelfarb-sher.com/options/condo_collections.htm (last visited Aug. 16, 2011) (discussing a proposed law that would give assessment liens a limited priority for six months).

199. N.Y. REAL PROP. LAW § 339-z (McKinney 2006).

200. Bankers Trust Co. v. Bd. of Managers of Park 900 Condo., 616 N.E.2d 848, 849 (N.Y. 1993).

201. N.Y. REAL PROP. ACTS § 1325(2) (McKinney 2006).

202. *See* First N.Y. Bank for Bus. v. 155 E. 34 Realty Co., 158 Misc. 2d 658, 661 (N.Y. Sup. Ct. 1993) (holding that special assessments are generally for capital improvements well beyond the period of receivership, and thus, obligation for the special assessments cannot be placed on the receiver).

203. *See* S.B. 1196, 2010 Sess. (Fla. 2010) (effective July 1, 2010).

204. S.B. 1196, 2010 Sess. (Fla. 2010) (codified at Fla. Stat. § 718.116 (2011)). The newly amended Florida provision attempts to permit associations to walk the fine line between incurring landlord liability and having the authority to collect rents and evict tenants. Tenants in Florida and New York, however, raise a valid complaint that they have no contractual or property relationship with the association (except indirectly through their landlord) and that even though the statute in question purports to immunize tenants who pay rents to the association against eviction by the landlord, landlords can do much to lower a tenant's quality of life while still acting within the strict "letter of the law" of a lease. *See* Kenric Ward, *Condo Associations Put 'Hammer' Down on Renters*, SUNSHINE STATE NEWS (June 2, 2010), http://www.sunshinestatenews.com/story/condo-associations-put-hammer-down-renters (highlighting the potential pitfalls of the new law for tenants).

that associations can restrict delinquent owners' use of common areas.[205]

Bankruptcy of a delinquent owner may impact an association's ability to collect delinquent assessments, particularly under Chapter 12, which permits junior liens to be "stripped" of their collateral claims when the collateral's value is less than the amount owed on a senior debt.[206] In a November 2010 decision, the U.S. Bankruptcy Court for the Eastern District of Virginia ordered that a community association be stripped of its unpaid assessment lien in the amount of nearly $7000 because the property was subject to a first mortgage debt that exceeded its current county-assessed value, which, the court opined, left no excess security to which the association's lien could attach.[207] Although the association argued that the cited real estate value for the property was "artificially low" because of a depressed housing market,[208] the court refused to preserve the lien "based solely on anticipated future increase in the value of a secured creditor's collateral."[209] The court held that while under-secured creditors' liens are generally valid, in the case of a party whose secured claim has "inconsequential value," a bankruptcy filing should cause the lien to disappear.[210] The operation of the Bankruptcy Code in this case further bolsters the argument that a junior priority for association liens is inequitable, particularly in cases of homes securing under-collateralized mortgages.

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205. S.B. 1196, 2010 Sess. (Fla. 2010).

206. *See In re* Cook, No. 10-10113-SSM, 2010 WL 4687953 at *1–2 (Bankr. E.D. Va. Nov. 10, 2010) (holding that Section 506(d) of the Bankruptcy Code makes any junior lien void upon a prior lien exhausting a creditor's collateral); *see also* 11 U.S.C. § 523(a)(16) (2006). Although Congress has specified that post-petition assessments are non-dischargeable in Chapter 7 bankruptcies, this carve-out specifically does not apply to pre-petition debts including assessments. *Id.*

207. *In re Cook*, 2010 WL 4687953, at *2. Interestingly, county tax assessed value is not how a property's value is typically determined. Market players typically price according to comparable sales or stream-of-income value for a property, and even judicial review of foreclosure sale prices admits that there is no precise benchmark for real property valuation. *See* B.F.P. v. Resolution Trust Corp., 511 U.S. 531, 545 (1994) (mentioning that there are several ways to determine a property's fair market value).

208. The association cites the "economic crisis that was triggered by the sub-prime mortgage loan meltdown" as having caused the drop in property valuation. *In re Cook*, 2010 WL 4687953, at *2.

209. *Id.*

210. The court also noted that "[a]lthough there may well be policy arguments favoring preservation of liens for pre-petition assessments when debtors in reorganization cases propose to retain the property, such arguments are properly addressed to Congress." *Id.*

II. ALTERNATIVES TO FAILED PRIVATE GOVERNANCE

Under current laws, owners in a CIC face financial uncertainty stemming from the ownership structure and assessment model of their community. Linked fiscal fortunes means that owners face the threat of ever-increasing assessments due to their neighbors' delinquencies, and these unpaid assessments may never be recovered because of such neighbors' mortgage defaults. The status quo in most states is not only destabilizing, it is also inequitable. Association maintenance preserves the value of a lender's collateral, and passing the pro rata share of upkeep costs onto non-defaulting owners results in unjust enrichment of the lenders.[211] Courts and legislatures have struggled to resolve such unfairness, particularly now that the current crisis has highlighted this deficiency in the CIC assessment system.

A. Other Attempted and Proposed Solutions

1. Limited Priority Liens

a. UCIOA and Six-Month Limited Priority Lien

The drafters of the Uniform Common Interest Ownership Act ("UCIOA"),[212] recognizing that assessment liens would ordinarily be junior in priority to individual first mortgage liens, crafted an "innovative" solution to the problem of assessment nonpayment during mortgage default: the six-month "limited priority lien."[213] The UCIOA model, which has been adopted by eight states to date,[214] provides that

211. *See generally* RAWLS, *supra* note 5, at 96 (advocating that beneficiaries of a cooperative venture should bear the costs of such a venture on a *pro rata* basis); Hart, *supra* note 5, at 185–86 (arguing that enjoyment of benefits by parties not bearing associated costs is inequitable).

212. *See generally* UNIF. COMMON INTEREST OWNERSHIP ACT (1994) [hereinafter UCIOA]. In 1977, the National Conference of Commissioners on Uniform State Laws began drafting the Uniform Condominium Act based on the 1974 Virginia model. Subsequently, the Conference prepared three uniform laws governing condominiums, cooperatives, and homeowners associations—the three forms of privately governed communities with different ownership structures. These were the Uniform Condominium Act, the Uniform Planned Community Act, and the Model Real Estate Cooperative Act. The Conference then combined the three acts, resulting in the UCIOA. This Act contains provisions governing condominiums, planned unit development/homeowner associations, as well as cooperatives.

213. Carl Lisman, Chair of UCIOA's Drafting Comm., Presentation to the Maryland Task Force on Common Ownership Communities—Maryland Dep't of Hous. and Cmty. Dev. at the American Homeowners Resource Center: The Uniform Common Interest Ownership Act (June 9, 2006) (transcript available at http://www.epohoa.org/index.php?option=com_content&view=article&id=104:formation-1975-a-birth-of-ucioa&catid=93:news&Itemid=111). Lisman seems to believe that the UCIOA limited priority lien solves the problem of non-payment of assessments, noting that "we are now convinced that we are more brilliant than we thought we were." *Id.*

214. *See infra* notes 221–28 (explaining that these eight states include Nevada, Alaska,

an assessment lien, which is normally subordinate in priority to first mortgages on units, is given limited priority upon foreclosure of the first priority mortgage lien "to the extent the common expense assessments based on the periodic budget adopted by the association . . . would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien."[215] Thus, an association under UCIOA would have a priority position arising at a mortgage foreclosure sale for unpaid assessments up to an amount equal to six months of regular-assessment assessments.[216]

The six-month capped "super priority" portion of the association lien does not have a true priority status under UCIOA since this six-month assessment lien cannot be foreclosed as senior to a mortgage lien. Rather, it either creates a *payment* priority for some portion of unpaid assessments,[217] which would take the first position in the foreclosure repayment "waterfall," or grants *durability* to some portion of unpaid assessments,[218] allowing the security for such debt to survive foreclosure.[219]

The UCIOA priority portion does not include costs incurred by the association to collect delinquent assessments, such as attorney fees. Some states, however, have enacted statutory variations that include such costs.[220] According to Washington, D.C. lawyer Catherine Park,

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Colorado, West Virginia, Connecticut, Vermont, Minnesota, and Delaware). Legislative proposals to adopt UCIOA are pending in six more states: Utah, Indiana, New Jersey, South Carolina, Kentucky, and Ohio.

215. UCIOA § 3-116.

216. *Id*. Under such a capped priority arrangement, the priority position of the association lien is split: a super-priority position is given to up to six months of unpaid assessment amounts, and the remainder of unpaid amounts is accorded the typical priority position of the association lien, namely subordinate to the first mortgage lien. *Id*.

217. *See*, *e.g.*, MINN. STAT. ANN. § 515A.3-115 (West 2002 & Supp. 2010), *amended by* H.F. 1023, ch. 116, 2011 MINN. SESS. LAW SERV. (West) (providing that the lien does not have priority over a senior mortgage lien, but allows for recovery of assessments for a period of six months). Under this interpretation, six months of unpaid assessments are paid out of foreclosure proceeds prior to repayment of the first mortgage.

218. Under this interpretation, a lien securing six months of unpaid assessments would survive the first mortgage foreclosure. One problem with this second interpretation of the super-priority provision is that post-foreclosure, an association often still has to bring a lawsuit against the buyer or lender to recover the six months of allowable unpaid assessments. This can be onerous for the association. For example, in Georgia, an association cannot recover the costs of bringing an action to recover the six months' worth of assessments against the lender. First Fed. Sav. Bank of Ga. v. Eaglewood Court Condo. Ass'n, Inc., 367 S.E.2d 876, 878 (Ga. Ct. App. 1988) (finding that the statutory language limited recovery from the lender at six months of assessments, not including the costs of collecting such assessments).

219. The effect depends on a state's interpretation of the provision.

220. *See*, *e.g.*, MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 1996 & Supp. 2002); CONN. GEN. STAT. ANN. § 47-258 (West 2009 & Supp. 2011) (allowing for recovery of attorney's fees within the priority portion).

who specializes in condominium law and litigation, the failure of strict UCIOA states to include attorney costs can be exploited by mortgage lenders, which gamble that an association will not hire an attorney to recover "a mere six months" of unpaid assessments.[221]

The lien priority concept contained in UCIOA has gained traction even in states that have not otherwise enacted these uniform acts. Today, in the eight UCIOA states (Alaska,[222] Colorado,[223] Connecticut,[224] Delaware,[225] Minnesota,[226] Nevada,[227] Vermont,[228] and West Virginia[229]), in ten more states (Alabama,[230] Florida,[231] Illinois,[232] Maryland,[233] Massachusetts,[234] New Jersey,[235] Pennsylvania,[236] Rhode Island,[237] and Washington[238]), and in the

221. Catherine Park, *"Super Lien" Legislation: How Super is it Really? And Why Isn't the Mortgage Industry Complying with the Legislation?*, LAW OFFICE OF CATHERINE PARK (July 10, 2010), http://cparklaw.com/condolaw/2010/07/10/super-lien-legislation-how-super-is-it-really-and-why-isnt-the-mortgage-industry-complying-with-the-legislation. According to Park, the only way for would-be homeowners to protect themselves in such jurisdictions is to "avoid buying in a small community" and thereby hope to minimize the budgetary impact of assessment defaults. *Id*.

222. ALASKA STAT. § 34.08.470 (2010).

223. Colorado Common Interest Ownership Act, COLO. REV. STAT. § 38-33.3-316 (LexisNexis 2010); *see infra* notes 241–46 and accompanying text.

224. CONN. GEN. STAT. ANN. § 47-258.

225. DEL. CODE ANN. tit. 25, § 81-316 (2009).

226. MINN STAT. ANN. § 515B.3-115(a), (e)(1)–(3), (f), (i) (West 2002 & Supp. 2010), *amended by* State Agencies–Courts And Common Interest Ownership Act, ch. 116, sec. 16, § 515B.3-115, 2011 MINN. SESS. LAW SERV. (West).

227. NEV. REV. STAT. ANN. § 116.3116(2)(c) (LexisNexis 2010), *amended by* Uniform Laws–Amendments–Common Interest Communities Act, ch. 389, sec. 49, § 116.3116, 2011 Nev. Legis. Serv. (West); *see infra* notes 273–74 and accompanying text.

228. VT. STAT. ANN. tit. 27, § 1323 (2006).

229. W. VA. CODE ANN. § 36B-3-116 (LexisNexis 2005).

230. ALA. CODE § 35-8A-316 (LexisNexis 1991).

231. FLA. STAT. ANN. (West 2011); *see infra* notes 280–86 and accompanying text.

232. 765 ILL. COMP. STAT. ANN. 605/9 (West 2009). Section 9(g) of the Illinois Condominium Property Act requires the association board to have "taken action" to trigger the requirement that subsequent purchasers of a foreclosed unit pay six months of unpaid assessments. *Id*.

233. MD. CODE ANN., REAL PROP. § 11-110 (LexisNexis 2010), *amended by* Condominiums and Homeowners Associations—Priority of Liens Act, ch. 387, sec. 2, § 11-110, 2011 Md. Legis. Serv. (West) (granting a mere four-month, $1200-capped priority to association assessment liens at mortgage lender foreclosure).

234. MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 1996 & Supp. 2002). The Massachusetts statute includes a provision for attorneys' fees together with a dollar-amount cap. *Id.*

235. N.J. STAT. ANN. § 46:8B-21 (West 2003 & Supp. 2010).

236. 68 PA. CONS. STAT. ANN. § 3314 (West 2004).

237. R.I. GEN. LAWS § 34-36.1-3.16 (1956 & Supp. 2010).

238. WASH. REV. CODE ANN. § 64.34.364 (West 2005).

District of Columbia,[239] community association liens enjoy a limited priority, typically capped at six months or less. Legislatures in five states (Indiana, Kentucky, Ohio, South Carolina, and Utah) have been considering adopting a UCIOA-based statute that would include a six-month lien priority for unpaid assessments.[240] Even with these progressive statutory developments in many states, more than thirty states lack any lien priority for association assessments.

To illustrate the typical UCIOA lien priority approach, consider the Colorado Common Interest Ownership Act ("CCIOA").[241] Under the Act, association liens, which include assessments and all collection costs, are considered automatically perfected as of the date the association was created.[242] This type of lien is subordinate to property tax liens and to a first deed of trust on the property, but it is superior to all other encumbrances of record, regardless of when such other lien is filed.[243] At foreclosure of a first deed of trust on a property,[244] the association lien will be paid according to a limited priority position to the extent of six months of budgeted assessment amounts.[245] Colorado courts have held that the lien may be more than assessments alone, as it also includes "attorney fees, interest & other allowable items."[246] In

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239. D.C. CODE § 42-1903.13 (2001).

240. *See* MALLACH, *supra* note 29, at 12 (advising state policymakers to consider allowing borrowers of mortgages in foreclosure a six month forbearance period).

241. COLO. REV. STAT. § 38-33.3-316 (2011). The 1992 version of the Colorado Common Interest Ownership Act ("CCIOA") automatically applies to associations created after 1992, but any pre-1992 association can elect to avail itself of the protections and provisions of the Act. By electing to come under the 1992 CCIOA, an association can effectively change the provisions in its own governing documents, without filing an amendment, since application of the law is deemed to change inconsistent declaration language in order to conform to the Act.

242. *Id*. The automatically perfected lien applies to "any assessment levied against that unit or fines imposed against its unit owner," which includes fees, late charges, attorneys' fees, and interest. *Id.* § 38-33.3-316 (1). There are no limits on late fees and interest, but it is arguably unclear whether the statutory language includes attorney fees.

243. *Id.* § 38-33.3-316 (3). This is because the priority timing for the association lien relates back to the recordation of the declaration. This applies only to liens for deeds of trust recorded after 1992 when CCIOA was created. For all such provisions, the super-priority six-month lien applies, regardless of language in the community documents or the deed of trust to the contrary. *Id.*

244. A deed of trust is essentially a mortgage. The common foreclosure method for mortgage liens in Colorado is non-judicial foreclosure through power of sale in a deed of trust. The only way to foreclose an association lien, however, is through a judicial proceeding. *See*, *e.g.*, ORTEN CAVANAGH RICHMOND & HOLMES, LLC, COLO. FORECLOSURE LAWS 1–2, 8 (Mar. 2008), *available at* http://www.ocrhlaw.com/library/Colorado_Foreclosure_Laws.pdf (explaining the non-judicial foreclosure procedure in Colorado and contrasting the non-judicial procedure to the mandated judicial foreclosure procedure for association liens).

245. *Id.* at 8.

246. First Atl. Mortg., LLC v. Sunstone N. Homeowners Ass'n, 121 P.3d 254, 255 (Colo. App. 2005) (citing COLO. REV. STAT. § 38-33.3-316 (2)(b) (2010)).

Colorado, the lien is not payable out of foreclosure proceeds, but rather survives the foreclosure of the first deed of trust (a durability interpretation of the UCIOA lien priority provision).[247]

Within non-UCIOA states, some lien priority statutory provisions originated in response to past housing crises imperiling community associations in that jurisdiction. For example, Massachusetts' lien priority law grew out of the state's real estate boom and bust of the late 1980s and early 1990s.[248] Two decades ago, associations in Massachusetts struggled with massive budget shortfalls when homeowners abandoned units they could no longer afford, forcing the communities to increase assessments on the remaining owners to keep the association afloat. The remaining owners often could not afford to make up extra payments to bridge the budgetary gap, which led to a domino effect of assessment and mortgage delinquencies.[249] Today, CIC liens in Massachusetts have a capped super-priority because of judicial and legislative efforts to protect communities during the 1990s.[250]

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247. This follows logically from the limitation on non-judicial foreclosure of association liens. *See supra* notes 201–02 (explaining that New York case law provides that all sums related to a first mortgage lien on a unit within a community, including collection fees and costs, take priority over an association lien). However, New York legislation provides that if a unit is delinquent on assessments, the association is able to obtain a court-approved receiver to pay regular assessments to the association before making any mortgage payments. N.Y. REAL PROP. ACTS. § 1325(2) (McKinney 2006). The association may also collect rents directly from a tenant. *Id.*

248. MICHAEL GOODMAN & JAMES PALMA, OFFICE OF THE PRESIDENT, UMASS DONAHUE INST., WINNERS AND LOSERS IN THE MASSACHUSETTS HOUSING MARKET: A STUDY FOR CITIZENS' HOUSING AND PLANNING ASSOCIATION AND THE MASSACHUSETTS HOUSING PARTNERSHIP 2 (2004), *available at* http://www.massbenchmarks.org/publications/studies/pdf/housingmarket04.pdf.

249. *See* Grahame K. Wells, *The Use of Super-Liens to Promote Cooperation Between Condominium Associations and Lenders*, 13 ANN. REV. BANKING L. 477, 477–78 (1994) (citing Henry L. Judy & Robert A. Wittie, *Uniform Condominium Act: Selected Key Issues*, 13 REAL PROP., PROB., & TR. J. 437, 475 (1978)). The troublesome state of the economy during the late 1980s and early 1990s left many condominium owners with severe financial problems, which in turn, led those owners to stop paying condo fees. Subsequently, the condos could no longer afford to perform proper maintenance or pay utility bills, the utilities were shut off by their providers, and local governments condemned the buildings. *Id.*; *see also* James Winokur, *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 353, 355 (1992) (discussing the real estate economy of the 1990s as a catalyst for creating limited lien priorities in several states).

250. Baker v. Monga, 590 N.E.2d 1162, 1164 (Mass. App. Ct. 1992) (holding that owners had an absolute obligation to pay assessments and that owners lack the right to withhold payments); s*ee also* Trs. of Prince Condo. Trust v. Prosser, 592 N.E.2d 1301, 1302 (Mass. 1992) (reiterating the *Monga* court's holding, stating that "[f]or the same reason that tax payers may not lawfully decline to pay lawfully assessed taxes because of some grievance or claim against the taxing governmental unit, a condominium unit owner may not decline to pay lawful assessments"). The Massachusetts legislature attempted to further mitigate the harm felt by associations losing their

Rhode Island's lien priority law is one of the newest in the nation, and it passed unanimously in the state's House and Senate in June 2008.[251] This legislation increased the capped foreclosure and collections cost amount to $5000 and $7500, respectively (inclusive of legal fees), and provided for a six-month lien priority for assessment liens upon foreclosure of the first mortgage.[252] Before the measure came to a vote, and when seeking the governor's veto thereafter, the Rhode Island Mortgage Bankers Association strenuously objected to the new law's lien priority provisions, claiming that they would spell the end of residential mortgage finance for community association housing in Rhode Island.[253] Legislative counsel to the Bankers Association bemoaned the measure, claiming that "it's basically picking the lenders' pockets, at the end of the day."[254] Rhode Island disagreed and passed the measure.

By crafting legislation that creates a six-month limited lien priority for assessments, state legislatures hope to motivate first mortgage lenders to help pressure non-paying owners to pay their delinquent obligations. If their borrowers make all their association payments, lenders can avoid paying six months' worth of assessments out of their foreclosure proceeds. If, however, the property is under-collateralized and mortgage foreclosure takes vastly longer than six months, the six-month priority cap actually may (perversely) induce a lender to further delay foreclosure until there is a ready third-party purchaser on hand. This is because a lender purchasing at foreclosure will be liable for all subsequent assessments, and the foreclosure will also trigger the six-month payment obligation, increasing the prospective lender costs of foreclosing. Also, a lender is still likely to recover more in an upside-down loan if a borrower makes payments on the mortgage rather than association deficiencies because the lender will only have to reimburse a six-month capped amount of association deficiencies at some future time.

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entire assessment lien by passing legislation that provides for a six-month lien priority arising at closing. MASS. ANN. LAWS ch. 183A, § 6 (LexisNexis 2011).

251. R.I. GEN. LAWS § 34-36.1-3.16 (2010). The previous law not only failed to provide any lien priority for assessment liens, but capped an association's reimbursement for foreclosure costs at $2500, with any additional costs having to be paid by the community as a whole. Patricia Antonelli, *Changes to Rhode Island Law Affect Foreclosures, Priority of Condominium Liens for Assessments, Mortgage Escrow Accounts and Reverse Mortgages*, PARTRIDGE SNOW & HAHN LLP (July 2008), http://www.psh.com/content345.

252. R.I. GEN. LAWS § 34-36.1-3.16 (2010).

253. Dunn, *supra* note 6, at G1 (quoting Terrance Martiesian, a lawyer for the Rhode Island Mortgage Bankers Association, who remarked that "[a] bank is not going to take second place . . . in the chain of liens against the property. . . . They want to be first.").

254. *Id.* (quoting James Hahn).

b. Federal Housing Impacts on Association Fiscal Recovery

Federal agencies and GSEs, such as Fannie Mae and Freddie Mac, insure or guarantee more than nine out of every ten mortgages that have been originated since the meltdown in credit markets in 2008.[255] The FHA now insures nearly 50% of all residential mortgages, up from 1.7% of the market in 2006.[256] As the buyer or insurer of nearly every currently originated mortgage loan, these federal policies regarding lending risk have an enormous impact in terms of capital availability. The policies of the FHA and the GSEs impact the resolution of the community assessment issue in two ways: first, by requiring any super-priority of assessment liens to be limited at six months' worth of assessments and, second, by prohibiting loans secured by units located in condominiums with high rates of neighborhood mortgage defaults.[257]

The GSE secondary market purchasers and the FHA insurers specifically define qualifying mortgages as a mortgage subject to no greater than a six-month capped assessment lien priority.[258] This effectively prevents association recovery beyond that threshold.[259]

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255. DEP'T OF TREASURY & U.S. DEP'T OF HOUS. & URBAN DEV., REFORMING AMERICA'S HOUSING FINANCE MARKET: A REPORT TO CONGRESS 12 (2011), *available at* http://www.treasury.gov/initiatives/Documents/Reforming%20America%27s%20Housing%20Finance%20Market.pdf [hereinafter TREASURY/HUD REPORT]; *see also* CTR. FOR AM. PROGRESS, A RESPONSIBLE MARKET FOR HOUSING FINANCE: A PROGRESSIVE PLAN TO REFORM THE U.S. SECONDARY MARKET FOR RESIDENTIAL MORTGAGES 2 (2011), *available at* http://www.americanprogress.org/issues/2011/01/pdf/responsiblemarketforhousingfinance.pdf (explaining that "Fannie Mae and Freddie Mac also now purchase more than 80 percent of all multifamily mortgages, loans to owners, and developers of rental residential properties").

256. CTR. FOR AM. PROGRESS, *supra* note 255, at 44–45; *see also Government Affairs Update: FHA Condo. Recertification Requirements*, NAT'L ASS'N OF REALTORS, http://www.realtor.org/wps/wcm/connect/15f94c8044f67a04b112f35d6aeab3b5/FHA%2BCondo%2BRecertification%2BRequirements%2B12.8.10.pdf?MOD=AJPERES&CACHEID=15f94c8044f67a04b112f35d6aeab3b5 (last visited Aug. 16, 2011); Rick Newman, *Kill Fannie and Freddie? Not Likely*, U.S. NEWS & WORLD REPORT (Feb. 21, 2011, 12:12 PM), http://money.msn.com/investing/kill-fannie-and-freddie-not-likely-usnews.aspx (explaining that most mortgages issued are currently supported by Fannie Mae, Freddie Mac or the FHA). In contrast, private lenders handled twenty percent of mortgages during "normal" times. *Id.*

257. *See infra* notes 258–59 and accompanying text.

258. *See* FANNIE MAE, FORM 1054 (1208): WARRANTY OF CONDOMINIUM PROJECT LEGAL DOCUMENTS, *available at* https://www.efanniemae.com/sf/formsdocs/forms/pdf/projectrevs/1054.pdf (specifying that in order for a loan to be qualifying, "[a]ny first mortgagee who obtains title to a condominium unit pursuant to the remedies in the mortgage or through foreclosure will not be liable for more than six months of the unit's unpaid regularly budgeted dues or charges accrued before acquisition of the title to the unit by the mortgagee"); *see also Condominium Unit Mortgages—Project Analysis*, FREDDIE MAC (Apr. 2011), http://www.freddiemac.com/learn/pdfs/uw/condoprojectanalysis.pdf (requiring that the first mortgagee obtaining title to the unit be liable "for no more than six months of unpaid, regularly budgeted assessments or charges (for late fees and collection costs) accrued before acquisition").

259. Financing for non-qualifying loans is increasingly hard to obtain in the current economic climate. *See* Dunn, *supra* note 23, at G1 (discussing Rhode Island foreclosure).

These definitions of qualifying mortgages make it impossible for a state to increase the priority of a community assessment. Such funding or insuring requirements therefore indirectly, but effectively, limit a community's ability to fully recover delinquent assessments at foreclosure of an underwater unit. These federal guidelines drive the bulk of all mortgage lending and unless the six-month limitation is changed, will prevent state legislatures from acting to solve the community assessment delinquency problem.

In addition to their priority requirements for qualifying mortgages, policies of these entities significantly limit finance capital availability for condominium units. The Department of Housing and Urban Development ("HUD") maintains a list of "Approved Condominium Projects," and FHA, Fannie Mae, and Freddie Mac will not insure or purchase mortgages to units in condominiums that are not on the approved list.[260] The new approval process implemented in the wake of the Housing and Economic Recovery Act of 2008 now disallows "spot loan" approvals—approvals based on applications for individual unit mortgages rather than the condominium as a whole.[261] Condominium projects will not be approved unless, *inter alia*, no more than 15% of the total units are in arrears (more than thirty days past due) of their association assessments.[262] An association with more than 15% delinquent owners can go after those owners personally for the unpaid amounts and would be wise to do so.[263] But if the owners are unable to

260. *See* Mortgagee Letter 2009-19 from Brian D. Montgomery, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees & All FHA Roster Appraisers 1 (June 12, 2009), *available at* http://www.bestfhalender.com/wp-content/uploads/2010/01/09-19ml.pdf [hereinafter Montgomery, Mortgagee Letter 2009-19] (stating that the FHA "will now allow lenders to determine project eligibility, review project documentation, and certify to compliance . . . . HUD will continue to maintain a list of Approved Condominium Projects"); Mortgagee Letter 2009-46A from David H. Stevens, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees 1 (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46aml.pdf ("This Mortgagee Letter (ML) waives five provisions of that guidance and serves as a temporary directive to address current housing market conditions."); Mortgagee Letter 2009-46B from David H. Stevens, Assistant Sec'y for Hous.–Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees and All FHA Roster Appraisers 1 (Nov. 6, 2009), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46bml.pdf [hereinafter Stevens, Mortgagee Letter 2009-46B] (stating that the FHA will allow lenders to determine project eligibility, review project documentation, and certify compliance, but FHA will continue to have a list of approved condominium projects).

261. *See supra* note 260. Previously, individual loans in a community could earn HUD approval even if the community as a whole did not get blanket approval from HUD. Such per-unit approval is no longer an option.

262. Stevens, Mortgagee Letter 2009-46B, *supra* note 260, at 4.

263. *See supra* notes 159–77 and accompanying text (discussing association collection efforts).

pay, the paying members make up the budgetary shortfall, while they are simultaneously denied access to financing because of their neighbors' default. Even if a community earns a coveted spot on HUD's "Approved" list, that approval expires in two years unless all requirements are re-certified to the satisfaction of HUD.[264]

Other requirements for condominium project approval also impact the resolution of the assessment delinquency issue and have contributed to a slowdown in condominium unit sales in an already sluggish market.[265] HUD requires that "[n]o more than 10 percent of the units" be owned by one entity, and states that "[a]t least 50 percent of the units of a project must be owner-occupied."[266] Such limitations may practically limit the ability of a condominium association to foreclose on liens for unpaid assessments and rent out units in the community in order to attempt to recover some amounts toward the delinquency while also prohibiting troubled owners from generating income from property rental to meet obligations.[267] Furthermore, such restrictions make it more difficult for a unit to be sold, since once a community passes the 15% delinquency tipping point (or the 50% rental tipping point), financing for would-be purchasers is essentially no longer available. And most ironically, if a condominium's documents restrict a unit owner's freedom to rent a unit, which it must do to ensure compliance with HUD's 50% rental limitation, the FHA has deemed the documents

264. *See* Montgomery, Mortgagee Letter 2009-19, *supra* note 260 (explaining that the recertification deadline for previously approved condominiums, previously set for December 7, 2010, was extended to dates from December 31, 2010 to March 31, 2010, staggered according to the original project approval date); *see also Government Affairs Update: FHA Condominium Recertification Requirements*, NAT'L ASS'N OF REALTORS (Dec. 8, 2010), http://www.realtor.org/wps/wcm/connect/15f94c8044f67a04b112f35d6aeab3b5/FHA%2BCondo%2BRecertification%2BRequirements%2B12.8.10.pdf?MOD=AJPERES&CACHEID=15f94c8044f67a04b112f35d6aeab3b5 ("Mortgagee Letter 2009-46B states that FHA approved condominium projects must be recertified every two years").

265. *See, e.g.*, Mandyvilla, Comment to *New FHA Condo Guidelines*, BROKER OUTPOST MORTGAGE FORUMS (Dec. 20, 2009, 7:55 AM), http://forum.brokeroutpost.com/loans/forum/2/283263.htm ("[Realtors should] motivate sellers to slash the price [of condominium units offered for sale] NOW on their listings before the market does it for them. . . . This is going to be the nail in the condo market. Values are going to plummet around here due to the number of projects that are at 51% concentration [of investor owners] and above.").

266. Montgomery, Mortgagee Letter 2009-19, *supra* note 260, at 4.

267. *See* DAVID H. STEVENS, ASSISTANT SEC'Y FOR HOUS./FED. HOUS. COMM'R, U.S. DEP'T OF HOUS. & URBAN DEV'T.: CONDO APPROVAL PROCESS (May 2010), *available at* http://portal.hud.gov/hudportal/documents/huddoc?id=MAY2010.pdf (noting that although David Stevens, Assistant Secretary of HUD, explained in May 2010 that HUD modified this "50% owner occupancy requirement to allow the exclusion of vacant and tenant-occupied REOs from the calculation," such exclusions do not apply to real estate owned by *associations* rather than *lending banks*).

as violating the "free transferability" provisions.[268] The result is that it is impossible for a condominium to be adequately approved for FHA insurance, either because it allows rentals or because it does not. Fannie Mae and Freddie Mac require similar owner-occupancy percentages, and thus, a condominium today cannot simultaneously satisfy the criteria of the GSEs and the FHA.[269]

Because nearly half of all mortgage loans are now insured by the FHA, and almost the entire remainder is sold on the secondary market to either Fannie Mae or Freddie Mac, the policies of the FHA, Fannie Mae, and Freddie Mac hugely impact resolution of the issue of assessment recovery.[270] The current requirements for loans, however, work at cross-purposes: while the delinquency rate is used as a proxy for community fiscal health, the priority limits on association assessments remove from a community a potentially crucial tool for ensuring the association's financial well-being. In recognition of the harm to communities and lenders that can result from a community with excessive delinquencies, it seems that the FHA, Fannie Mae, and Freddie Mac should use their market power and definitions of qualifying mortgages to support community health rather than place roadblocks to recovery.

c. State Efforts to Add or Enhance Lien Priority

Because capped lien priority typically protects only six months' worth of assessments, the longer it takes to get a paying owner to take title to the unit, the less protection the law provides. In early 2010, Lender Processing Services, Inc. estimated that on average, it took fifteen months for a home loan to go from being thirty days late to the property being sold in foreclosure.[271] The lengthy foreclosure timeline is caused in part by the sheer magnitude of the increase in foreclosure

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268. 24 C.F.R. § 203.41 (2011).

269. Letter from Loura K. Sanchez, Managing Partner, Hindman Sanchez, to Comm. Ass'ns Inst. (Nov. 23, 2010) (on file with author).

270. *See* TREASURY/HUD REPORT, *supra* note 255, at 12 (explaining that the lack of private capital in the housing market since 2008 has led government agencies to insure or guarantee the vast majority of new mortgages); Jody Shenn & John Gittelsohn, *FHA Home-Loan Volume Is Sign of 'Very Sick System,' Agency's Stevens Says*, BLOOMBERG (May 24, 2010), http://www.bloomberg.com/news/2010-05-24/fha-home-loan-volume-is-sign-of-very-sick-system-agency-s-stevens-says.html (noting that the FHA, Fannie Mae and Freddie Mac have been financing more than 90% of U.S. home lending since the 2008 market collapse); Saskia Scholtes, *Fannie and Freddie Drive Home Loans*, FIN. TIMES (Apr. 2, 2008, 7:23 PM), http://www.ft.com/intl/cms/s/0/65e8ab08-00dd-11dda0c5000077b07658.html#axzz1TWkKeq6Y (discussing how government-sponsored mortgage companies have become the "backbone" of the U.S. mortgage market); *see also infra* Part II.A.1.c.

271. Viega, *supra* note 8.

volume over the past few years—in 2010, there were more foreclosures commenced each month than were typically commenced in an entire year prior to 2005.[272] The recent foreclosure moratoriums and government investigations into bank procedures, introduced in all fifty states in October 2010, significantly lengthened the time needed to complete foreclosure,[273] as lenders have (appropriately) responded to increased procedural scrutiny by slowing the process to ensure validity of the foreclosure.[274]

Some states have responded to the longer foreclosure timeline and the financial dire straits of associations by increasing the capped amount of their lien priority statutes. Nevada increased the six-month period to nine months,[275] and Florida increased its cap to the lesser of twelve months' worth of assessments or 1% of the outstanding mortgage loan amount.[276] Although both of these enhanced lien priority measures increased ultimate recovery by an association, they failed to solve the underlying problem that still plagues the six-month capped priority laws: once the designated period has elapsed (be it six or nine or twelve months), lenders have no further incentive to contribute to property upkeep or to expeditiously foreclose so that someone new can take title.

The housing crash prompted the Nevada Legislature to swiftly pass legislation strengthening lien priority protection for assessment liens, increasing the six-month lien priority to a nine-month priority, effective October 1, 2009.[277] The state legislators were mindful of the FHA and GSE guidelines, however, so the Nevada statute has an automatic carve-out for mortgages purchased by the GSEs, limiting the lien priority to the maximum allowed by such entities' guidelines (namely, six

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272. *See supra* notes 18–19 and accompanying text (reporting 2010 foreclosure statistics).

273. Ariana Eunjung Cha & Dina Elboghdady, *50 State Attorneys General Announce Foreclosure Probe*, WASH. POST, Oct. 13, 2010, at A13.

274. Ensuring compliance with foreclosure procedure is crucial to protecting borrower rights and equity. Because the sale price at a foreclosure is not subject to substantive review, strict adherence to procedural safeguards is the only way that the system can ensure the price obtained is fair and that the borrower is given all notice and the right to redeem, which statutory law and equity require. *See, e.g.*, BFP v. Resolution Trust Corp., 511 U.S. 531, 545 (1994) (refusing to review the adequacy of a foreclosure sale price and instead focusing exclusively on the foreclosure process, stating, "[w]e deem, as the law has always deemed, that a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with").

275. NEV. REV. STAT. ANN. § 116.3116(2)(c) (2010).

276. FLA. STAT. ANN. § 718.116 (West 2010 & Supp. 2011), *preempted by In re* Spa at Sunset Isles Condo. Ass'n, Inc., No. 10-33758-PGH, 2011 WL 3290239 (Bankr. S.D. Fla. July 13, 2011).

277. NEV. REV. STAT. ANN. § 116.3116(2)(c) (2010).

months).[278] This carve-out undercuts the statute's effectiveness dramatically, as the vast majority of residential mortgage loans are originated for resale on the secondary market.[279] In addition, increasing the cap to nine months, even when applicable, rapidly became insufficient recovery as the post-default/pre-foreclosure duration of mortgages in the state increased.

Florida was the next state to increase the assessment lien priority cap amount. The Florida Distressed Condominium Relief Act of 2010, effective July 1, 2010, provides that a first mortgagee taking title to property through foreclosure is liable for the twelve months of unpaid common expenses and regular periodic assessments that came due during the immediately preceding year.[280] The total potential exposure of lenders under this statute, however, is capped at 1% of the outstanding mortgage debt.[281] While the previous change in the law implementing a six-month cap inspired widespread adherence among lenders who have not contested its retroactive application, Florida courts have not yet stated definitively that the Florida amendment creating a twelve-month cap can be applied retroactively.[282] In addition, although states like Colorado have specified that their statutory lien priority provisions trump association documents with provisions to the contrary, it is unclear whether this is true in Florida or whether Florida associations must amend their documents to take

278. *Id*.

279. *See* TREASURY/HUD REPORT, *supra* note 255, at 2. Secondary resales today are primarily through Fannie Mae and Freddie Mac. *Id.*

280. Distressed Condominium Relief Act, 2010 Fla. Sess. Law Serv. 36 (codified at Fla. Stat. Ch. 718.701–08). Previous modifications in the law increased the cap to twelve months for single family homes in CICs but left the cap at six months for condominium units. The 2010 amendment equalized recovery in both types of CICs. *Id.*

281. FLA. STAT. ANN. § 718.116(1)(b)2 (2011). According to some Florida lawyers, the new law permits unlimited recovery of unpaid assessments from third-party buyers at mortgage foreclosure (unlimited durability of the association lien) and caps recovery only from lenders. Telephone interview with Ben Solomon, Attorney, Association Law Group, P.L., North Bay Village, Fla. (Sept. 28, 2011) (notes on file with author) [hereinafter Solomon Interview]. Other Florida attorneys dispute this reading of the law, noting that the twelve-month cap applies to all foreclosure sales, regardless of the identity of the buyer, and expressing doubt that the new twelve-month limit will apply to foreclosures of mortgages originated before 2010. Telephone interview with Chuck Edgar, Attorney, Cherry, Edgar & Smith, P.A., Palm Beach Gardens, Fla. (Sept. 27, 2010) (notes on file with author) [hereinafter Edgar Interview]. Edgar agrees that the statutory language is ambiguous on this point but notes that there is nothing in the legislative history to suggest that Florida legislators intended to create a different rule for lender and third-party foreclosure buyers. *Id.*

282. Edgar notes that "Everyone is collecting the six months of assessments, and lenders aren't fighting it." Edgar Interview, *supra* note 281. But Edgar also opines that the twelve-month cap may not apply to mortgages originated prior to July 2010 and believes that the legislature in Florida cannot retroactively impose the cap, and only the federal government, not a state government, could pass a law that effects such an "impairment of contract." *Id.*

advantage of the enhanced lien priority if the documents reference the prior (six-month) capped level.[283] The flaws of Florida's newly amended statute are already apparent, and less than a year later, new legislation has been introduced to "refund and expand upon those amendments and to clarify other condo association issues."[284]

Florida has been coping with perhaps the worst volume and quality of foreclosures in the nation during the past few years, and the large quantity of foreclosures and many lender missteps have so far discouraged lenders at foreclosure from challenging the law or its application.[285] Even if unchallenged, the long delay between commencing and completing foreclosure proceedings in Florida makes the twelve-month capped priority still inadequate in many cases anyway.[286] In Florida, as in other states, the best way to ensure repayment of assessment amounts is to immediately start legal proceedings when a homeowner has not paid his dues to get a personal money judgment against the owner in order to compel collection. Pursuing a money judgment is often the cheaper and easier route for an association to take to recover unpaid assessments.

The Florida law is so new that the state's mortgage market has not yet reacted to the change. Interestingly, Florida's twelve-month limit does not have a GSE limit carve-out like the Nevada provision.[287] It is unclear how this limitation will play out in Florida with respect to availability of mortgage capital, since Fannie Mae and Freddie Mac specifically exclude debts for which a lender could be liable for more than six months of assessment charges from pools of qualifying mortgages.[288] Mortgage originators today almost never originate non-

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283. *See id.* (noting that everyone is taking advantage of the six-month cap, despite the fact that it is unclear whether or not Florida associations need to amend their documents to take advantage of the enhanced lien priority); Solomon Interview, *supra* note 281 (stating that Florida law permits unlimited recovery of unpaid assessments from third-party buyers at mortgage foreclosure and caps recovery only from lenders).

284. Joshua Krut, *Board of Contributors: After Sweeping Changes in Florida's Condo Law, Expect New Revisions*, DAILY BUS. REV. (Feb. 23, 2011), http://www.law.com/jsp/article.jsp?id=1202482933797 (calling this pending legislation the "glitch bill" because it is designed to clarify unanswered questions relating to the amendments of the prior year).

285. *See* Edgar Interview, *supra* note 281 (agreeing that the statutory language is ambiguous but that the legislature did not intend to create a different rule).

286. *See, e.g.*, *supra* notes 110–12 and accompanying text (identifying incidents in which enhanced lien priority statutes failed to protect condominium associations).

287. It does, however, have a dollar-based cap of 1% of the mortgage loan amount. FLA. STAT. § 718.116(1)(b)2 (2010).

288. Section B4-2.1-06 of Fannie Mae's lending guidelines explicitly states that Fannie Mae will not purchase debt if the holder of the mortgage could be liable for more than six months of regular common expenses charged by a community association. *See* FANNIE MAE, SELLING GUIDE 575–76 (June 28, 2011).

FHA loans that they cannot sell on the secondary mortgage market, and the only truly active secondary residential mortgage market purchasers are the GSEs.[289] It remains to be seen if the Distressed Condominium Act adversely impacts the availability of mortgage financing in CIC homes in Florida, or if the GSEs will not enforce these guidelines there or will change their mandates.

After facing much resistance from lender lobbyists, the Maryland General Assembly approved a statute to grant CIC assessment liens a capped priority in mortgage lender foreclosure sales.[290] The new law requires that $1200 of assessments (or up to four months of assessments, if less) be paid to an association prior to payment on the mortgage debt at foreclosure.[291] Since foreclosure in Maryland takes a minimum of five months to complete,[292] this capped assessment liability is clearly inadequate to cover all of an association's costs during the pendency of foreclosure.

Bills specifically aimed at creating six-month limited priority for association assessment liens are currently pending in Ohio and Missouri. Each case is strongly supported by individuals who reside in CICs and community association lobbies, and each case is strongly opposed by bank lobbies. In Ohio, efforts to pass a UCIOA-based lien priority for assessments (House Bill 408) failed to achieve legislative action in the legislature's 2010 session.[293] The efforts are still alive, and proponents of the measure hope that 2011 will see passage of a law creating a provision for six months of assessments plus attorney fees, costs, and expenses to enjoy lien priority superior to all liens but those for property taxes. National and state lenders in Ohio have strongly opposed the bill, contending that it will increase lending costs and complexity and will chill mortgage lending in an already semi-frozen housing capital market.[294]

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289. *See* TREASURY/HUD REPORT, *supra* note 255, at 2 (discussing how the new plan developed by the administration will bring private capital into the market and decrease the role of Fannie Mae and Freddie Mac).

290. H.B. 1246, 428th Gen. Assemb. (Md. 2011). The original bill set the priority cap higher—six months plus late fees and collection costs—but this proposal met vigorous opposition by the Maryland Bankers Association. *Community Association Law Letter*, THOMAS SCHILD LAW GROUP LLC, 1 (Spring 2011), http://www.schildlaw.com/Spring%202011%20Newsletter.041811.pdf. The legislature cut down the cap in an effort to appease the mortgage lender lobby. *Id*.

291. Md. H.B. 1246.

292. *See* Mallory Malesky, *How Long Does Foreclosure Take in Maryland*, EHOW (Mar. 23, 2011), http://www.ehow.com/info_8098323_long-foreclosure-maryland.html (explaining Maryland foreclosure procedures).

293. *See* MALLACH, *supra* note 29 (discussing the foreclosure crisis in Ohio).

294. *See* Ann Fisher, *Condo Associations Want Plan to Make Owners Pay*, THE COLUMBUS

Banks are also concerned with potential retroactive application of the priority law with respect to loans that have already been funded.[295] While active debates on limited priority statutes remain in Ohio and Missouri, in many other states, efforts to create a limited lien priority for association assessments have never gained traction.[296]

d. Inadequacy of Limited Priority Liens

The priority law for community assessment liens varies among the states, but this problem has been insufficiently addressed in all of them. When unpaid upkeep costs are potentially unlimited, capped losses for the lender necessarily result in unlimited losses allocated to the members of the community. Thus, even a "super-priority" piece allocated to assessment liens becomes inadequate once that period has expired.

When foreclosure takes longer than six months and when foreclosure proceeds are inadequate to pay off a first mortgage—and both of these factors are more and more common today—only a fraction of unpaid assessments are paid, requiring paying members of the association to fund the remainder.[297] Furthermore, even in some jurisdictions with a limited association lien priority, proceeds at foreclosure do not automatically apply to unpaid assessments (the capped portion being deemed a durability rather than payment priority provision), and thus the association has to bring a lawsuit—and incur more community costs—just to recover the amounts that are legally theirs. Miami Beach Commissioner Jerry Libbin calls this problem an "outrageous loophole" in the law.[298]

DISPATCH, July 5, 2009, at 01B.

295. *See id.* ("Banks and other lenders typically have opposed such laws, contending that they increase the cost and complexity of lending.").

296. *See, e.g.*, S.B. 411, 2010 Gen. Assemb., Reg. Sess. (Va. 2010) (stricken Jan. 27, 2010) (establishing limited lien priority for condominium association assessments).

297. *See* Coleman, *supra* note 104, at 1A (noting that condominium owners in good standing are often charged "special assessments" to make up for unpaid fees from delinquents owners).

298. Admin, Comment to *Ruling May Help Homeowner Associations*, HISTORIC CITY NEWS (Feb. 6, 2010, 2:31 PM), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546. Libbin heralded the reverse foreclosure tactic, *see infra* Part II.A.2, as an important step toward protecting owners in condominiums. *See id.* (noting that Libbin applauded a Miami-Dade Circuit court ruling ordering a "reverse foreclosure"). Florida's legislature considered a bill that would have required banks to complete foreclosure after a year of filing or pay all unpaid assessments, but this proposal never came to a vote. *See* Rob Samouce, *Laws Needed to Get Delinquent Properties Back on Market*, NAPLES DAILY NEWS (Jan. 2, 2010), http://www.naplesnews.com/news/2010/jan/02/laws-needed-get-deliquent-properties-back-market/ (noting that strong bank lobbying was the cause of legislative inaction on the bill); *see also HOA's Forcing "Reverse Foreclosures*,*"* TITLE SEARCH BLOG (Mar. 1, 2010, 10:26 AM), http://titlesearchblog.com/2010/03/01/hoas-forcing-reverse-fore closures/ (remarking that the bill

The general problem of unpaid assessments is dramatically exacerbated in the current market context where lenders (sometimes deliberately) delay foreclosure on defaulting properties.[299] Lenders can—and today often do—delay foreclosure. It is true that foreclosure can take a long time for other reasons: mortgage loan servicers are currently overwhelmed with the number of defaulting borrowers, and lenders look hopefully to future market price rebounds to recover under-collateralized loan amounts. In addition, mortgage servicers' faulty record-keeping and failure to follow legally-mandated procedures operate to stretch out the foreclosure timeline as well.[300]

But lenders also sometimes strategically delay based on their calculation that they will be unable to sell the property at foreclosure or resell the property afterwards because of the sluggish housing market.[301] Procrastination can help lenders avoid incurring the obligations of home ownership, including property taxes and community association assessments. This is particularly true in cases where there is a very real risk that the ultimate sale price for the property will not reimburse such costs. Once the lender owns the real estate (real estate owned, or "REO" properties), the lender itself is responsible for assessment charges and, unlike insolvent mortgage borrowers, can typically be sued successfully for assessment payments they neglect to make.[302] Because this obligation is assumed upon taking title, lenders in many cases prefer to postpone foreclosure,

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"never saw the light of day for a vote by the legislature").

299. *See*, *e.g.*, Marshall L. Jones, *Condo Associations Battle Deadbeat Owners, Balky Banks in Collecting Fees*, REAL EST. L. & INDUS. REP., Apr. 6, 2010, at 3 ("As lenders institute foreclosure proceedings against defaulting condominium owners, some condominium associations are seeing lenders delay in completing the foreclosure process.").

300. *See supra* note 3 and accompanying text. In addition to servicer and bank moratoriums on foreclosures, several states, including Connecticut and Texas, froze all foreclosures in October 2010 pending inquiry into faulty and fraudulent loan servicing procedures. Several other states stopped foreclosures by J.P. Morgan Chase, GMAC and Ally Financial, the institutions tainted with the "robo-signing" scandal. *See* Cha, *supra* note 3, at A9 (noting that the moratoriums have now been lifted, but the pace of foreclosure remains slow).

301. *See* Coleman, *supra* note 104, at 1A (noting that some banks deliberately delay taking back property worth less than the outstanding mortgage); Benny L. Kass, *Condo Associations Saddled with Unpaid Dues Demand that Banks Stop Delaying Foreclosures*, WASH. POST, Nov. 20, 2010, at E3 (noting that condo associations are often left with unpaid dues when banks, wanting to avoid assuming liability on unpaid condominium dues and taxes, delay foreclosure on a unit).

302. *See, e.g.*, Leigh Katzman, *Waiting for the Bank to Foreclose: A Modern Day Story*, KATZMAN GARFINKEL ROSENBAUM, 1–3, http://kgblawfirm.com/pdfs/Waiting for the bank to foreclose-LCK.pdf (last visited Oct. 30, 2011) (detailing all the costs that a lender will incur upon taking title to real estate at a mortgage foreclosure sale and concluding that "the bank can comfortably delay completing its foreclosure action knowing the full extent of its liability for past due assessments").

hoping that the market will improve and property resale will be more quickly forthcoming. As Florida attorney Ben Solomon explains, "[t]he bottom line is the banks don't want to assume the liability associated with the unit, including the obligation to pay maintenance assessments to the association."[303] In the meantime, collateral values are preserved through assessments that lenders neither pay nor reimburse.

Today, the delay between initial mortgage default and actual foreclosure sale is longer than ever before. Since bank liability for previously unpaid assessments is capped—or, in many places, non-existent—mortgage lenders receive an unjust enrichment of collateral upkeep at the cost of other members of the community. Currently, there is nothing in the law to prevent such an outcome.

Foreclosure delays increase the ultimate charges borne by the non-defaulting neighbors but also cause neighboring owners to suffer in other ways. As unpaid assessments increase, dues increase, units fall into disrepair, and abandonment increases the likelihood of vandalism and squatters. When foreclosure finally happens, both property values and quality of life for the community have declined.[304]

Focusing on the complete lack of even a capped assessment priority in a majority of states, Washington, D.C. association law expert and syndicated columnist Benny Kass has publicly called for nationwide campaigns to create UCIOA-like provisions in those states that have not yet passed such a law.[305] But even if the thirty-three states with no limited priority passed UCIOA-based six-month (or larger) caps, the underlying problem would persist: lenders can offload a theoretically unlimited amount of upkeep costs of their collateral onto innocent members of the community with no adequate recourse at law for the community and its paying members. And since the limited priority of assessment liens under UCIOA and similar statutes only takes effect upon a first mortgage foreclosure, the limited priority lien fails to force the bank's hand and achieve a more expeditious resolution through conveying the unit to an owner willing and able to contribute to community costs.[306]

303. Sutta, *supra* note 6.

304. *See, e.g.*, Rogers, *supra* note 181, at 1–3 (describing the course of foreclosure proceedings); *supra* Part I.B.2 (discussing the financial tragedy of the commons associated with foreclosures in condominium associations).

305. *See* Kass, *infra* note 356 (stating that such monthly-based limited priority lien systems "must be enacted all over the country as soon as possible").

306. Note that some creative litigators have attempted to do just that, with some limited success in Florida. *See infra* Part II.A.2.

State legislatures could close this "loophole" by mandating true priority for community assessment liens (at least with respect to dues that are unpaid during a period of mortgage default) or by making CIC assessment liens non-extinguishable in foreclosure. Capping community losses rather than lender losses would eliminate the distortion that the current potential "free ride" creates for lenders weighing the costs of foreclosure. This would encourage lenders to pay community assessments during borrower defaults, whether or not it also encourages the pace of foreclosure to increase. Either way, the community's losses and contagion effects of the distressed properties is contained: at some defined point in time, a solvent interest-holder in a unit will be encouraged to pay the unit's equitable allocation of costs. This type of limited priority would be vastly more equitable than the UCIOA-type of total-amount capped lien, both in terms of allocating upkeep costs and in terms of efficiently motivating housing rollover and market stability.

2. Creative Litigation Strategies

Florida is perhaps the epicenter of the CIC assessment crisis.[307] Florida was the site of one of the largest housing booms over the past few decades.[308] In particular, condominium development and financing flourished in Florida through 2007.[309] Condominiums in Florida

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307. *See* ElBoghdady, *supra* note 10, at A14 (noting that nine of the twenty regions with the worst foreclosure rates were in Florida); Brad Heath, *Most Foreclosures Pack into a Few Counties*, USA TODAY, Mar. 6, 2009, at 1A (noting that eight counties in Arizona, California, Florida, and Nevada were responsible for one quarter of all foreclosures in the U.S. in 2008). *See generally* Prashant Gopal, *Florida Condo Owners Footing Bill for Foreclosures*, BLOOMBERG BUS. WK. (Nov. 29, 2007), http://www.businessweek.com/the_thread/hotproperty/archives/2007/11/florida_condo_o.html (detailing results of the 2009 Florida Community Association Mortgage Foreclosure Survey). Florida is also one of the states most impacted by the housing crisis in general.

308. *See* MAUREEN F. MAITLAND & DAVID M. BLITZER, S&P/CASE-SHILLER HOME PRICE INDICES 2009, A YEAR IN REVIEW 5–6 (2010), *available at* http://www.standardandpoors.com/indices/index-research/en/us/?type=All&category=Economic (follow "S&P/Case-Shiller Home Price Indices: 2009 A Year In Review (PDF)" hyperlink) (showing double-digit rise in home prices in Florida, followed by a precipitous decline as the real estate market went into crisis); Haya El Nasser, *Florida Growth Outpaces National Trend*, USA TODAY (Mar. 22, 2011, 3:25:38 PM), http://www.usatoday.com/news/nation/census/2011-03-17-florida-census_N.htm (comparing growth rates in Florida to the rest of the country); *see also South Florida Absorbs Growth Across the Board*, SE. REAL EST. BUS. (Sept. 2005), http://www.southeastrebusiness.com/articles/SEP05/highlight2.html (enthusiastically discussing the robust growth of the real estate market in Florida—which in hindsight seems ironic and naïve).

309. *See, e.g.*, Richard Peep, *Condo Culture: How Florida Became Floridistan*, NEWGEOGRAPHY (May 22, 2011), http://www.newgeography.com/content/002245-condo-culture-how-florida-became-floridastan (telling of the appeal and growth of condominium developments and investment properties in Florida in the 1990s).

attracted many real estate investor-buyers,[310] and the demographics of the state—in particular, the high percentage of retired persons—made low-maintenance/high amenity housing particularly appealing. But this same demographic makes the population more vulnerable to escalating monthly housing costs. Because of these factors, Florida today presents the most extreme case of foreclosure delay spillovers and community governance insolvency. This foreclosure delay is rampant: there are ample news reports of lenders' strategic postponement of public auctions,[311] and the average foreclosure now takes longer than a year and a half.[312] Although the amended Florida law permits a capped recovery after mortgage foreclosure of an amount equal to the lesser of twelve months' worth of unpaid association assessments or 1% of the outstanding mortgage loan amount,[313] in most cases this limited amount will not cover all of an association's unpaid assessments.

Florida attorneys representing community associations have become very creative in seeking recovery for their clients. One particularly interesting tactic has been termed a "reverse foreclosure."[314] To achieve a reverse foreclosure, the association must first foreclose on its assessment lien and take title to a delinquent unit subject to the first mortgage lien.[315] The association, as now-owner of the property, files a motion for summary judgment in the mortgage lender's own foreclosure action, seeking judgment in favor of the lender.[316] The association

310. A majority of the condominium units in Florida in 2007 were non-owner occupied (investor properties). *See* Shimberg Ctr. for Affordable Hous., *State of Florida's Housing, 2007 Executive Summary*, AFFORDABLE HOUS. ISSUES, Apr. 2008, at 1, 3, *available at* http://www.shimberg.ufl.edu/pdf/Newslet-Apr08.pdf (listing statistics for owner-occupied condos in Florida).

311. *See, e.g.*, Coleman, *supra* note 104, at 1A ("[L]enders are in no hurry to take back delinquent units, only to have to turn around and sell them amid a market that has crashed.").

312. Interview with Kevin Miller, Attorney (Oct. 2010) [hereinafter Miller Interview] (notes on file with author).

313. S.B. 1196, 2010 Sess. (Fla. 2010) (codified at FLA. STAT. § 718.116 (2010)).

314. *See* Coleman, *supra* note 104, at 1A (describing reverse foreclosures as a "a tool that can force banks to pay association maintenance fees when unit owners don't); Susannah Nesmith, *Ruling Could Give Embattled Associations Relief*, DAILY BUS. REV. (Jan. 27, 2010), http://www.law.com/jsp/article.jsp?id=1202466596282 (describing a "reverse foreclosure" ruling in a Miami-Dade Circuit Court case forcing a bank to take title to a property from a homeowner association); Paul Brinkman, *Miami Judge Grants Reverse Foreclosure*, S. FLA. BUS. J. (Jan. 25, 2010, 4:04 PM), http://www.bizjournals.com/southflorida/stories/2010/01/25/daily10.html (quoting attorney Ben Solomon, who notes that reverse foreclosures reverse "will finally help associations force banks to take title to financially upside down units much faster than ever before"); *"Reverse Foreclosure" Makes Banks Accountable to HOA*, FLA. L. J. (Jan. 25, 2010), http://www.thefloridalawjournal.com/2010/01/reverse-foreclosure-makes-banks-accountable-to-hoa/ (noting reverse foreclosure is a legal strategy for condominium and homeowners associations to prevent banks from stalling foreclosures).

315. *See* Nesmith, *supra* note 314 (describing the procedures for enforcing a reverse foreclosure).

316. *Id.*

waives all claims for notice and sale of the property under Florida's foreclosure laws and moves that the court immediately order the title to be transferred to the lender. [317]

Keys Gate Community Association successfully employed the reverse foreclosure approach on a home to which it had taken title in 2007 after the owners stopped paying assessments.[318] The first mortgage lender on the unit, HSBC Bank USA, filed its own notice to foreclose two months after the association took title, but the foreclosure sale never happened.[319] Finding itself stuck with an empty house and two-and-one-half years worth of unpaid dues (over $5000), the association attempted the new strategy of moving for summary judgment in favor of the mortgage lender.[320] In January 2010, Miami-Dade Circuit Judge Jerald Bagley accepted the association's argument and ordered title immediately transferred to HSBC, making it liable for all future community assessments.[321] The court also ordered HSBC to pay the association's legal fees and court costs in connection with the reverse foreclosure action as well as the capped lien priority amount that trumped the first mortgage lien. Because this amount was capped, the association had to write off $3820 in unpaid fees, but at least the long delay in finding a financially responsible unit owner was finally over.[322] As Keys Gate attorney Ben Solomon put it, "[t]he quicker we can move these distressed properties through the process and into the hands of somebody who will pay a mortgage and pay taxes and pay their dues, the quicker we can get the economy back on track."[323]

In the wake of the Keys Gate success, the reverse foreclosure strategy gained popularity during early 2010.[324] Ben Solomon's firm, Association Law Group, filed eighty-three foreclosures around the state,

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317. *Id.*; Paul Owers & Lisa J. Huriash, *Fighting Over Foreclosures—Homeowner Associations Target Delinquent Tenants, Lax Lenders*, SUN SENTINEL, Aug. 10, 2010, at 1A.

318. HSBC Bank USA v. Keys Gate Cmty. Ass'n, Inc. No. 07-18411 CA 09 (Fla. Jan. 12, 2010).

319. *Id.*

320. Coleman, *supra* note 104, at 1A.

321. Peter L. Mosca, *Florida Court Decision Could Impact Builders and Bank Foreclosure Processes*, REALTY TIMES (Feb. 17, 2010), http://realtytimes.com/rtpages/20100217_floridacourt.htm.

322. *Id.*; *see also* Coleman, *supra* note 104, at 1A (describing Keys Gate Community Association's use of the reverse foreclosure tactic).

323. Nesmith, *supra* note 314.

324. *See Ruling May Help Homeowner Associations*, HIST. CITY NEWS (Feb. 5, 2010), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546 (noting that some firms have been in favor of reverse foreclosure to avoid paying past due fees).

with varying success.[325] The reverse foreclosure concept is novel, and both judges and lenders were confused by the summary judgment motion.[326] Some courts did not realize that the association in such cases was arguing for judgment for the lender; some lenders did not realize this either. While the Miami-Dade judges have been receptive to the idea of a reverse foreclosure, no district court has yet considered and approved the tactic.[327]

In some cases, the exotic nature of the reverse foreclosure claim caused lenders to just walk away. For example, Citibank responded to a reverse foreclosure motion by just writing off the entire mortgage debt, leaving the association owners owning the unit.[328] However, the association had hoped to win a financially competent owner by losing the foreclosure case, and by winning the case, the association lost access to the bank's deep pocket for future assessment costs.[329]

The reverse foreclosure strategy is interesting, but it is legally cumbersome and unpredictable. In addition, this judicial tactic is limited to situations where (a) the association has previously foreclosed on its lien, subject to a first mortgage lien, and (b) the first mortgagee has already filed a foreclosure action. If a lender has not yet commenced a court action for foreclosure, no summary judgment motion can be filed. In addition, the reverse foreclosure requires the un-reimbursed costs of the association's own foreclosure action. Furthermore, the entire recovery by the association in Florida is capped at 1% of the outstanding mortgage loan or twelve months of assessment costs.[330] If the unit in default already has a tenant, there is an even better option available to the association. Under the 2010 amendment, the association can collect rents from a defaulting unit without having to foreclose or file a motion in a lender's proceeding, which may permit a more immediate and greater recovery for the community.[331]

Association lawyers in Florida have made other attempts to find an avenue for recourse within the existing legal framework. The Association Law Group pioneered a tactic they call "The Mortgage Terminator" to wipe out a mortgage lien in cases where an association has foreclosed on the unit and the mortgage lender has not commenced

325. Solomon Interview, *supra* note 281.

326. *Id.*

327. Miller Interview, *supra* note 312.

328. Sutta, *supra* note 6.

329. *See id.* (discussing Citibank's willingness to hand over title).

330. FLA. STAT. ANN. § 718.116.(1)(b)(1)(a)-(b) (West 2011).

331. *Id.*

foreclosure proceedings.[332] The association title-holder of the property brought its own case against Wells Fargo in a Broward County case in 2010, claiming that the bank lost its equitable claim to its real estate collateral by deliberately delaying commencement of foreclosure proceedings.[333] The court agreed and wiped out the mortgage lien.[334]

In another case where the lender strategically delayed foreclosure, the condominium association sued to force the lender to act. The trial court, in *United States Bank National Ass'n v. Tadmore*, found the association's arguments compelling and ordered the lender to "diligently proceed with the pending foreclosure action . . . or pay monthly maintenance fees on the condominium unit in foreclosure."[335] The court based its holding on its general equitable powers, concluding that the association was unreasonably prejudiced by the lender's deliberate delay in pursuing foreclosure.[336] Thus, the court reasoned that it was fair and equitable to order the lender to pay monthly assessments even prior to foreclosure.[337] The trial court decision in *Tadmore* at first sparked a flurry of interest in the concept of using equity to force an expeditious foreclosure, but the holding was short-lived. The appellate district court in *Tadmore* reversed, holding that the lender could not be obliged to pay condominium assessments on a unit it did not (yet) own.[338] There was no contractual obligation to pay those fees, and no obligation would arise until the lender acquired title.[339] Although the association's claim was made in equity, the court of appeals held that equity could only follow the law, not divert from it.[340]

Other associations pin their hopes on provisions in the Florida foreclosure statute that mandate a foreclosure sale to be scheduled no sooner than twenty and no later than thirty-five days after court

332. Daniel Vasquez, Broward *Case May be First of Many*, MIAMI HERALD (Oct. 10, 2010), http://www.algpl.com/news/press/MH-Oct-10-2010.pdf.

333. *Id.*

334. *Id.*

335. U.S. Bank Nat'l Ass'n v. Tadmore, 23 So. 3d 822, 822 (Fla. Dist. Ct. App. 2009).

336. *Id.* at 823.

337. *Id.*

338. *Id.*

339. *Id.*

340. The court noted that "equity follows the law" and reasoned that therefore, equity "cannot be utilized to impose this obligation without limitation before title is passed." *Id.* While the *Tadmore* approach was creative, it is unsurprising that the trial decision was reversed. There is a long-standing view that each lienholder can determine its own foreclosure timing. *See* NELSON & WHITMAN, *supra* note 58, at 612 (stating that a foreclosure on a junior lien cannot affect a senior mortgagee's interest because the senior should be allowed to choose when to sell).

filing.[341] Although Florida attorney Kevin Miller opines that an association might be able to claim violation of this provision when foreclosure is unduly delayed, lenders uniformly have maintained that the provision creates remedies for the mortgagee alone.[342] In addition, an association, as a junior lienholder, could ask the court for a management conference for the foreclosure case according to a procedural rule designed to move cases along.[343]

The Florida statute leaves unanswered the question of how far association documents can go to enhance the scope and priority of the assessment lien.[344] Citing the statutory provision giving mortgage lenders priority over association liens,[345] the court in *Coral Lakes Community Ass'n, Inc. v. Busey Bank, N.A.*, for example, refused to hold a foreclosing lender jointly and severally liable with its borrower for unpaid assessments despite language in the declaration to that effect.[346] In an earlier case with similar declaration language, however, a Florida district court held that a wholly-owned subsidiary of the mortgage lender who acquired title at foreclosure would be deemed a third party not entitled to protection by the assessment priority cap[347] and thus, could be sued personally for the entire unpaid assessment amount.[348] The details of which entities could and could not be sued personally for unpaid assessments, based on language in the association's declaration, could end up being quite complicated as the disputes regarding transfer of mortgages muddy the question of which entity holds what interest in the property. The Florida statute is unclear, and Florida laws are inconsistent on this point.

341. FLA. STAT. ANN. § 45.031 (1) (a) (West 2011).

342. Miller Interview, *supra* note 312. Even if courts agreed with the association's arguments with respect to this provision, there would be no way to use the statute to force lenders to commence a foreclosure proceeding.

343. *Id.*

344. A fifteen-year-old Florida case suggests that total super-priority of an association lien could be created by the association declaration. Holly Lake Ass'n v. Fed. Nat'l Mortg. Ass'n, 660 So. 2d 266, 269 (Fla. 1995). The hope that such precedent would endure has been chilled by a more recent Florida decision where the association documents provided that any subsequent parcel owner "regardless of how his or her title has been acquired, including by purchase at a foreclosure sale" is personally, jointly and severally liable for all unpaid assessments, along with the prior delinquent owner. Coral Lakes Cmty. Ass'n, Inc. v. Busey Bank, N.A., 30 So. 3d 579, 582 (Fla. Dist. Ct. App. 2010).

345. FLA. STAT. ANN. § 720.3085 (6) (West 2010).

346. *Coral Lakes Cmty. Ass'n, Inc.*, 30 So. 3d at 584.

347. FLA. STAT. ANN. § 718.116(1) (West 2010).

348. Strangely, the court held that the statutory limitation on post-foreclosure recovery of assessments applied only to limit a lender-purchaser at foreclosure, leaving a third-party foreclosure purchaser fully responsible for unpaid assessments. Bay Holdings, Inc. v. 2000 Island Blvd. Condo. Ass'n, 895 So. 2d 1197, 1197 (Fla. Dist. Ct. App. 2005).

3. True Lien Priority: An Analogy to Property Taxes

Community associations function like governments: they perform public functions and are funded by assessments paid by their citizenry. In fact, the trend over the past few decades has been for public governments to assign to private communities more and more responsibility for services that a municipality would otherwise provide.[349] Community governance and upkeep costs incurred by municipalities are funded through property taxes, and unpaid property taxes are secured by a lien on the subject property that enjoys true super-priority status. Unpaid taxes are therefore paid first (or remain burdening the property) at the foreclosure sale. The simplest solution to the CIC tragedy of the commons posed by unpaid and uncollectable assessments would be to grant true priority to liens securing such amounts, analogizing the assessments to property taxes. If association liens were granted complete and true priority over mortgage liens, then the association foreclosure would necessarily bring mortgage lenders "to the table" to pay for their collateral upkeep charges or to participate in a joint foreclosure proceeding.

On the one hand, an analogy between community assessments and property taxes is compelling; both governments offer public upkeep to a community such as paving, snow removal, and open space maintenance. In these ways, the community functions like a municipality proxy by providing services to the public.[350] In fact, taxpayers who live in New Jersey CICs have successfully claimed the right to offset a portion of their community assessments from property taxes based on a double taxation complaint.[351] However, this analogy can only be taken so far. Many community-provided amenities are actually a supplement to municipal services rather than their replacement, and in the vast majority of states, assessments are not legally considered local "taxes."[352] To the extent that community services provide private community benefits (such as amenity upkeep), they represent individual

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349. *See* TREESE ET AL., *supra* note 16, at 6 (stating that government privatizes its functions, requiring community associations to fulfill an otherwise municipal obligation).

350. The town of Reston, Virginia was the first CIC and provides many municipal government services. RESTON ASSOCIATION, http://www.reston.org/default.aspx?qenc=HzT9ACzZbNs%3d&fqenc=HzT9ACzZbNs%3d (last visited Aug. 1, 2011).

351. *See* HYATT, *supra* note 15, at 133 (citing Borough of Englewood Cliffs v. Estate of Allison, 174 A.2d 631, 640 (N.J. Super. Ct. 1961)) (reasoning that a property's true value does not include value of public rights transferred to a community).

352. Assessments are not deductible from federal and state tax impositions, for example, even when the community association services are a proxy for services normally provided by local municipalities. *See* HYATT, *supra* note 14, at 106 (arguing that community associations target assessments in a manner that local government cannot).

property-carrying costs rather than funding a benefit to the broader public, akin to property taxes.

Lenders would likely have strong objections to the idea that community assessments should be granted true priority by virtue of their tax-like function and likely will predict the disappearance of home mortgage credit should such a rule be adopted.[353] Nevertheless, having property taxes prime the mortgage lien has not dissuaded lenders from making mortgage loans. Lenders routinely protect themselves against any superior-priority payment obligation of their borrowers through establishing property tax escrow accounts. Lenders could demand similar escrow accounts for community assessments.[354] In fact, current Fannie Mae and Freddie Mac forms already specifically anticipate escrow account mandates for such amounts.[355]

4. Consent and Control by Community Members

Unlike a mortgage lender, who has the ability to perform a credit inquiry and refuse to lend money to a financially risky borrower, homeowners in condominiums and homeowner associations have no ability to force their neighbors to disclose the details of their finances. Even if this information were available, owners currently have little ability to control who buys properties in their community. One potential solution to the problem of financial interdependence in privately governed communities, however, would be to permit communities to perform credit diligence regarding prospective new members and control entry into the association. Washington, D.C. lawyer Benny Kass has suggested this type of solution: enable community boards of directors to approve or disapprove all potential purchasers of units.[356]

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353. The vigorous opposition mounted by the mortgage banking lobbyists to attempts to institute even a limited lien priority in states such as Ohio is a case in point. *See* Fisher, *supra* note 294, at 01B.

354. Such escrow accounts, however, might be more administratively expensive than those for insurance and taxes because many CICs assess monthly rather than yearly or bi-yearly.

355. *See* EFANNIEMAE.COM, https://www.efanniemae.com/sf/formsdocs/documents/sec instruments/ (last visited July 30, 2011) (providing mortgage documents by state). Associations, on the other hand, are vastly more limited in their ability to create property-specific escrow accounts upon, say, resale. Unless community documentation so provides, any efforts would be struck down as *ultra vires*.

356. Benny Kass, *Foreclosures are Impacting Condominium Projects*, REALTY TIMES (Apr. 30, 2007), http://realtytimes.com/rtnews/reu2pages/bennylkass.htm?open&Vol=32&ID=715 realty (posing the question: "If the lenders will not screen their borrowers, why should a community association have to suffer by having a new owner who will not be able to meet his/her financial obligations to the association?").

Cooperatives have long had such ability to control the identity of their members.[357] New York cases have repeatedly upheld pre-approval provisions in cooperative documents and even individual denials of approval for cooperative membership based on criteria as indirectly relevant as an applicant's fame or legal training.[358] The justification for legally permitting such practices in cooperatives is typically its disparate ownership structure: owners are co-investors in an entity that holds title to the building in addition to being tenants of their particular unit. Financing of the building occurs at two levels: through the entity title holder and at the individual-unit-owner level. Because of this increased financial interconnectedness, courts have opined that cooperatives should be able to self-select their members.[359] In the context of condominiums and homeowner associations, however, power to disapprove would-be unit purchasers would be more problematic, opening a Pandora's Box of discrimination. The possible danger posed by such a solution underscores the importance of finding and enacting a viable solution through the priority law instead.

Property law is hostile to restraints on alienation, and courts suspiciously scrutinize restrictive covenants limiting the ability of an owner to sell his or her property. Economic theory in general argues for

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357. Cooperatives must still abide by the Fair Housing Act and may not discriminate based on membership in a protective class. Robinson v. 12 Lofts Realty, Inc., 610 F.2d 1032, 1036 (2d Cir. 1979).

358. *See, e.g.*, Weisner v. 791 Park Ave. Corp., 160 N.E.2d 720, 724 (N.Y. 1959) ("[T]here is no reason why the owners of the co-operative apartment house could not decide for themselves with whom they wish to share their [building]."); DeSoignies v. Cornasesk House Tenants' Corp., 800 N.Y.S.2d 679, 682 (N.Y. App. Div. 2005) (upholding the board's absolute right to control leasing "for any reason or no reason"); Simpson v. Berkley Owner's Corp., 623 N.Y.S.2d 583, 583 (N.Y. App. Div. 1995) (the cooperative board "had the right to withhold their approval of petitioners' purchaser for any reason or no reason"); Bachman v. State Div. of Human Rights, 481 N.Y.S.2d 858, 859–60 (N.Y. App. Div. 1984) (upholding the denial of a transfer of shares in an apartment because it was not discriminatory); Goldstone v. Constable, 443 N.Y.S.2d 380, 381–82 (N.Y. App. Div. 1981) (holding that "directors of this cooperative housing corporation have the contractual and inherent power to approve or disapprove the transfer of shares and the assignment of proprietary leases, absent discriminatory practices prohibited by law"). Cooperative boards have refused to permit owners to transfer units to many famous individuals, including Madonna, Gloria Vanderbilt, Mariah Carey, Calvin Klein, Antonio Banderas, Melanie Griffith, and former President Richard Nixon. MARRIANE M. JENNINGS, REAL ESTATE LAW 255 (8th ed. 2008) (citing Ellen Wulfhorst, *New York Apartment Buyers Face Powerful Co-Op Boards*, EPOCH TIMES, Jan. 27–Feb. 2, 2005, at 13); *see also* Harvey S. Epstein, Note, Weisner *Revisited: A Reappraisal of a Co-op's Power to Arbitrarily Prohibit a Transfer of its Shares*, 14 FORDHAM URB. L.J. 477, 481–85 (1985–1986) (explaining that cooperative boards in New York arbitrarily prohibit transfer of residences, and applicants are subject to increasing scrutiny). For a current dispute involving the famous Dakota complex in Manhattan's Upper West Side, see Basil Katz, *Lawsuit Peeks into World of New York City Co-ops*, REUTERS, Feb. 3, 2011, *available at* http://www.reuters.com/article/2011/02/03/us-housing-newyork-idUSTRE7129IR20110203.

359. Subject to anti-discriminatory limitations imposed by the Fair Housing and the Civil Rights Acts.

free alienation of property so that society may achieve the property's highest and best use, as well as maximize its value.[360] Although free alienation increases individual member risks in the context of the entangled finances of a common interest community, courts typically strike down consent requirements as incompatible with fee simple absolute ownership rights.[361] Even explicit contract regimes restricting free transferability in the name of community, harmony, and joint objectives have been struck down as a restraint on alienation that is repugnant to the fee simple.[362] Retaining the right to approve purchasers through a covenant regime impermissibly recalls feudal controls; courts have consistently refused to enforce such restrictions.[363]

An association's right of first refusal to purchase a unit has been upheld, however, because an owner can be made economically whole by selling to the association in lieu of an objectionable buyer.[364] But such a provision will inadequately protect the financial interests of the community because it requires the community itself to fund the purchase and upkeep of a unit as the only way to block a prospective buyer. This is even more financially burdensome than permitting a prospective buyer to take title and then incur the costs of enforcing assessment obligations.

Although it is difficult to force bare approval requirements limiting an owner's ability to sell his unit in a condominium or homeowner association, it is very ordinary in a common interest community to control an owner's ability to rent a unit. Absolute prohibitions on renting are sometimes claimed to be an unreasonable restriction of fee title, but courts typically enforce initial limits on renting (an owner must occupy the unit for the first year, for example); limits on short-term

360. JOSEPH WILLIAM SINGER, PROPERTY LAW: RULES, POLICIES, AND PRACTICES 450 (4th ed. 2006).

361. *See, e.g.*, Northwest Real Estate Co. v. Serio, 144 A. 245, 246 (Md. 1929) (holding that limitations on restraint of alienation are invalid).

362. *See, e.g.*, Riste v. E. Wash. Bible Camp, Inc., 605 P.2d 1294, 1295 (Wash. Ct. App. 1980) (holding that a clause preventing a grantee from transferring title for fee simple without approval from the grantor is a restraint on alienation and therefore void).

363. *See, e.g.*, Aquarian Found., Inc. v. Sholom House, Inc., 448 So. 2d 1166, 1169 (Fla. Dist. Ct. App. 1984) (holding that an association's right to withhold consent to a unit's transfer was "obviously an absolute restraint on alienation" because the association was not required to purchase the unit at fair market value itself upon refusing consent); *Northwest Real Estate Co.*, 144 A. at 246 (striking down as "clearly repugnant to fee-simple title" a deed covenant providing that land may not be subsequently sold without consent of the grantor); *Riste*, 605 P.2d at 1294 (refusing to enforce a restriction for a CIC limiting sale of land to persons approved by the seller church).

364. *See, e.g.*, Wolinsky v. Kadison, 449 N.E.2d 151, 155 (Ill. App. Ct. 1983) (holding that an association may exercise its right of first refusal after considering a prospective buyer's qualifications).

leasing (no leases with a term less than six months, for example); and even limits on the number of units in a community that can be rental-occupied at any time.[365] Such leasing limitations are typically upheld even when they are created in non-unanimous amendments to the governing documents.[366] Not only do courts enforce aggregate limitations on the percentage of units in a CIC that can be rented at any one time, but Fannie Mae, Freddie Mac, and the FHA have issued guidelines that limit the percentage of a community that can be rented out, likely as a proxy for financial health of the community.[367]

Although permitting association boards to exercise approval rights over sales might be judicially justified as an extension of the broad enforcement of leasing restrictions boards already can exercise in any case, it would be bad policy to rely on board diligence and approval as a way to protect the community's financial health, and this approach should be avoided. From a legal standpoint, requiring prior approval of purchasers would create a hardship for owners who are trying to sell, and indeed the approval right is repugnant to the fee. Such a requirement would mean that a would-be seller would not only have to find a willing buyer, but would also have to prove that the candidate was a credible financial risk. In a tight market, the hardship and delay caused by this requirement would further freeze out sales of units and would increase the possibility that an owner would default instead of re-selling.

In addition, the power to approve buyers is fraught with the potential for abuse by other members of the association, and to solve one problem (uncollectable assessments) by creating others (too much board power limiting freedom to transfer property and the potential for insidious discrimination) is nonsensical. These problems are already rampant and difficult to resolve in co-ops.[368] Further, using the CIC structure to

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365. Woodside Vill. Condo. Ass'n, Inc. v. Jahen, 806 So. 2d 452, 462 (Fla. 2002) (holding that a leasing restriction was reasonable).

366. *See* Apple II Condo. Ass'n v. Worth Bank & Trust, 659 N.E.2d 93, 97 (Ill. App. Ct. 1995) (holding that the leasing restrictions were a valid exercise of association authority). Even disparate impact based on race does not invalidate a leasing restriction. *See* Villas West II of Willowridge v. McGlothin, 841 N.E.2d 584, 601 (Ind. Ct. App. 2006) (refusing to hold that every discriminatory action is illegal), *vacated*, 885 N.E.2d 1274 (Ind. 2008).

367. Fannie Mae and Freddie Mac will not buy loans secured by properties in common interest communities where more than 49% of the units are occupied by tenants rather than owners. *See* FANNIE MAE, CONDOMINIUM PROJECT REVIEW: OPTIONS FOR PROJECT APPROVAL 1–2 (2010), *available at* https://www.efanniemae.com/sf/refmaterials/approvedprojects/pdf/condoprojectreview.pdf (outlining the requirements for project approval); FREDDIE MAC, FREDDIE MAC CONDOMINUM UNIT MORTGAGES 3 (2011), *available at* http://www.freddiemac.com/learn/pdfs/uw/condo.pdf (outlining more requirements for project approval).

368. *See* Matt Chaban, *Board to Death: As Co-ops Swagger Back from the Brink, Brooklyn Pols Plot Their Demise*, N.Y. OBSERVER (Apr. 26, 2011), http://www.observer.com/2011/real-

create legal limits on a seller's right to transfer to certain types of borrowers harkens back to the days of racial discrimination because the perpetuation of racial segregation was the initial motivation for forming many early suburban CICs.[369]

The unsavory history of homeowner associations—still obvious from many first-generation restrictive covenants in the land records—reveals a dark side of private governments: racially segregated neighborhoods where restrictive covenants contractually barred would-be sellers from selling to certain would-be buyers based on pernicious discriminatory criteria. The U.S. Supreme Court in *Shelley v. Kraemer* held with tortured legal reasoning that racially-based restrictive covenants were unenforceable under the Fourteenth Amendment because the enforcement of a contract to discriminate would amount to government action.[370] Then, Congress passed the Fair Housing Act, which made discriminatory sale restrictions illegal and invalid.[371] Today, because of that Act, decisions to rent or sell housing may not lawfully be based on "race, color, religion, sex, familial status, or national origin."[372]

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estate/board-death-co-ops-swagger-back-brink-brooklyn-pols-plot-their-demise (reporting that cooperative boards in New York need not disclose the reason for disapproving a prospective member and that it remains difficult and unpredictable to obtain board approval and sell or buy in a cooperative in New York); *see also* Bay Holdings, Inc. v. 2000 Island Blvd. Condo. Ass'n, 895 So. 2d 1197, 1197 (Fla. Dist. Ct. Ap. 2005) (upholding a statutory cap that limits a first mortgagee's liability for unpaid assessments). A current bill proposes requiring cooperatives to provide a statement of the reasons for refusing consent to a transfer. A. 8347 § 1, 2011–2012 Reg. Sess. (N.Y. 2011), *available at* http://open.nysenate.gov/legislation/api/1.0/lrs-print/bill/A8347-2011. Several such bills have been introduced in the past. John Barone, *Limiting the Autonomy of Cooperative Apartment Corporation Governing Boards*, 2 CARDOZO PUB. L. POL'Y & ETHICS J. 179, 179 (2004).

369. In fact, many community association documents on the land records still contain racial occupancy clauses. Even though such clauses have no legal force today, their continuing existence in the chain of title serve as an unfortunate reminder of one of the initial motives of community ownership structures. It is well near impossible to strike such language from the record. *See* Stephen Magagnini, *Reminders of Racism, Old Covenants Linger on Records*, SACRAMENTO BEE, Jan. 17, 2005, at A1 (reporting on the difficulty of removing a restrictive racial occupancy clause from a Sacramento community association's property records).

370. 334 U.S. 1, 19 (1948) (holding that state action existed when a court enforced racial restrictions). The holding of *Shelley* has continually perplexed legal theorists because it was decided in the 1940s. *See, e.g.*, Francis A. Allen, *Remembering* Shelley v. Kraemer*: Of Public and Private Worlds*, 67 WASH. U. L. Q. 709, 710–12 (1989) (arguing that the significance of *Shelley* changes over time); Lino Graglia, *State Action: Constitutional Phoenix*, 67 WASH. U. L. Q. 777, 787 (1989) (stating that of the Supreme Court cases regarding state action, the *Shelley* holding is the most criticized); Mark Tushnet, Shelley v. Kraemer *and Theories of Equality*, 33 N.Y. L. SCH. L. REV. 383, 384–85 (1988) (arguing that the substantive holding in *Shelley* was identical to the state action holding).

371. Fair Housing Act of 1968, 42 U.S.C. §§ 3601–3619 (2006).

372. 42 U.S.C. § 3604 (2006).

On the one hand, it is perhaps too soon in our history to give blanket membership approval power to community associations because the original *raison d'etre* of homeowner associations was to keep certain people out of them.[373] If such power existed, courts would necessarily need to exercise some sort of oversight scrutiny to assess the reasonableness of any approval or denial to make sure it did not violate the provisions of the Fair Housing Act or otherwise impermissibly bar alienability of property. The benefits of any self-protecting membership approval empowerment, therefore, must be balanced against the costs of potential discrimination and the cost of judicial efforts needed to police appropriate disapprovals of neighbor sales.

Mortgage lenders (theoretically) already do credit diligence on would-be buyers in communities as part of their underwriting.[374] It would be costly and difficult to force an association to inquire as to credit scores, employment, and salary. Such inquires would also be unnecessary in cases where another entity is already assessing these exact same criteria for a would-be buyer—namely, his or her mortgage lender. It would be wasteful and inefficient to require the non-expert volunteer directors to try to replicate this effort.

Because neighbors do not (and probably should not) have the ability to do financial investigations of would-be buyers in their community, association members cannot manage their own risks in this regard. Mortgage lenders, on the other hand, are best able to do such investigations at the lowest cost because they specifically assess the financial health of potential borrowers and can set the terms or limit the availability of mortgage loans accordingly.[375]

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373. *See supra* note 370 and accompanying text.

374. From 2000 to 2007, many mortgage originators neglected to do any credit diligence or at least did a terrible job. *See* Yuliya Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, 24 REV. FIN. STUD. 1848, 1873–75 (2011) (showing a decrease in the spread between prime and subprime mortgages, which is typically used to compensate lenders for the increased risk of subprime mortgages, concluding that the decrease in this spread was not sustainable, and indicating that loosening underwriting standards was one of the factors). In 2006, Steven Krystofiak, president of the Mortgage Brokers Association for Responsible Lending, submitted a written statement into the record of a Federal Reserve public hearing on mortgage regulation, reporting that his organization had compared a sample of 100 stated income mortgage applications to IRS records and found almost 60% of the sampled loans had overstated their income by more than 50%. *Inside the Liar Loan: How the Mortgage Industry Nurtured Deceit*, SLATE MAG. (Apr. 24, 2008, 11:25 AM), http://www.slate.com/id/2189576 (citing Written Statement of Krystofiak, President, Mortgage Bankers Association for Responsible Lending, Building Sustainable Homeownership: Public Hearing on the Home Equity Lending Market Before the Federal Reserve Bank of San Francisco (June 16, 2006), http://www.federalreserve.gov/secrs/2006/august/20060801/op-1253/op-1253_3_1.pdf).

375. Mortgage lenders also perform collateral due diligence (property appraisals) and are therefore well-situated to prevent a property from being so over-burdened with debt that a

B. Eroding Mortgage Priority

1. Equitable Reallocation of Payment Default Costs

Capped recoveries and limited priority liens are ineffective in a climate of underwater loans and long foreclosure timelines. Reverse foreclosures and other creative litigation strategies may obtain relief in certain situations but are inadequate to generally protect communities from the fallout of foreclosure freezes. Although there is some appeal to analogizing assessments to property taxes and granting a true priority status to assessment liens, it would be almost impossible for such a proposal to garner sufficient political support to pass. Allowing community members more extensive approval rights over property transfers within their community raises property and liberty rights concerns that vastly outweigh the benefits of permitting self-policing due diligence in sales. The best party to perform credit diligence of new (or refinancing) members in a CIC is the party already performing this role: the mortgage lender.[376] The best party to control for unrealistic loans, sloppy foreclosure proceedings, and unwarranted delays is also the mortgage lender. Thus, the mortgage lender should bear costs occasioned by its failure to diligently protect against the foreseeable externalities of its lending activities. In a situation where the property is underwater, the only party with a valuable interest in the property is the mortgage lender. The lender, as the sole property interest holder in this case, should bear the upkeep costs that protect and enhance the value of its security pending foreclosure.

Statutes should be passed in each state to create proper incentives for lenders to monitor or pay assessment delinquencies. Rather than relying on limited-priority liens, this proposal—an eroding first priority for first mortgage liens—would treat the priority position of a lender's first lien as conditioned upon foreclosure within a certain amount of time after mortgage default (e.g., six months). Thereafter, every month of unpaid assessments would become secured by a lien superior in payment priority to the first mortgage. Importantly, such a lien would have no upside cap, meaning recovery by the association would theoretically be unlimited, while the maximum paid by the neighbors would be limited. Such an eroding mortgage approach would cap the loss to the association rather than the loss to the lender, which is appropriate because it is the lender who controls the timing of the foreclosure sale.

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foreclosure sale will not net sufficient proceeds to cover obligations secured by the property.

376. *See supra* note 375 and accompanying text (noting that mortgage lenders perform collateral due diligence).

Under this proposal, the priority of the assessment lien would effectively erode the first priority of the mortgagee. This would likely incentivize lenders to pay assessments on behalf of their borrowers who are delinquent and add such costs to the debt. Most mortgage instruments already permit lenders to do this. Increased lender responsibility for its share of community upkeep might also motivate more expeditious foreclosure proceedings. Either way, the costs borne by an association would be minimized.[377] This better cost allocation regime would make sure that lenders are no longer distorted in their foreclosure timing analyses, which would ensure that delays in foreclosure result from relevant loan and market factors, not from a lender's mere desire to free-ride by avoiding collateral upkeep costs.

Lenders would reasonably respond to such a law by making a better credit evaluation prior to advancing funds regarding a borrower's ability to pay not only the mortgage loan but also the applicable assessments. Lenders would also have even more reason to ensure an accurate appraisal of collateral value. Any change in the legal framework of home lending that achieves this outcome is likely beneficial to individuals and the economy as a whole.[378] Also, such an evaluation currently cannot be done by the association itself, but it can be easily and cheaply achieved by lenders.[379] Lenders might respond to such a law by establishing an escrow account for association assessments, similar to accounts lenders already require for property tax and insurance amounts (and as already anticipated by Fannie Mae and Freddie Mac form instruments).[380] Finally, this law would motivate lenders during foreclosure to pay outstanding assessments to avoid incurring additional costs and fees. Having an assessment back-up source would benefit all property values in the community and keep other owners from being penalized for having delinquent neighbors. Lender-funded upkeep also avoids the situation of unjust enrichment that currently exists when neighbors end up paying for the upkeep on mortgaged properties for which they hold no interest.

Allowing a first mortgage lender's priority to erode over time as foreclosure is delayed is therefore both equitable and efficient.

377. Reasonable collection costs should be included in the priority lien amount; however, this proposal does raise the important question of collection cost and late fee abuses, discussed *infra* Part II.B.4.

378. *See generally supra* Part I.A.2 (discussing the negative externalities of constructive abandonment).

379. Lenders today are evaluating not only their borrowers' ability to pay assessment obligations, but also the ability of all other owners in the community to pay their assessments.

380. *See supra* note 354 and accompanying text (noting that lenders routinely establish property tax escrow accounts to protect themselves against superior priority payment obligations).

Uncapping lender liability for assessments will lead to assessment obligations being met more frequently by someone. This approach will also create a disincentive for irresponsible delays in foreclosure and, unlike the six-month limited-priority regime, will continue to be effective even if foreclosure does take a long time to complete. A system of eroding mortgage priority could allocate some limited portion of unpaid assessments to a community or could allocate all unpaid amounts to the lender, depending on when the lien erosion "clock" would start.[381]

Unlike the limited lien priority system, an eroding first priority system will not merely reduce association losses—it will tangibly improve community stability. Because responsible neighbors will be insulated from default spillover, recovery can occur; investors can purchase units secure in the knowledge that their investment is not subject to the unforeseeable and uncontrollable default rates of neighboring property loans. Lenders can lend on units in CICs knowing that the community will continue to be maintained and property values will be preserved, all at a cost allocation that is fair and equitable.

Ultimately, this system even benefits the first mortgage lenders who bear priority erosion losses as well because the value of their collateral will be preserved. Eroding lien priority should lead to a better recovery in foreclosure sales, which should offset the priority losses the system entails. For this reason, the GSEs should revise their policies and permit uncapped lender responsibility for collateral upkeep. Although a six-month limit is easier for a lender to prospectively quantify (because the maximum amount of foreclosure proceeds paid to an association is pre-determined), this approach depresses the property's value and limits capital availability to the entire community. Allowing a fairer allocation of community costs justifiably supports values and stability in the community—an outcome beneficial for the community's lenders as well as its owners.

2. Promoting Foreclosure as Policy

One effect of the eroding mortgage priority solution is that lenders will be discouraged from delaying foreclosure just to avoid payment of community assessments. A possible result is that foreclosures of community association properties may proceed more expeditiously,

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381. In lieu of having a front-end delay before erosion of a lien begins, a state could choose a shared-liability approach to assessments, mandating that a certain percentage of all unpaid assessments at foreclosure enjoy a payment priority. Under this system, the cost to a neighborhood would continue to grow as foreclosure is delayed, but so would the cost to a lender. This approach, however, would at least somewhat curtail the lender's collateral upkeep free-ride.

which is arguably harder on defaulting homeowners who face losing their homes more quickly. Although it is politically difficult for governments to push for quicker foreclosures (which is seen as making the poor owners lose vis-à-vis the banks), providing an incentive for banks to foreclose promptly is actually good in terms of the neighbors and the community as a whole.[382]

In some ways, both defaulting borrowers and mortgage lenders benefit from foreclosure delays, all at the expense of the community.[383] Delinquent owners can stay in their homes, cost-free,[384] and lenders can wait out a bad market while avoiding the carrying costs on a property.[385] The people who really lose from this delay are those least able to control for it: the innocent neighbors who fund the unpaid assessment bills.

Undue foreclosure delays adversely affect the wider market as well. Without lower-priced sales to pull down comparable sale values of homes, housing prices remain propped up at unsustainable levels. Delaying foreclosure sales, therefore, also delays the housing market

382. Politicians frequently balk at this approach of "getting it over with," and economists disagree about whether it is better to allow borrowers rent-free possession during a general market downturn or not. *See, e.g.*, Brady Dennis & Ariana Eunjung Cha, *Pelosi Calls for Federal Inquiry on Mortgage Lenders*, WASH. POST, Oct. 6, 2010, at A15 (discussing political reasons to push for foreclosure moratoriums while quoting Guy Cecala, the publisher of *Inside Mortgage Finance*, as warning that further slowdown in foreclosure sales would "delay significantly any recovery of the housing market"); Dina ElBoghdady, *Anxiously Waiting for the Sale to Go Through*, WASH. POST, Oct. 9, 2010, at A11 (discussing why foreclosure delays increase market uncertainty and the problems that result); Pearlstein, *supra* note 121, at A09 (explaining that "the longer the foreclosure process goes on, the longer it will take for the excess supply of houses to be absorbed, for prices to stabilize and for the real estate market to return to something closer to a normal equilibrium").

383. At the least, the parties benefit from delays where there is not a third party to buy the property from the lender at foreclosure or soon thereafter.

384. News stories tell of increasing numbers of homeowners who stop paying their mortgages, betting that it will take the lender a very long time to foreclose and explain that the threat of foreclosure is so temporally remote that it becomes merely "theoretical." *E.g.*, David Streitfeld, *Owners Stop Paying Mortgages . . . and Stop Fretting About It*, N.Y. TIMES, June 1, 2010, at A1 ("A growing number . . . are fashioning a sort of homemade mortgage modification, one that brings their payments all the way down to zero.").

385. *See* Ruger, *supra* note 2, at A1 ("[B]anks put off the foreclosure sales in many cases because once they take the property, they become liable for taxes, fees and maintenance."). Some banks even delay after acquiring the property at a foreclosure sale, waiting as long as possible to record the deed in order to procrastinate the day they are legally required to contribute to property upkeep. In the past year, some states legislatures have proposed laws to address this trend, requiring that deeds be filed within thirty or ninety days of a foreclosure sale. *See, e.g.*, S.B. 141, 150th Gen. Assemb., Reg. Sess. (Ga. 2009) (requiring foreclosure deeds to be recorded within ninety days); S.B. 128, 75th Sess. (Nev. 2009) (requiring foreclosure deeds to be recorded within thirty days).

from reaching equilibrium.[386] Only when prices reflect fundamental values will the market start recovering in earnest.

Undue foreclosure delays also discourage home buyers and investors who face uncertain timing and title.[387] Lenders avoid financing because of the uncertainty posed by community properties left in limbo.[388] In addition, delaying foreclosures also keeps the capital markets from establishing accurate pricing for mortgage-backed securities products, slowing the recovery in that market as well.[389]

During the limbo of threatened foreclosure, properties are generally not maintained at the optimal level.[390] This threat to quality of our housing stock is nowhere greater than in CICs, where a few delinquent properties can actually cause a decrease in the upkeep of the entire community. Our housing stock is at risk of deterioration if responsible "gatekeepers" are not funding its upkeep. The longer the limbo is drawn out, the more extreme upkeep problems will be.

It sounds draconian, but the best thing for the community in the case of a nonpaying unit owner facing foreclosure is to have the foreclosure sale take place as swiftly as possible. Unnecessary delay costs the entire community money and increases uncertainty. Any benefits accruing to the lender (or borrower) from such delay are purchased with other people's money. Plus, perceived lender benefits may be illusory because decline in collateral upkeep and increase in community assessment deficiencies will significantly drive down the value of the property and the lender's ultimate recovery at foreclosure.

3. Lender Disorganization and Misbehavior

Blame for the financial troubles of associations—like blame for the housing crisis—targets the mortgage lenders,[391] but the eroding lien

386. In 2006, the Office of Federal Housing Enterprise Oversight ("OFHEO") calculated the ratio of equivalent rents to home prices (comparing the amount for which a given home would rent to the home's purchase price) and found that nationwide, the average rental value of homes was only 70% of the purchase price. Stewart & Brannon, *supra* note 40, at 16 fig.1.

387. *See supra* note 122 and accompanying text (discussing how the uncertainty of assessments affects would-be buyers and new investors).

388. *See supra* notes 260–64 and accompanying text (describing the obstacles to financing faced by condominiums that are in limbo).

389. *See supra* notes 4 and 10 and accompanying text (discussing how many foreclosure sales do not even cover the amount owed on the mortgages and how the amount of mortgages in default force a fewer number of individuals to cover the burden of upkeep costs).

390. *See supra* Part I.A.2 (noting that a defaulting homeowner facing foreclosure has little incentive to make improvements on the home).

391. Miami Beach City Commissioner Jerry Libbin, for example, blames "greedy banks" that "refuse to take financial responsibility for their reckless lending" for causing the mass of association delinquencies that end up saddling the remaining owners of condominium units with

proposal is not punitive. Rather, proper upkeep allocation is a prerequisite to market recovery. Thus far, mortgage lenders have strongly objected to being forced to pay assessments on behalf of properties they are unable to sell quickly,[392] although their own self-interest leads banks to take on maintenance obligations for collateral not located in privately-governed communities. Governments and consumer protection groups have begged lenders to cut homeowners a break, yet homeowners face being sued by Florida associations for not foreclosing quickly enough.[393] The volume of defaulted properties is itself a barrier to expeditious foreclosure.[394] Servicers are overwhelmed with as many new mortgage defaults each month as previously occurred in an entire year.[395]

In the case of homes not located in CICs, lenders cannot avoid maintenance of constructively (or literally) abandoned properties prior to foreclosure. To prevent the ravages of permissive waste, lenders hire a manager to maintain such properties, buy insurance on the properties, and even pay to have necessary repairs done. Such collateral preservation steps are merely prudent business decisions and do not necessarily force lenders to foreclose at a time other than their choosing. Alternately, lenders can decide to modify loan obligations to free up borrower capital to meet needed upkeep costs. Lenders outside of CICs regularly act upon the clear understanding that maintenance of collateral value is in their own best interest. The only reason lenders do not incur such costs in CIC properties is that someone else is already doing the maintenance and picking up the tab.

"huge special assessments." *Miami Beach Commissioner Jerry Libbin Applauds 'Reverse Foreclosure' Ruling, Renews Call for State Lawmakers to Enact Comprehensive Foreclosure Reforms*, PR NEWSWIRE (Jan. 27, 2010), http://www.historiccity.com/2010/staugustine/news/florida/ruling-may-help-homeowner-associations-2546. Libbin has been "spearheading a state-wide campaign to protect condominium unit owners from unfair assessments levied on them" because of the housing meltdown, claiming that "loopholes in laws have allowed banks to escape from paying their fair share—forcing tens of thousands of Florida condo unit owners in good standing to pick up the tab." *Id.*

392. Alex Sanchez, president and CEO of the Florida Bankers Association, explains the lender perspective: "We get hit from every side. Some people say we're foreclosing too fast; others say we're foreclosing too slow [sic]. Bankers want to keep Florida families in their homes. Foreclosure is a last remedy." Coleman, *supra* note 104, at 1A.

393. *See supra* Part II.A.1.c (discussing government efforts to extend foreclosure timelines).

394. *See* Eunjung Cha & Dennis, *supra* note 3, at A9 (warning that uncertainty in foreclosure procedures scares away buyers and creates an even more "traumatic market" situation, where foreclosure buyers are even more scarce); Gretchen Morgenson & Geraldine Fabrikant, *Florida's High Speed Answer to a Foreclosure Mess*, N.Y. TIMES, Sept. 5, 2010, at BU1 (explaining that the huge backlog of foreclosure cases in Florida has led to some corner-cutting by the judicial department as well as lenders and that the backlog continues to increase anyway).

395. Viega, *supra* note 9.

Foreclosures cannot proceed when it is unclear who owns what loans.[396] Because a mortgage follows the note, only ownership (and, typically, possession) of the note evidencing the debt can permit an entity to foreclose on the mortgage. Before the advent of the secondary mortgage market and securitization, note ownership was easy to track because in most cases loan originators remained holders of the instrument. But with the growth of the secondary market and the innovation of mortgage-backed securitization and its related products, ownership of mortgage debt was passed on post-closing and became segmented through pools of loans.[397] By the mid-1990s, most mortgage

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396. On October 13, 2010, all fifty states began a joint investigation into mortgage foreclosures. This investigation was sparked by the "robo-signing" scandal. Robo-signing refers to the practice of having employees sign off on thousands of foreclosure affidavits, stating that they had reviewed the underlying paperwork when, in fact, they had not. *See* Eunjung Cha & Dennis, *supra* note 382, at A15 (discussing House Speaker Nancy Pelosi's call for the Justice Department to investigate mortgage lenders and how Maryland joined other states that sought to halt foreclosure sales while lender forgery and fraud claims were fully explored). The robo-signing scandal and associated moratoriums slowed down the foreclosure process significantly and left millions of homes "in limbo." *Id.*; *see also Congressional Oversight Panel: Hearing on TARP Foreclosure Mitigation Programs*, 111th Cong. 3 (2010) (testimony of Julia Gordon, Center for Responsible Lending) (stating that servicers engaged in "shoddy, abusive, and even illegal practices related to the foreclosure process" cause a lack of confidence in the process among buyers, which slows the absorption of real estate-owned inventory and an overall recovery of the housing market); Eunjung Cha, Mufson & Yang, *supra* note 3, at A11 (discussing the political pressure for the federal government to impose a full moratorium on foreclosures due to concerns over banks' foreclosure procedures); *supra* note 3 and accompanying text (discussing the moratoriums on mortgage foreclosures announced by large lenders due to sloppy or fraudulent servicer foreclosure procedures, describing the political reaction to the moratoriums, and stating that the procedural concerns prompting the moratoriums still linger despite the fact that the moratoriums have since been lifted). Although the moratoriums have now been lifted, the pace of foreclosure has significantly slowed in the wake of such scandals, resulting in a renewed focus on foreclosure procedure and mortgage ownership. For a more detailed discussion of some of the problems of note ownership and chain of title for mortgage notes in the secondary market and a proposal regarding possible future systemic solutions, see Dale A. Whitman, *How Negotiability has Fouled up the Secondary Mortgage Market, and What to Do About It*, 37 PEPP. L. REV. 737, 757–69 (2010).

397. The securitization concept basically holds that by splitting a group (pool) of mortgage loans into multiple classes (tranches) with a hierarchy of repayment rights (the top tranche has the least risky position in terms of credit and repayment risk), the mere grouping and tranching of the pool will dramatically reduce risks for investors holding the top tier position because the lower-positioned investors provide a buffer by bearing the first loss. Theoretically, this is true even if the entire pool is made up of risky mortgage loans: the lower tranches act as a risk shock absorber. Wall Street opined that pooling and tranching can be done several times, supposedly reducing risk of top-tiered securities with each re-tranching. This theory, widely accepted in the dawn of the twenty-first century, seems to work less well under real market stress—as seen in the meltdown of the subprime market. The structure of securitization in the abstract was not the problem, it was rather the valuation model for securitized products that was inadequate. For an overview comparison of securitization and traditional bank lending, see Gerald Hanweck, Anthony Sanders & Robert Van Order, *Securitization Versus Traditional Banks: An Agnostic View of the Future of Fannie Mae, Freddie Mac and Banks*, FINREG21 (Sept. 28, 2009), http://www.finreg21.com/lombard-street/securitization-versus-traditional-banks-an-agnostic-

banks no longer intended to originate mortgages for their own portfolios but rather acted as intermediaries—originating mortgages in order to sell them on the secondary market in turn.[398]

Loan ownership changes, through secondary market sales of mortgage loans, pooling, tranching, and securitization sales of pieces of those loans, were supposedly all tracked through the Mortgage Electronic Registration System ("MERS").[399] Although MERS records of loans often do permit ownership to be tracked, the individual notes have in many cases become lost along the way.[400] Because the lien (the mortgage) follows the payment obligation (the note), production of the note or a court-allowed substitute is a prerequisite to commencing a foreclosure proceeding.[401]

The delay is unfortunate but unavoidable: foreclosure as a process requires strict adherence in order to assure the fairness of the result.[402] If foreclosures must slow down to ensure procedural due process, then a slower timeline is essential.[403] The costs of these foreclosure delays, however, should be borne by the entities who could have avoided the problems causing the delays—namely, the lenders or servicers. Hopefully, foreclosures will not be delayed more than necessary as a result of political posturing because foreclosure delay causes far more problems than it solves.[404]

Many of the problems plaguing the housing market today—from the robo-signing scandal to the poorly-underwritten loans in the first place—are products of lender sloppiness, disorganization, and (sometimes) misbehavior. The structure of the market itself encouraged

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view-future-fannie-mae-freddie-ma (providing a concise description of the development of mortgage-backed securitization); *see also* Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 535–51 (2002) (providing a summary of the basics of loan securitization).

398. ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 381–82 (3d ed. 2007). *See generally* ANDREW DAVIDSON, ANTHONY B. SANDERS & LAN-LING WOLFF, SECURITIZATION: STRUCTURING AND INVESTMENT ANALYSIS (2003).

399. *See* Whitman, *supra* note 396, at 765 n.157 (describing MERS, which was "created by the major participants in the secondary mortgage market to maintain an electronic, on-line registry of mortgage assignments").

400. *Id.* at 757.

401. *Id.* at 757–59.

402. This is very similar to how election law procedures assure fair election results and how trial procedures assure viable findings of fact.

403. It is paramount to ensure that foreclosure sales are valid because flawed foreclosures raise three problems that threaten housing markets and the broader economy: the foreclosure itself may not be warranted or conducted correctly (with proper parties); buyers at foreclosure are not assured of good title; and lack of confidence in titles to land slows housing market recovery.

404. *See supra* Part I.A.2 (discussing the negative impact of constructive abandonment).

risk-taking at the originating lender level. Because borrower credit risk was assumed by the secondary market purchaser and securitizer of the loans, often with insurance companies providing credit enhancement to the mortgage pool, and was then passed on (in whole or in part) to investors in the pool that provided the actual funds through purchasing mortgage-backed securities,[405] there was very little incentive for mortgage lenders to perform sufficient due diligence before advancing funds. The *New York Times* decries sloppy lending, property appraisals, and securities ratings, pointing out that "[s]ince we trust, why verify?" seems to have been the industry motto.[406]

Again, there were many guilty parties in sloppy lending and loan transfers. But as between the mortgage lenders and the borrower's neighbors, the lenders clearly emerge as more culpable. Thus, between these two categories of parties, the choice for cost allocation is likewise clear: the mortgage lender is the only party who can avoid similar problems in the future. As the least-cost avoider, economic theory supports the equitable judgment here: lenders should bear costs caused by their failure to carefully underwrite their lending, properly document their mortgage sales and securitizations, and promptly and correctly foreclose.[407]

Lenders uniformly lobby to keep the system as-is, particularly in states with no limited lien priority for assessments. But in reality, bankers' associations that decry a viable solution to private governance failure are acting against their own long-term interest. Although lenders may see themselves as paying the price of revisions in the lien priority scheme, they very well could also be lenders on non-defaulting units currently being burdened with increasing assessments or, at the very least, facing the uncertainty of assessment increases in the future. A lender may desire to make a loan on a unit in a community where a large percentage of owners could stop paying assessments at any time. This uncertainty hurts owners and their lenders.[408]

Alternatively, if the community could ensure the expected revenue stream, the risk to all lenders decreases even though their exposure in

405. *See supra* note 397 (describing the securitization concept involving pools and tranches).

406. Floyd Norris, *Banks Stuck with Bill for Bad Loans*, N.Y. TIMES, Aug. 20, 2010, at B1.

407. This is not to say that uncertain foreclosures should be permitted. Strict procedural protections and requirements must be maintained. But any additional community costs incurred by lender missteps must be borne by lenders alone—not by the neighborhoods in which their collateral is located.

408. This is why Fannie Mae, Freddie Mac, FHA, and other lenders impose a limit on the percentage of delinquencies before they will purchase or insure (or originate) loans in a community association. It is also why the GSEs want to approve community reserves levels. *See supra* Part II.A.1.b (discussing how lender policies affect assessment recovery).

terms of their non-paying borrowers goes up. The downside, however, should not pose a problem; lenders can manage this risk much more easily than the uncertainty risk related to potentially unrecoverable assessments. Lenders already take measures to protect themselves against property tax amounts that can accrue and are payable prior to their mortgage loan out of foreclosure proceeds. Lenders need only to set up reserve accounts and affirmatively require payment of association assessments to control for borrower misbehavior and their own loss exposure from the loss of lien priority.

Lenders also benefit from legislation empowering associations to ultimately recover their upkeep costs because, by keeping the community association solvent and active, lenders reap the benefits of supported property values and well-maintained communities. Even when lenders "save" money by delaying foreclosure to avoid paying assessments, they drive down the property value of their own collateral by causing community assessments to increase while services decline. In essence, lenders commit their own waste when they fail to ensure payment of association assessments.

4. Association Assessment Abuses

Some commentators target association expenditures in general as wasteful spending, but statutory oversight of association budgeting and amenities is not a good idea. Rather than pass laws requiring communities to tighten their belts, this is best left to the governance system in place. There is nothing preventing members from voting to cut back services and save community funds. Furthermore, if a lender begins paying assessments after foreclosure, the lender will be able to assert the unit's voting rights and have some input into community costs and fees.

Associations are typically empowered to charge late fees and collection costs in addition to delinquent assessments.[409] Clearly, associations must be able to recoup the costs of collecting delinquent assessments. Some assert, however, that late fees and collection costs are out of control.[410] Allegations abound that community associations hire lawyers who abuse the system by charging outrageous fees.[411]

409. HYATT, *supra* note 15, at 121–22 (describing two methods of imposing late fees in CIC associations: flat rate and monthly interest fees).

410. *See, e.g.*, Ngoc Nguyen, *Hard-Pressed Homeowners Facing Another Financial Threat*, N.Y. TIMES, Apr. 15, 2011, at A19A (depicting cases where association debts were "turned over" to collection agencies and the tenfold increase in the amount owing due to fees and interest).

411. *Id.*; *see also* Shirley Wise, *Reverse Foreclosures—Are the Associations the Victims Here?*, EZINEARTICLES (Aug. 30, 2010), http://ezinearticles.com/?Reverse-Foreclosures---Are-the-Associations-the-Victims-Here?&id=4879390 (reporting that "the association attorneys add

Some California lawmakers, for example, have highlighted the danger of so-called "foreclosure factories"—law firms and collection agencies that charge an association $1500 to $2000 for taking over a foreclosure proceeding against a delinquent owner.[412] The associations tack the amount paid to assessment collectors onto the delinquent charges, and the collection cost amounts can be "shockingly high."[413]

Current government oversight of collection cost charges is minimal: only the California State Legislature has considered specifically limiting debt collection practices of CIC associations.[414] Recent attention to the plight of both association residents and nonpaying owners facing foreclosure suggests that additional state regulation of assessment collection may be on the horizon.[415]

Concern over unconscionably high late fees and collection costs may be warranted, as there are few legal limits on what a CIC association can impose on its members as long as it follows the procedures set forth in its governing documents.[416] If mortgage lenders are on the hook for

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outrageous fees for their services," are "unwilling to discount the amount not even by a dollar" and that these unfair practices "need to be questioned"). *See generally* EVAN MCKENZIE, PRIVATOPIA: HOMEOWNER ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENT (1996) (criticizing the entire governance system of CICs as prone to abuse).

412. *Id.*; *see also* Wasserman, *supra* note 12 (describing the problems related to associations that can easily foreclose on homes and describing recent legislative efforts to make foreclosure more difficult).

413. Ngai Pindell, *Tensions Between HOA Super Liens and Purchasers at Foreclosure*, LAND USE PROF BLOG (Jan. 29, 2010), http://lawprofessors.typepad.com/land_use/2010/01/tensions-between-hoa-super-liens-and-purchasers-at-foreclosure.html. Collection costs charged by associations are much maligned. Professor Pindell opines that "the only entities capable of engendering more ill will than over-zealous lenders are HOAs" and notes that "many see these perceived, excessive HOA charges as yet another manifestation of unchecked and intrusive power over homes and communities." *Id.*

414. *See* S.B. 561, 2011–2012 Reg. Sess. (Cal. 2011) (providing that "an association shall not voluntarily assign or pledge the association's right to collect payment or assessments to a third party . . . [unless] the third party agrees in writing to collect payments or assessments on behalf of the association in the manner set forth in this chapter" and prohibiting "a third party that has contracted with an association to collect assessments, fees, or payments . . . [from] act[ing] as trustee in foreclosure proceedings"); *see also* Nguyen, *supra* note 411, at A19A (reporting that "the California Senate Judiciary Committee passed a bill to curtail predatory practices by collection agencies" for homeowner association debt). The federal Fair Debt Collection Practices Act may also apply to limit the tactics an association may employ to collect unpaid assessments. *See* Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692–1692p (2006); *supra* note 162 and accompanying text (discussing the Fair Debt Collection Practices Act).

415. Pending bills in Utah and Arizona bar the use of debt collectors to obtain unpaid assessments. Conlin & Lush, *supra* note 5.

416. *See, e.g.*, O'Buck v. Cottonwood Vill. Condo. Ass'n, 750 P.2d 813, 818 (Alaska 1988) (upholding association rule banning television antennae in spite of no showing of adverse effect on the value of units and holding that owners of units in CICs "consciously sacrifice some freedom of choice in their decision to live in this type of housing"); Villa de las Palmas Homeowners Ass'n v. Terifaj, 90 P.3d 1223, 1234–35 (Cal. 2004) (upholding amendment to

unpaid assessments plus fees, such lenders might validly complain that an association might manipulate costs in order to obtain coverage of community expense from lenders' deep pockets. There may therefore be compelling reasons to have statutory limits on late fees and charges that an association can impose in order to prohibit a paying majority from unfairly allocating association costs. Some statutory oversight would be particularly warranted in cases where such charges are ultimately recoverable in full from a first mortgage lender in its foreclosure sale. Just as the current inequitable allocation of costs among members is unfair, it would be equally unfair to pass on a lion's share of community costs to lenders.

CONCLUSION

Today's unprecedented delay in foreclosures of vast numbers of financially underwater property harms non-defaulting owners in privately governed communities. The financial "commons" of entangled fiscal fortunes in such neighborhoods illustrates a fundamental flaw in the common interest community system of ownership that must be remedied to prevent the potential failure of such governance forms during periods of great economic stress. The adverse external impact of community assessment delinquencies is an important but often overlooked problem, which under the current housing crisis is reaching critical levels in some localities. Certain government and market actions, including current foreclosure moratoriums and delays, exacerbate the problem, spreading financial distress to innocent homeowners and bringing property values down in a tangible and significant way. Leaving community associations effectively bankrupt is a lose-lose scenario and we need prompt legislative action to prevent this result.

Current lien priority laws fail to protect the interests of such communities and their paying members. Even in the handful of states that have enacted protective limited lien priority provisions with respect to community association assessments, assessment lien priority is almost always capped at six months' worth of delinquent assessments. Because foreclosures take months or years longer than the time period representing the recoverable assessment amounts, such laws provide no real incentive for lender responsibility or expeditious foreclosure sales. As foreclosure is delayed, costs continue to mount while neighbors pay the costs left unpaid by delinquent owners.

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condominium declaration banning pets despite statute providing that no declaration can prohibit all pets).

To effectively preserve property values and protect blameless homeowners in planned communities, states across the nation must adopt measures to enable private governments to perform their roles. Allowing delayed foreclosures to erode the lien priority of a first mortgage achieves the needed result with the most contained and best-allocated costs. Although creating incentives for prompt foreclosures may at first glance seem perverse in a difficult economy, it is the only answer to the insolvency contagion threatened by assessment delinquencies and foreclosure delays. Finding solvent owners to replace those who hold title to houses they can ill afford—both in terms of financing and upkeep costs—is paramount. Continuing to mandate that paying members of a community association provide private financial support to the defaulting homeowners is unfair, inefficient, and poor policy indeed.