



## Financial Services & Products ADVISORY ■

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### HOA Liens Are First in Line

On September 18, 2014, the Supreme Court of Nevada issued its decision in *SFR Investments Pool 1, LLC v. U.S. Bank*,<sup>1</sup> in which the court considered the competing priorities of the holder of a first lien and the purchaser of property at a homeowner association's foreclosure sale. The decision in *SFR Investments* comes on the heels of a recent ruling by the D.C. Court of Appeals<sup>2</sup> that underscored similar tensions between condominium and homeowner associations and mortgage lenders about payment of delinquent association assessment charges.

#### Discussion

Currently, the laws of 23 jurisdictions contain provisions that afford a so-called "super-priority" to the liens available to condominium associations and/or community associations (generally known as HOAs). This super-priority effectively makes such liens superior in their position to the liens of mortgage loans and other types of liens, but the laws of the states that confer super-priority status vary. Nevada law in particular provides that an HOA may impose a lien against a unit for unpaid dues and affords nine months of unpaid dues higher priority than a previously recorded first deed of trust; it affords the lien lower priority for any additional unpaid dues.<sup>3</sup>

The super-priority lien rights originated in legislation such as the Uniform Condominium Act (UCA) adopted by the Uniform Law Commission (ULC) in 1980 and the Uniform Common Interest Ownership Act (UCIOA) and the Uniform Planned Community Act (UPCA), which were adopted by the ULC in 1982. The five states that have adopted versions of the UCA have included super-priority lien provisions in their statutes.<sup>4</sup> All eight states that have adopted versions of UCIOA have included language in their enabling legislation giving HOA liens priority over mortgages or deeds of trust to one degree or another.<sup>5</sup> Two states retain "first generation" condominium statutes based generally on the Horizontal Property Regimes Act (HPRA) first adopted by Hawaii in 1961, but have more recently updated those

<sup>1</sup> 120 Nev. Adv. Op. 75. (Sept. 18, 2014).

<sup>2</sup> *Chase Plaza Condo. Ass'n, Inc. v. JPMorgan Chase Bank, N.A.*, Nos. 13-CV-623, 13-CV-674, \_\_\_ A.3d \_\_\_, 2014 WL 4250949 (D.C. Aug. 28, 2014) (District of Columbia's highest court determined that a homeowner association's non-judicial foreclosure extinguishes a first deed of trust).

<sup>3</sup> Nev. Rev. Stat. Ann. § 116.3116(1), (2).

<sup>4</sup> The UCA states with priority are Alabama, Pennsylvania, Rhode Island, Tennessee and Washington.

<sup>5</sup> The UCIOA states with priority are Alaska, Colorado, Connecticut, Delaware, Minnesota, Nevada, Vermont and West Virginia.

statutes to include the super-priority lien.<sup>6</sup> Finally, seven jurisdictions have stand-alone statutes that afford some degree of priority to an HOA's lien over those of other lienholders.<sup>7</sup> Pennsylvania, which adopted the UCA, is also the first and only state to have adopted the UPCA.

In *SFR Investments*, the property at issue was located in a common-interest community subject to certain covenants, conditions and restrictions (CC&Rs) that were recorded in 2000. In 2007, the borrowers executed a promissory note and deed of trust on the property in favor of the lender, U.S. Bank. By 2010, the borrowers were delinquent on their HOA dues and defaulted on their obligations to U.S. Bank. The HOA and U.S. Bank each commenced non-judicial foreclosure actions. At the HOA's foreclosure sale, the foreclosure purchaser, SFR Investments Pool I, LLC—a real estate speculator—purchased the property and received and recorded a trustee's deed. During that time, U.S. Bank's trustee's sale had been postponed. Following the HOA's foreclosure sale, SFR Investments sued U.S. Bank, alleging that the foreclosure sale by the HOA extinguished U.S. Bank's first priority lien.

- The trial court dismissed the suit, holding that the HOA could not foreclose on its lien and extinguish the first priority lien unless it did so at a judicial foreclosure sale. SFR Investments appealed to the Nevada Supreme Court, which reversed the trial court in a 43 decision. Notably, the court held that:
- The statute splits the lien of the HOA into a "superpriority piece" and a "subpriority piece."
- The superpriority piece of the HOA's lien consists of the "last nine months of unpaid HOA dues and maintenance and nuisance-abatement charges" and is prior to the first priority lien.
- The subpriority piece consists of "all other HOA fees or assessments" beyond the "last nine months of unpaid HOA dues" and is subordinate to the first priority lien.
- The superpriority piece of the lien could be foreclosed upon non-judicially and such a sale will extinguish the first priority lien.
- Provisions contained in the CC&Rs for the HOA that purport to subordinate the entire HOA lien to a first priority lien, often referred to as "mortgagee protection clauses," are unenforceable under Nevada law.

The majority rejected U.S. Bank's argument that Nevada's "super-lien" statute creates merely a payment priority between the HOA and the beneficiary of a first deed of trust, not a true priority lien. Notably, the court deferred to the plain language of Nev. Rev. Stat. Ann. § 116.3116(2), which gives an HOA true super-priority lien status, including the ability to extinguish a first deed of trust upon a foreclosure sale. The court specified that the statutory language providing for an HOA lien "prior to" other liens and encumbrances relates to lien priorities and "does not speak in terms of payment priorities."

The court was not persuaded by U.S. Bank's argument that it is inequitable to allow a nominal lien to extinguish a first deed of trust securing debts in amounts considerably greater than the nominal lien. The court observed that, "as a junior lienholder, U.S. Bank could have paid off the [HOA] lien to avert loss of its security; it could have also established an escrow for [HOA] assessments to avoid having to use its own funds to pay delinquent dues."

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<sup>6</sup> The HPRA states with priority are Hawaii and Massachusetts.

<sup>7</sup> Other jurisdictions with priority include the District of Columbia, Florida, Illinois, Maryland, New Hampshire, New Jersey and Oregon.

The majority further stated that it was premature to rule on U.S. Bank's arguments that the foreclosure by the HOA deprived it of due process and declined to address U.S. Bank's argument that the foreclosure by the HOA was commercially unreasonable. The court rejected U.S. Bank's argument that the foreclosure notices prepared by the HOA were not sufficiently descriptive, ultimately shifting the burden to U.S. Bank by stating that "nothing appears to have stopped U.S. Bank from determining the precise superpriority amount in advance of the sale or paying the entire amount and requesting a refund of the balance."

## **A&B Observations and Conclusions**

The *SFR Investments* decision sheds new light on the tension between HOAs and lenders, making clear that, at least under the laws of some states, the lender must be proactive in order to safeguard the priority of its lien.

As the court in *SFR Investments* suggests, one way of securing lien priority would be for the lender to require escrows for condominiums and planned unit developments subject to HOA dues. In addition, lenders would be wise to monitor HOA dues and have systems in place to ensure that required advances are made for any unpaid dues before they become delinquent. The key would be to devise procedures that would prevent an HOA from having an actionable lien capable of being foreclosed upon. In the event a delinquency on a loan does get to the foreclosure stage, the first lien holder (via its servicer, or otherwise) should purchase the property to ensure that the lien is not wiped away, as was the result in this Nevada case.

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