

Common Interest Communities

by Ginny Rutledge
Sirote & Permutt, P.C.
USFN Member (AL)



This excerpted overview introduces the new HOA Talk column that will periodically run in the USFN Report. The full-length overview is found in the article library

at www.usfn.org. Future columns here will address specific states.

A major segment of the U.S. population is organized into housing clusters containing individually-owned residential homes and common areas. These common areas and facilities range from park-like open spaces to streets, lighting, water and sewer facilities, and recreational facilities. Common interest communities (CICs) include condominiums, townhouses, free-standing single-family residences, and other planned unit developments.

Assessments & Liens

Community associations are diverse with respect to financial strength and the management experience of elected officers. The key to maintaining CIC infrastructure and common assets is the ability of the association boards to collect assessments. Unfortunately, this is also the main source of financial strain on association boards. When the economy is in a downward mode, it becomes more difficult for associations to collect assessments. Typically, an owner's failure to pay assessments often coincides with his failure to make mortgage payments on the home.

Regardless of the absence of such language in the association declaration, many state statutes impose a lien on behalf of an association for delinquent and unpaid dues. These liens are usually subject to a first mortgage securing the home. States differ on when the lien comes into existence. Some states provide

that the recording of the CIC declaration itself constitutes record notice and perfection of the lien for assessments, while other states require that the lien be recorded in order to be perfected. Foreclosure of the assessment lien is often not the best choice for an association since the costs of foreclosing the lien often exceed the amount of the lien. The foreclosure sale typically does not generate sufficient funds to satisfy all of the senior liens, not to mention the association lien.

"Super Priority" Liens

The problem of realizing on defaulted assessments and the liens that secure them is somewhat lessened in states that have adopted the Uniform Common Interest Ownership Act (UCIOA) and related lien priority provisions. The UCIOA contains provisions for the formation, management, and termination of any CIC. The "super priority" lien provisions found in the UCIOA allow associations to have a limited lien priority over prior recorded senior liens. An association has a super lien for six months of unpaid dues, while any senior liens have priority over the remaining dues. This priority may include unpaid dues and, when the state statute specifies, late fees and attorneys' fees. Only a handful of states have adopted the UCIOA, but many states have adopted similar lien priority provisions applicable to some or all forms of CICs.

These super lien provisions are a compromise of interests between associations and lenders. Financial viability for associations is established due to strengthened collection powers. In addition to giving an association a limited share of the sale proceeds generated upon a senior mortgage holder foreclosure, associations now are able to get the defaulted property into a status of generating regular assessment revenues more quickly. An association can also encourage the senior mortgage holder to go ahead and pay the delinquent assessments in order to gain control over the foreclosure of the assessment lien.

Simply stated, a lender's foreclosure typically produces a solvent owner. This results in a more stable condition for the affected property because the dues will be paid on a regular basis. Prior to foreclosing, a senior mortgage holder is often forced to protect its interest by paying assessments it may not otherwise be obligated to pay. Such assessments are paid in order to prevent the association from foreclosing its lien. This is especially important in those states with a limited redemption period. Once the redemption period expires, the senior mortgage holder may no longer have the right to redeem the property.

Special Assessments

If the regular, periodic assessment is insufficient to cover items not provided for in the annual budget, the association may impose a special assessment. Any project, whether it is installing a new roof or building a new clubhouse, can prompt a special assessment. In some parts of the country, special assessments for condominium associations are becoming more common because of the rising insurance rates and unexpected costs of the catastrophic hurricane seasons of 2004 and 2005. For example, in Alabama, some condominium owners along the gulf coast have seen bills as high as \$70,000 in an attempt to recover from the disastrous storm damage of Hurricanes Ivan and Katrina.

There is little, if any, case law on whether these special assessments can be included in the six months of dues taking priority over a first mortgage in the super lien states. Most super lien jurisdictions allow for common assessments adopted in the annual budget. A special assessment, by definition, is an assessment not budgeted for by the association. Some states specifically exclude special assessments by statute, while other states make no reference to special assessments.

Escrowing Assessments

The best approach for lenders taking a security interest in a home located in a common interest community is to be fully aware of all

see HOA Talk on page 22

HOA Talk *continued from page 17*

the issues surrounding these communities. Some policy makers contend that lenders are more equipped to deal with these issues because they can investigate a borrower's credit, vary the size of a loan, or require a borrower to escrow funds to cover the dues. A lender already takes financial responsibility to protect its investment by paying insurance, certain maintenance fees, and property taxes. Association assessments in the super lien states are becoming very similar to property tax assessments because of their super priority status. Requiring a borrower to escrow association dues, or at least six months' worth of dues in the super lien states, may lower the risk of homeowners facing assessments that may increase while home values decrease. This requirement will also protect the security interests of lenders. ■