

BERDING | WEIL COMMUNITY ASSOCIATION ALERT

Legal News and Comments for Community Association Boards and Managers



Assessment Collection in an Economic Crisis

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A few years back, California enacted legislation affecting non-judicial and judicial foreclosure of assessment liens which made the process more complicated and risky than before. Changes to the law suggested a governmental policy favoring the resolution of many assessment disputes in Small Claims Court. Now, in the current economic crisis and real estate meltdown, assessment collection in Small Claims Court is quickly becoming the most efficient way to collect assessments.

Statutory Assessment Collection

The standard method of assessment collection employed by community associations follows the procedure set forth in the Davis-Stirling Act, concluding with a non-judicial foreclosure sale. Under this method, a community association writes to the delinquent owner and requests payment of past due assessments. If the informal letter is unsuccessful, the association engages a collection agency to pursue collection of the account. The collection agency prepares and mails via certified mail the statutorily required pre-lien notice, which usually includes an offer to "meet and confer." Thirty days later, if the account remains unresolved, the board of directors decides to record an assessment lien against the unit.

If the account remains unpaid 30 days after recording of the assessment lien, the association is free to enforce the lien in any manner permitted by law, including sale by the court (judicial foreclosure), or sale by the trustee designated in the notice of delinquent assessment (non-judicial foreclosure). In the non-judicial context, the sale is handled pursuant to the statutory procedure for non-judicial sale of a mortgage or deed of trust. Under this procedure, the trustee records a Notice of Default which triggers a three-month period before which a Notice of Trustee's Sale can be recorded. If the account remains unresolved after three months, the trustee then records a Notice of Trustee's sale setting forth the time and place of the sale.

If the sale occurs, and no one outbids the association, the trustee executes a Certificate of Sale putting title of the unit in the name of the association. Under legislation effective January 1, 2006, the completion of the sale triggers a 90 day right of redemption period under which the unit owner has the right to regain title to the unit provided he or she pay the association the delinquent assessments owed on the unit. If the owner fails to redeem, the association receives a Trustee's Deed to the unit, taking fee title to the unit subject to all prior recorded liens.

Under this process, the goal of the association is to have the owner pay the delinquent assessment or risk losing the unit, including its equity. Equity is calculated by taking the fair market value of the unit and subtracting all recorded and outstanding liens recorded against the unit.

For example:

Unit fair market value	\$350,000
1st Mortgage to ABC Bank	(\$200,000)
2nd Mortgage to XYZ Bank	(\$ 50,000)
Assessment Lien	(\$ 4,500)
Equity	\$ 95,000

The prospect of losing \$95,000 in equity is the driving force that motivates the owner to pay the delinquent assessment before the non-judicial sale occurs. This is the association's desired result. Further, the opportunity to obtain a unit, and its equity, for a relatively nominal amount provides an incentive for third parties to attend the sale and bid at the non-judicial foreclosure sale, thereby completing collection of the delinquent assessment. The right of redemption reduces somewhat the marketability of a unit because a third party bidder takes the unit subject to the owner's right to regain title. However, to redeem the unit, the foreclosed owner would need to pay the third party bidder the amount paid at the sale to acquire the unit.

A successful bidder at a non-judicial foreclosure sale, be it the association or a third party, acquires the unit subject to all senior liens. This means that the successful bidder will either need to assume the loans relating to the senior liens, or pay them off. If the obligations owed to the senior lien holders go into default, through non-payment or otherwise, the party that acquired the unit at the non-judicial foreclosure sale faces the same fate as the delinquent assessment owner.

Assessment Collection in the Current Environment

As discussed above, the motivating factor in resolving delinquent assessments through non-judicial foreclosure is the protection of the unit's equity. This motivation is lost, however, when the unit has little or no equity. This is the issue faced by many associations in today's economic climate and falling property values. The statutory method of assessment collection is no longer an attractive option to resolve delinquent assessments. Many times, an owner will stop paying maintenance assessments but continue to service the mortgage debt on the unit. Non-judicial foreclosure of an assessment lien will not motivate this owner to pay the delinquent assessments because he has no equity to protect.

Here, an association is saddled with an owner that refuses to pay his assessments with only the unattractive option of non-judicial foreclosure. The unit owner remains in the unit, using his or her share of common area amenities, but refusing to contribute his or her assessment dollars for these amenities.

Consider the following example:

Unit fair market value	\$ 350,000
1st Mortgage to ABC Bank	(\$ 200,000)



2nd Mortgage to XYZ Bank	(\$ 50,000)
Assessment Lien	(\$ 4,500)
Equity	(4,500)

Here, the association's lien attaches to nothing because there is no equity in the unit to secure it; the association is an unsecured creditor. Essentially, the association has not improved its position vis-a-vis the delinquent owner by recording the assessment lien. If the association completes a non-judicial foreclosure sale, it will obtain title to a unit worth \$250,000 but encumbered with senior liens in the amount of \$250,000; the association obtains nothing. Because there is no equity in the unit, third parties have no incentive to bid at the sale. Further, now the association will have to incur the expense of insuring the unit, and evicting the occupant. Worse, if the association does not service the senior mortgages, they will foreclose, leaving the association with nothing other than an obligation to pay collection and foreclosure charges.

In other common situations, the owner cannot pay his mortgage lender, which forces the lender to foreclose. If the association recorded an assessment lien, it is likely junior to the mortgage lien, and will be wiped out when the senior lender forecloses. In this situation, the unit is no longer available to collect the assessment. Many times, associations assume that once their assessment lien is wiped out, they can no longer collect the delinquent assessment. An association will simply "write-off" the assessment as uncollectible.¹ This assumption is in error. Under California law, the obligation to pay assessments is the debt of the owner and it is personal to him or her. The ability to lien and foreclose is merely an enforcement technique. If an owner is foreclosed by his or her lender, wiping out the association's assessment lien, the now displaced owner *still owes the association the amount of the delinquent assessment*. Even though the unit is no longer available for collection, the owner may have other assets (a job, a bank account, brokerage accounts, a car) that the association may look to for collection.

An owner's other assets can be made available for assessment collection by filing a civil lawsuit, either in Small Claims Court or Superior Court. The object of such a lawsuit is obtaining a civil money judgment for the amount of the delinquent assessment, late charges, interest, collection costs, and attorneys' fees. These judgments are relatively easy to obtain and are enforceable for 10 years. Further, they can be renewed for another ten years if unsatisfied. Of particular note, judgments can be recorded with the county recorder to create a judgment lien. This lien can attach to after-acquired property. In other words, the association can obtain a lien on real property that the delinquent owner may own *in the future*.

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