THE PROPERTY LINE

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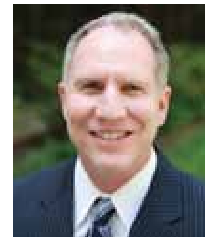
Foreclose or Sue? What is the Better Option?



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Community associations have the power to foreclose upon homes in order to collect delinquent assessments. However, during this current economic downturn, often times, there are circumstances where it is in the associations' best interests to refrain from wielding that power. This is especially true since, most likely, the associations will become the owners of the homes through their foreclosures. Under such circumstances, it may be in the associations' best interests to file lawsuits in order to collect delinquent assessments.

Most associations have the power to foreclose upon homes in order to collect delinquent assessments, without having to file lawsuits. At the foreclosure sale, either a third party bidder at the sale becomes the owner, or if there are no bidders, then the association becomes the owner.

Also, typically, when a homeowner decides to no longer own a home that is worth less than the amount owed, the homeowner will not only fail to pay assessments, but will also fail to pay the mortgage. If a lender timely forecloses, then it is usually more economical for an association to wait for the lender to foreclose, rather than proceeding with foreclosure, itself.

However, during the economic downturn, most lenders have failed to timely foreclose. Further, since most homes are worth less than the homeowner owes on the mortgage, there are usually no bidders at the association's foreclosure sales. Therefore, associations become the owners of the foreclosed-upon homes, without having recouped any losses from the delinquent assessments

At first blush, an association foreclosing on and then renting out a home seems like a viable solution. However, associations may encounter several liability risks: (1) the lender can foreclose and extinguish the association's ownership of the home; (2) the association and its board risk lawsuits for "rent skimming," (renting out the home, keeping the rents, and not paying the mortgage); (3) the association may lack insurance coverage if a person gets injured at the home; (4) the association may need to evict the foreclosed-upon homeowner; (5) the association's board will incur the time and expense of being a landlord; (6) property taxes may need to be paid; (7) the foreclosed-upon homeowner may have intentionally damaged the home; and (8) associations will incur the typical costs of home ownership, such as utilities, garbage, sewer, pest control, landscape maintenance, etc.

As such, associations may choose to sue homeowners for delinquent assessments, rather than foreclosing. Boards should consider the following factors when deciding whether to sue: (1) the association must be able to locate the homeowner in order personally serve them with the lawsuit papers; (2) either a board member and/or the community manager must attend the court trial; and (3) even if the association obtains a judgment, the homeowner may be financially unable to pay it.

Fortunately, it is common for homeowners to pay the association when sued. Also, associations have multiple options when attempting to enforce judgments through garnishing wages, levying bank accounts, and recording the judgments against the homeowner in counties where they may own other property.

Accordingly, associations may want to refrain from foreclosing upon and thereby becoming owners of homes, and should consider, as an alternative, filing lawsuits to attempt to collect the delinquent assessments.

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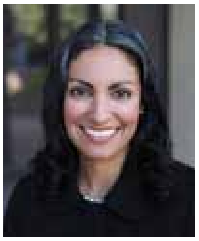

My Association Owns A Property but the Ex-Homeowner Still Lives There: Now What?

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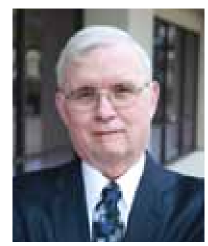
More and more associations are becoming the owners of properties within their developments. Whether this is part of a Board's carefully reasoned decision or the lesser of two evils, when an association becomes the legal owner of a property, there are a number of issues to address. The first, and most common problem, is how the association should proceed when the ex- homeowner still lives at the Unit - i.e. how does an association evict someone?

"Unlawful Detainer" is the legal term for eviction and it involves a number of steps which should be closely monitored by the association's legal counsel. The first step involves posting a Notice to Quit, which provides the resident that the property is now owned by the association, they are trespassing on the property and they have a few days to abandon the premises. The Notice warns, however, that if the resident does not abandon the property, the association will immediately commence formal eviction proceedings. If abandonment has not taken place after the deadline set forth in the Notice to Quit, the association should immediately file a formal Complaint in Superior Court. This Unlawful Detainer complaint will set forth the facts explaining how the association gained ownership of the property, that the resident was provided with notice of their need to abandon the property and requesting the Court to provide relief to the association in the form of immediate exclusive possession to the property, money damages and attorneys' fees and costs.

When handled properly, an Unlawful Detainer proceeding can be quick and efficient, providing the association with exclusive possession of the property so it can decide what steps to take next. If the legal requirements are not met, however, the association may need to start the process all over again, thereby wasting more time. As such, sound legal advice and oversight is crucial to ensure proper handling of these matters. Feel free to contact Angius & Terry for further information on this process and our new flat fee schedule for Unlawful Detainers and related proceedings.

Ownership of Properties Following Foreclosure Sale



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Many associations who obtain title to a property within the development through foreclosure of an assessment lien decide to rent the property until the lender forecloses. Rent will usually be higher than the monthly assessment, so the association may be able to recover some of the delinquent assessments of the prior owner. Any lease of the property should be in writing and should contain terms requiring the tenant to conform to the governing documents and notifying the tenant that the lender may foreclose on the property in the future.

Some association managers have expressed concern about the possibility of liability for "rent skimming' if the association accepts rent but fails to make the mortgage payment. Civil Code Section 891 does prohibit "rent skimming" which is defined as using revenue received from rental of a property without first applying the revenue to the monthly mortgage payments. However, this statute only permits a lender to make such a claim when there has been rent skimming with regard to at least five separate properties within a two-year period. In any case, additional legal steps, such as notifying the bank of the association's intent to rent the property and not make mortgage payments and similar disclaimers in the lease agreement will minimize any possibility of a claim for rent skimming. We are not aware of any claim of rent skimming against a homeowners association for renting a property after foreclosure.

The association needs to make sure it is properly insured as a landlord. The duties and liabilities of a landlord are, in some respects, much broader than those of an association. A landlord must make sure the property is habitable, with functioning utilities and adequate sanitation, light and heat (among other things). In renting the property, the landlord may be liable for discrimination claims. A discussion with the association's insurance agent should determine whether additional insurance will be required to cover the association as a landlord.

The board for the association acting as a landlord needs to keep in mind that, as owner of one of the properties in the development, it is now a member of the association and subject to the obligations of all other owners under the governing documents (unless the governing documents specifically exempt the association as landlord from such obligations). The association may be required to perform maintenance which are the owners' responsibility under the governing documents and to pay assessments. Such potential expenses should be reflected in the board's financial planning.

Rental of foreclosed properties is one option for boards to improve their cash flow temporarily but involves additional obligations and liabilities. Contact Angius & Terry to discuss the best manner in which to proceed if your association owns a property.