Priority of Condominium Associations' Assessment Liens vis–à–vis Mortgages: Navigating in the Super-Priority Lien Jurisdictions

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CONTENTS

INTRODUCTION

The Great Recession, which lasted from December 2007 through June 2009, was longer than any recession since World War II.[1] It followed a collapse in housing values and stock prices, with both gross domestic product and the number of jobs declining by about 6% and median family incomes declining by about 8%.[2] The current low interest rates, a steady flow of hiring in the U.S., and an improved economy are all helping to attract new shoppers who can now afford to own or rent a home.[3] Despite these trends, it is important to learn from the Great Recession and to be ready for what lies ahead because each downturn in the cyclical real estate market has a huge impact on the economy as a whole.[4] Times of crisis test the lien foreclosure process, pushing it to its limits and exposing a variety of weaknesses.

The downturn hit common interest communities hard—such as condominiums, planned communities, and cooperatives—because many unit owners were unable to pay the assessments needed to provide services for the people living in them.[5] When certain owners do not pay the assessments due, the burden shifts to the remaining owners via increased assessments or reduced services, putting the property value at risk.[6]

Pursuant to statute, unpaid assessments constitute a lien on an owner's unit, which can be the basis for a foreclosure action.[7] Moreover, in almost half of the states, the general common law rule that "first in time is first in right"[8] is trumped when association liens for assessments are

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1. BUS. CYCLE DATING COMM., NAT'L BUREAU OF ECON. RESEARCH 1 (2010), http://www.nber.org/cycles/sept2010.pdf [https://perma.cc/CMR4-QJYH].

2. *See* Sheldon Danziger, *Evaluating the Effects of the Great Recession*, 650 ANNALS AM. ACAD. POL. & SOC. SCI. 6, 6 (2013).

3. *See* Jeffry Bartash, *Housing Starts Highest Since Before Great Recession*, MARKETWATCH (Aug. 18, 2015, 11:34 AM), http://www.marketwatch.com/story/housing-starts-highest-since-before-great-recession-2015-08-18 [https://perma.cc/K5BY-S73A].

4. *See* Teo Nicolais, *How to Use Real Estate Trends to Predict the Next Housing Bubble*, HARV. DIV. OF CONTINUING EDUC. (Feb. 20, 2014), http://www.dce.harvard.edu/professional/blog/how-use-real-estate-trends-predict-next-housing-bubble [https://perma.cc/GR6Z-ZSQB]. According to Teo Nicolais, the next major crash will not happen until after the next real estate market peak in 2024. *Id.*

5. *See* JOINT EDITORIAL BD. FOR UNIF. REAL PROP. ACTS, THE SIX-MONTH "LIMITED PRIORITY LIEN" FOR ASSOCIATION FEES UNDER THE UNIFORM COMMON INTEREST OWNERSHIP ACT 5 (2013), http://www.uniformlaws.org/shared/docs/jeburpa/2013jun1_JEBURPA_UCIOA%20Lien%20Priority%20Report.pdf [https://perma.cc/LEV9-PZSL] [hereinafter JEB REPORT].

6. *See id.* at 1.

7. *See id.*; RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 6.5 (AM. LAW. INST. 2000).

8. 15B AM. JUR. 2D *Condominiums and Cooperative Apartments, Etc.* § 35, Westlaw (database updated Sept. 2016); WILLIAM B. STOEBUCK & JOHN W. WEAVER, 18 WASHINGTON PRACTICE, REAL

placed in a priority position with respect to mortgage lender liens.[9] This "super priority" is motivated by the fact that when an owner is not paying assessments, the association becomes an involuntary creditor obligated to provide services[10] and to take care of the mortgaged home for the benefit of the lender.[11] Further, the association's financial stability and practical ability to provide services might also be affected.[12] Real estate tax liens, other governmental charges, and mechanics' liens have been awarded similar priority because of the interests of the general public.[13]

The Uniform Law Commission (ULC), also known as the National Conference of Commissioners on Uniform State Laws, has propounded the framework of the various uniform statutes adopted by most of the "super-priority" jurisdictions.[14] The ULC originally promulgated the Uniform Common Interest Ownership Act (UCIOA) in 1982 and amended it after considering the experience of states that adopted UCIOA or its predecessor acts.[15] The UCIOA combines provisions from the Uniform Condominium Act (1980) (UCA), the Uniform Planned Community Act (1980) (UPCA), and the Model Real Estate Cooperative Act (1981) with the goal of providing uniformity among all three forms of ownership.[16] In order to aid associations in collecting common expense assessments, these uniform laws provide that association liens are prior to all encumbrances that arise after the recording of the declaration, subject to limited exceptions.[17] The priority of association liens is effectively split because the first six (or more)[18] months of assessments are prioritized over the first mortgage, but all additional amounts owed to associations are subordinate

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ESTATE: TRANSACTIONS § 14.5 (2d ed. 2015). Under this doctrine, "generally, liens take precedence in order of time; the first in time being the first in right." Hollenbeck v. City of Seattle, 240 P. 916, 918 (Wash. 1925).

9. *See* HUGH LEWIS, FOUND. FOR CMTY. ASS'N RESEARCH, NATIONAL MATRIX OF ASSOCIATION "SUPER-PRIORITY" LIEN LEGISLATION 1 (2015), http://www.cairf.org/research/factbook/lien_priority_matrix.pdf [https://perma.cc/6WZN-GVNE].

10. *See* JEB REPORT, *supra* note 5, at 1.

11. *See* FOUND. FOR CMTY. ASS'N RESEARCH, 2015 COMMUNITY ASSOCIATION FACT BOOK 28 (2016), http://www.cairf.org/research/factbook/2015intro.pdf [https://perma.cc/27WA-8SDK].

12. *See* JEB REPORT, *supra* note 5, at 1.

13. *See generally id.*

14. *See About the ULC*, UNIF. LAW COMM'N, http://www.uniformlaws.org/Narrative.aspx?title=About%20the%20ULC [https://perma.cc/WA48-YWAZ].

15. *Common Interest Ownership Act Summary*, UNIF. LAW COMM'N, http://www.uniformlaws.org/ActSummary.aspx?title=Common%20Interest%20Ownership%20Act [https://perma.cc/SR8L-DW4S].

16. *See* UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116, at 3–6 (UNIF. LAW COMM'N 2014), http://www.uniformlaws.org/shared/docs/Common%20Interest%20Ownership/2014_UCIOA_Final_08.pdf [perma.cc/C2XZ-98AD] [hereinafter UCIOA].

17. *See* JEB REPORT, *supra* note 5, at 1.

18. For example, in Nevada, nine months of assessments have super-priority lien status. NEV. REV. STAT. ANN. § 116.3116 (West 2015).

to the first mortgage.[19] First mortgages tend to be purchase-money loans used to buy a house or a condominium, whereas second (or junior) loans tend to be home-equity loans. Notably, if an association forecloses its priority portion, it eliminates all subordinate liens, including the first mortgage. This is based on the fundamental principle that a valid foreclosure of a senior interest terminates not only the owner's title and equitable redemption rights but also all junior interests whose holders were joined as defendant parties.[20]

Washington State modeled the Washington Condominium Act after the UCA.[21] Although in some jurisdictions a second mortgage is typically subordinate to the full amount of the association lien,[22] in Washington State, any mortgage—not just the first mortgage—enjoys subsequent priority after the six-month assessment lien is satisfied as long as such mortgage was recorded prior to the delinquency date on the assessment sought to be enforced.[23] Additionally, the Washington State legislature has recently considered the adoption of the UCIOA, which could overhaul separate laws currently in place and provide uniformity among all three forms of ownership.[24]

This Note will discuss the issues concerning laws regulating lien priority in association foreclosure sales and argue that lenders, because they are in the best position to do so, should implement proactive strategies to protect their interests in association foreclosures. Part I provides an overview of uniform law development and a history of Washington's governing laws with a focus on recent problems relating to association lien priority. Part II presents analysis of the important court decisions applying the lien priority statute and discussion regarding current and proposed Washington law. Finally, Part III discusses potential solutions lenders should implement to balance the interests of associations and lenders in the aftermath of the foreclosure sale crisis.

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19. *See, e.g.*, UCIOA, *supra* note 16, § 3-116(a)–(c).

20. *See* RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.1 cmt. a (AM. LAW. INST. 1997); MICHAEL T. MADISON, JEFFRY R. DWYER & STEVEN W. BENDER, 2 LAW OF REAL ESTATE FINANCE § 10:5 (2014).

> A valid foreclosure of a mortgage terminates all interests in the foreclosed real estate that are junior to the mortgage being foreclosed and whose holders are properly joined or notified under applicable law. Foreclosure does not terminate interests in the foreclosed real estate that are senior to the mortgage being foreclosed.

RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES. § 7.1 (AM. LAW. INST. 1997).

21. *Condominium Act*, UNIF. LAW COMM'N, http://www.uniformlaws.org/Act.aspx?title=Condominium%20Act [https://perma.cc/BLA8-LM7T].

22. *See, e.g.*, OR. REV. STAT. ANN. § 100.450(7) (West 2003); 34 R.I. GEN. LAWS ANN. § 34-36.1-3.16 (West 2009).

23. *See* WASH. REV. CODE § 64.34.364(3) (2014).

24. *See infra* Part II.G.

I. BACKGROUND: A HISTORY OF ASSOCIATION LIEN PRIORITY STATUTES

In 2015, there were 338,000 common interest communities housing 68 million Americans, which represents approximately one in five households nationally.[25] About 21.1% of the U.S. population lived in association homes cumulatively valued at $5.28 trillion.[26] With $85 billion in assessments collected and another $23 billion in assessments contributed to reserve funds,[27] associations play a significant role in the national economy and in people's lives.[28] According to a 2014 survey, 12% of association residents report having been behind at some point on their association assessments.[29]

A. Development of Uniform Laws

To fund their important functions, associations need to collect assessments. Assessments fund many essential association obligations,[30] including professional management services, utilities, security, insurance, common area maintenance, landscaping, capital improvement projects, and amenities like pools and clubhouses.[31] A growing number of states

25. FOUND. FOR CMTY. ASS'N RESEARCH, STATISTICAL REVIEW FOR 2015 1, 3 http://www.cairf.org/research/factbook/2015_statistical_review.pdf [https://perma.cc/V54M-48VW] [hereinafter STATISTICAL REVIEW FOR 2015].

26. *Id.* at 3.

27. *Id.* As of 2015, Washington State ranked ninth nationally in the number of state residents living in associations, with 2,062,000 residents occupying associations. *Id.* at 2. The following states ranked higher than Washington in this statistical category: Florida, California, Texas, Illinois, North Carolina, New York, Massachusetts, and Georgia. *Id.*

28. In October 2016, there were 912,832 properties in the U.S. involved in some stage of foreclosure (default, auction, or bank owned); one in every 1,388 housing units was in foreclosure as of August 2016. *See U.S. Real Estate Statistics & Foreclosure Trends Summary*, REALTYTRAC, http://www.realtytrac.com/statsandtrends [perma.cc/L6RX-6ABE]; *U.S. Real Estate Trends & Market Info*, REALTYTRAC, http://www.realtytrac.com/statsandtrends/foreclosuretrends [https://perma.cc/NSZ6-Y4X5]. At that same time in Washington State, one in every 2,218 housing units was in foreclosure. *Washington Real Estate Trends & Market Info*, REALTYTRAC, http://www.realtytrac.com/statsandtrends/foreclosuretrends/wa [https://perma.cc/BXN9-NRT6].

29. FOUND. FOR CMTY. ASS'N RESEARCH, NATIONAL SURVEY OF COMMUNITY ASSOCIATION RESIDENTS, PUBLIC OPINION STRATEGIES 5 (2014), http://www.cairf.org/research/Americans_Grade_2014.pdf [https://perma.cc/4NMV-SM42].

30. Indeed, "in this era of privatized public services, with private associations rather than public governments collecting trash, maintaining roads and parks, and the like, association assessment charges have become more and more analogous to property taxes, liens which receive priority over virtually all others." James L. 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, 361 (1992).

31. *See* STATISTICAL REVIEW FOR 2015, *supra* note 25, at 3. In addition, associations have to "reserve funds for the repair, replacement and enhancement of common property, e.g., replacing roofs, resurfacing streets, repairing swimming pools and elevators, meeting new environmental standards and implementing new energy-saving features." *Id.* Notably, such special assessments are usually not subject to super priority over mortgages.

have enacted laws granting higher priority status to associations as secured creditors for the collection of delinquent assessments during the foreclosure or sale of financially distressed units.[32] The association's super-priority lien moves ahead of other creditors and is paid off from foreclosure sale proceeds, or the lien statutorily "survives" and continues to encumber the property after foreclosure under the first mortgage.[33]

The six-month limited priority, initially adopted in UCA in 1980—and later in UCIOA and the UPCA in 1982—was viewed as striking an equitable balance between the need to enforce collection of unpaid assessments and the need to protect the priority of lenders' security interests.[34] These statutes provide that association liens have a limited priority over mortgages, securing six months' worth of common expense assessments that became due immediately preceding the institution of an action to enforce a lien.[35]

Currently, twenty-one states, the District of Columbia, and Puerto Rico[36] have assessment priority lien statutes modeled after UCIOA, UCA, or stand-alone statutes.[37] Most of these statutes grant associations a super priority for up to six months of unpaid assessments, although these statutes vary in other details, such as the recoverability of attorney fees and costs;[38] the specific procedures for notice or recording of the delinquent assessment liens; and their applicability to both first and second mortgage loans, or only to first mortgage loans.[39] In some states, the super-priority

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32. *See* Gary A. Poliakoff, 1 LAW OF CONDOMINIUM OPERATIONS § 5:63 (2015).

33. *See id.*

34. *See* UCIOA, *supra* note 16, § 3-116 cmt. 2; UNIF. CONDO. ACT § 3-116 cmt. 2 (UNIF. LAW COMM'N 1980), http://www.uniformlaws.org/shared/docs/condominium/uca_80.pdf [https://perma.cc/8QSE-FD4C] [hereinafter UCA].

35. *See* UCIOA, *supra* note 16, § 3-116; UCA, *supra* note 34, § 3-116; UNIF. PLANNED CMTY. ACT § 3-116 (UNIF. LAW COMM'N 1980) http://www.uniformlaws.org/shared/docs/planned%20community/upca80.pdf [https://perma.cc/LF55-CWGH].

36. *Priority Lien for Collecting Delinquent Assessments*, COMMUNITY ASS'NS. INST., https://www.caionline.org/Advocacy/StateAdvocacy/PriorityIssues/PriorityLien/Pages/ [https://perma.cc/5TTD-ZVY2].

37. *See* LEWIS, *supra* note 9, at 1. The detailed summary of all priority statutes compiled by Hugh Lewis is very useful. UCIOA states with priority are Alaska, Colorado, Connecticut, Delaware, Minnesota, Nevada, Vermont, and West Virginia; UCA states with priority are Alabama, Missouri, Pennsylvania, Rhode Island, Tennessee (only payment-priority lien), and Washington; Hawaii and Massachusetts retained "first generation" condominium statutes based on Horizontal Property Regimes Act recently updated to include super-priority lien; other super-priority jurisdictions include the District of Columbia, Florida, Illinois, Maryland, New Hampshire, New Jersey, and Oregon. *Id.* at 2.

38. The 2008 revisions to UCIOA § 3-116 state, in addition to common expense assessments, "reasonable attorney's fees and costs incurred by the association in *foreclosing* the association's lien" may also be secured through super-priority liens (emphasis added). This language was changed to "reasonable attorney's fees and costs incurred by the association in *enforcing* the association's lien" in the 2014 revisions to UCIOA § 3-116. UCIOA, *supra* note 16, § 3-116 (emphasis added).

39. *See* Poliakoff, *supra* note 32.

lien is applicable only to condominium owners' associations (COAs),[40] while in others it also applies to properties managed by homeowners' associations (HOAs).[41] Certain other states provide super-priority liens only to HOAs, but not COAs.[42] Some jurisdictions consider assessment liens to exist from the time the declaration is recorded, while others create the lien from the time the claim or notice of lien is filed or recorded. Additionally, some states measure the super-priority period either from the recording of a memorandum of the association's lien rights, the institution of action, or the completion of the sale.[43]

The UCA intended that, in practice, mortgage lenders would likely pay the six months of assessments demanded by associations rather than allowing associations to foreclose on the unit.[44] Six months was chosen because it was anticipated that it would take that long for a lender to foreclose on a property for nonpayment of the mortgage.[45] An escrow for assessments could be required if the mortgage lender wished.[46] However, in practice, foreclosures took considerably longer; in many instances, lenders delayed foreclosures to avoid an obligation to pay for the assessments in the likely event that lenders would become unit owners after a credit bid and face a long holding period before resale.[47] In addition, lenders were expecting economic recovery during the period of delay.[48]

These factors—potentially constituting unjust enrichment[49] to lenders whose collateral was preserved unjustly by forcing honest owners

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40. *See, e.g.*, ALA. CODE 35-8A-316 (West 1990); HAW. REV. STAT. ANN. § 514B-146 (West 2014); MASS. GEN. LAWS ANN. ch. 183A, § 6 (West 2010); N.J. STAT. ANN. § 46:8B-21 (West 1997); OR. REV. STAT. ANN. § 100.450(7) (West 2003); 34 R.I. GEN. LAWS ANN. § 34-36.1-3.16 (West 2009); WASH. REV. CODE § 64.34.364 (2014); D.C. CODE ANN. § 42-1903.13 (West 2014).

41. *See, e.g.*, ALASKA STAT. ANN. 34.08.470(b) (West 1986); COLO. REV. STAT. ANN. § 38-33.3-316 (West 2014); CONN. GEN. STAT. ANN. § 47-258 (West 2013); DEL. CODE ANN. tit. 25, § 81-316 (West 2009); MD. CODE ANN., REAL PROP. § 11-110 (West 2011); MD. CODE ANN., REAL PROP. § 11B-117 (West 2011); W. VA. CODE ANN. § 36B-3-116 (West 1986).

42. *See, e.g.*, NEV. REV. STAT. ANN. § 116.3116 (West 2015).

43. *See* LEWIS, *supra* note 9, at 1.

44. *See* UCA, *supra* note 34, § 3-116 cmt. 2.

45. *See* UCIOA, *supra* note 16, § 3-116 cmt. 2.

46. *See* UCA, *supra* note 34, § 3-116 cmt. 2. Escrow accounts are meant to protect the lender, but the Real Estate Settlement Procedures Act of 1974, as amended (RESPA), limits the amount of funds that the lender can collect. 12 U.S.C. §§ 2601–2617 (2012). The lender may charge the borrower a monthly sum equal to one-twelfth of the total annual escrow payments that the lender reasonably anticipates paying from the account; in addition, the lender may add an amount to maintain a cushion no greater than one-sixth of the estimated total annual payments from the account, which is about two months' worth of escrow payments. *See* 12 C.F.R. § 1024.17(c)(1)(ii) (2016).

47. *See* UCIOA, *supra* note 16, § 3-116 cmt. 2.

48. *See* JEB REPORT, *supra* note 5, at 5.

49. Indeed, a 2012 Note proposes that California legislators adopt a statutory remedy modeled after the doctrine of unjust enrichment. *See generally* Courtney Newsom, Note, *No Free Ride: An Equitable Remedy to Protect Homeowners' Associations from Delayed Foreclosures*, 46 LOY. L.A. L. REV. 361 (2012).

to subsidize the difference[50]—triggered the most recent 2014 UCIOA revisions.[51] These revisions clarify lien priority rules after a series of conflicting court decisions and resolve interpretation problems that became evident during the aftermath of the Great Recession.[52] The 2014 revisions provided that an association lien is a true first priority lien and not a mere payment-priority lien[53] and that foreclosure by an association does not terminate the lender's interest unless the association provided notice to the record holder.[54] Furthermore, the ULC amended the UCIOA to ensure that association liens secure the priority amount "for each budget year" of associations as a rolling priority and not as a one-time occurrence for the entire length of the mortgage.[55] Finally, the ULC amended this section to allow associations to recover possession of a unit, pursuant to the state's forcible entry and detainer procedures, if the owner is in default for nonpayment of assessments for more than three months.[56]

B. History of Uniform Laws in Washington State

Washington State has a long and complex history of regulating associations. The Horizontal Property Regimes Act, enacted in 1963, applies to residential condominiums created on or before July 1, 1990.[57] The Washington State legislature enacted the Homeowners' Association Act in 1995.[58] Neither of these acts provide for statutory priority of liens for assessments.[59] The Washington Condominium Act (WCA),[60] enacted

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50. *See generally* Andrea J. Boyack, *Community Collateral Damage: A Question of Priorities*, 43 LOY. U. CHI. L.J. 53 (2011). This Note argues that more protections for associations are needed to prevent lenders from delaying foreclosures.

51. *See* UCIOA, *supra* note 16, § 3-116 cmt. 2.

52. *Id.* § 3-116 cmt. 2.

53. *See id.* § 3-116(a).

54. *See id.* § 3-116(r). This provision was added to prevent unfairness to lenders whose interest might be extinguished if an association did not provide notice to the lender. Such a provision is not necessary in states that permit only judicial foreclosure of association liens and in states that permit nonjudicial foreclosures but by statute provide that a foreclosure sale does not extinguish a subordinate lien unless the subordinate lienholder was provided notice. *See id.* § 3-116 cmt. 8.

55. *See id.* § 3-116(c)(1).

56. *See id.* § 3-116(j), (n).

57. *See* WASH. REV. CODE § 64.32 Notes (2014). If condominiums created under the Horizontal Property Regimes Act want to take advantage of certain Washington Condominium Act provisions, they can do that by amending their governing documents. Keller v. Sixty-01 Associates of Apartment Owners, 112 P.3d 544, 548 (Wash. Ct. App. 2005).

58. *See* WASH. REV. CODE § 64.38 (2014).

59. *See id.* §§ 64.32.200, 64.38.020. Although the HOA governing documents might designate an HOA priority over subsequently recorded mortgages, often they will state that an HOA lien is subordinate to a lender's mortgage. *See* Amy Loftsgordon, *Washington HOA and COA Foreclosures*, NOLO, http://www.nolo.com/legal-encyclopedia/washington-hoa-coa-foreclosures.html [https://perma.cc/TK32-CZAG].

60. *See* WASH. REV. CODE § 64.34 (2014).

in 1989, applies to condominiums created after July 1, 1990.[61] The legislature modeled the WCA after the UCA, but also tailored it specifically for Washington State before adopting it.[62]

In Washington and elsewhere, "[a]ll condominiums are statutorily created."[63] Because condominiums are created by statute, "the rights and duties of condominium unit owners are not the same as those of real property owners at common law."[64] "The property rights that owners of individual condominium units have are creations of the condominium statute and are subject to the statute, the declaration, the bylaws of the condominium association, and lawful amendments of the declaration and bylaws."[65] The peculiar powers[66] of condominium owners' associations (COAs) relate primarily to the management of common elements and to matters arising out of the fact that their members live in close proximity to each other.[67] Accordingly, COAs can manage common elements, regulate their use, impose and collect assessments[68] for their upkeep and improvement,[69] impose reasonable late charges,[70] and impose statutory liens for unpaid assessments.[71]

The WCA provides for the statutory priority of liens for assessments that COAs can levy.[72] COA assessment liens have priority over all other liens except (1) liens and encumbrances recorded before the recording of the declaration, (2) a mortgage recorded before assessments become delinquent, and (3) real estate taxes and other governmental assessments.[73]

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61. *See id.* § 64.34.010(1). Under WCA, a declaration is the document that creates a condominium by setting forth the information required by statute and any amendment to that document. *Id.* § 64.34.020(17). A condominium may be created only by recording a declaration, survey map, and plans. *Id.* § 64.34.200(1).

62. *See* S.B. Rep. No. 5263, at 5 (Wash. Feb. 6, 2015),

63. Shorewood W. Condo. Ass'n v. Sadri, 992 P.2d 1008, 1011 (Wash. 2000); WASH. REV. CODE § 64.34.010.

64. *See Shorewood W. Condo. Ass'n*, 992 P.2d at 1011.

65. *Id.* at 1012.

66. *See* WASH. REV. CODE § 64.34.304.

67. WILLIAM B. STOEBUCK & JOHN W. WEAVER, 18 WASHINGTON PRACTICE, REAL ESTATE: TRANSACTIONS § 12.5 (2d ed. 2015).

68. *See* WASH. REV. CODE §§ 64.34.304(1)(b), (f), § 64.34.360.

69. *See id.* § 64.34.328.

70. *See id.* § 64.34.364(13).

71. *See id.* § 64.34.364.

72. *See id.*

73. The relevant subsections of § 64.34.364 provide as follows:

> (1) The association has a lien on a unit for any unpaid assessments levied against a unit from the time the assessment is due.
>
> (2) *A lien* under this section *shall be prior to all other liens* and encumbrances on a unit *except*:
>
> (a) Liens and encumbrances recorded before the recording of the declaration;
>
> (b) *a mortgage* on the unit recorded before the date on which the assessment sought to be enforced became delinquent; and

Another exception to these exceptions provides that a portion of a COA's lien has priority over the mortgage.[74] This COA super-priority lien is limited to the assessment amount for six months prior to the date of foreclosure sale by either a lender or the COA, or the date of recording of a declaration of forfeiture by a vendor.[75]

When a COA forecloses upon a lien and there is a mortgage[76] on the unit recorded before the date on which the assessment became delinquent, the lender must receive notice of the pending foreclosure and have the opportunity to pay off the lien prior to the sheriff's sale to preserve its lien. If the lender does not pay off the lien, the mortgage lender's lien is extinguished.[77]

Until recently, if a lender foreclosed its own mortgage, the lender would usually pay the association the super-priority amount of assessments to extinguish its lien and clear title for the third-party bidder or the lender.[78] If such amount is not paid after the lender's foreclosure sale, then foreclosure would not extinguish the association's limited priority lien for the immediately preceding six months of assessments because that lien is senior and thus unaffected.[79] Any buyer in such a sale will take the property subject to the association's six-month, limited-priority lien and will not be liable for additional assessments that became due prior to foreclosure.[80]

> (c) liens for real property taxes and other governmental assessments or charges against the unit. A lien under this section is not subject to the provisions of chapter 6.13 RCW.

WASH. REV. CODE § 64.34.364(1)–(2) (2014) (emphasis added).

74. The relevant subsection of § 64.34.364(3) provides as follows:

> (3) Except as provided in subsections (4) and (5) of this section, *the lien shall also be prior to the mortgages* described in subsection (2)(b) of this section to the extent of assessments for common expenses, excluding any amounts for capital improvements, based on the periodic budget adopted by the association pursuant to RCW 64.34.360(1) which would have become due during the *six months immediately preceding* the date of a sheriff's sale in an action for judicial foreclosure by either the association or a mortgagee, the date of a trustee's sale in a nonjudicial foreclosure by a mortgagee, or the date of recording of the declaration of forfeiture in a proceeding by the vendor under a real estate contract.

§ 64.34.364(3) (emphasis added).

75. *See id.*

76. Under WCA, the term "mortgage" also includes a deed of trust or a real estate contract. *See id.* § 64.34.020(29).

77. *See infra* Part II.

78. Melissa Waite, *The HOA Foreclosure and Priority: Who is in First?*, 34, no.11 CLARK CNTY. BAR ASS'N (COMMUNIQUÉ) 1, 26 (Nov. 2013), https://www.clarkcountybar.org/wp-content/uploads/2013_11_Communique-Nov1.pdf [https://perma.cc/AG5E-5TYB].

79. *See id.*

80. *See* WASH. REV. CODE §§ 64.34.364(3), (11) (2014).

Additionally, a COA lien is not subject to the homestead exemption[81] if a COA provides an owner with notice that nonpayment of assessment may result in foreclosure and that the homestead protection shall not apply.[82] Moreover, only assessments for common expenses under the periodic budget that would have become due six months immediately preceding the date of the sale or forfeiture are given super priority, while any amounts for capital improvements are excluded.[83] In contrast to the 2008 and 2014 versions of the UCIOA, the WCA does not provide super-priority position for attorney's fees.[84] COAs can recover any costs and reasonable attorneys' fees incurred while collecting delinquent assessments,[85] but such costs and fees are junior to any mortgage on a unit.[86] Furthermore, if a lender has requested notice of delinquent assessments and the COA does not provide that notice, the priority lien amount is reduced by up to three months.[87]

A COA can choose to designate in its declaration that it can foreclose the liens for unpaid assessments nonjudicially in the manner of a trustee's foreclosure of a deed of trust under the Deeds of Trust Act, Chapter 61.24 of the Revised Code of Washington.[88] For a COA to be able to foreclose its lien nonjudicially, the declaration has to (a) contain a grant of the condominium unit in trust to a trustee qualified under the Revised Code of Washington § 61.24.010 to secure the obligations of the unit owners to pay assessments; (b) contain a power of sale; (c) provide that the units are not used principally for agricultural or farming purposes; and (d) provide that the power of sale may be exercised in the event of a default in the obligation to pay assessments.[89] However, if a COA forecloses its lien nonjudicially, it then loses its super-priority lien rights.[90] Thus, it would be practical for a COA to conduct nonjudicial foreclosure only if the unit is not burdened by any mortgage.

While the super-priority statute remained relatively unchanged since its inception in 1990, the recent economic downturn forced COAs to make

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81. If property meets the definition of a homestead, then up to $125,000 in net value of property, with few exceptions, is exempt from execution and sale and is not subject to judgment liens. WASH. REV. CODE §§ 6.13.030, 6.13.070(1) (2014); MARJORIE DICK ROMBAUER, 28 WASHINGTON PRACTICE, CREDITORS' REMEDIES–DEBTORS' RELIEF § 7.21.

82. *See* WASH. REV. CODE §§ 64.34.364(2), 6.13.080(6).

83. *See id.* § 64.34.364(3).

84. *Compare* UCIOA, *supra* note 16, §§ 3-116(c)(1), 3-116(c), *with* WASH. REV. CODE § 64.34.364(2)–(3).

85. *See id.* § 64.34.364(14).

86. *See id.* § 64.34.364(2)–(3).

87. *See id.* § 64.34.364(4).

88. *See id.* § 64.34.364(9).

89. *Id.*; DAVID H. ROCKWELL, JOSEPH P. MCCARTHY & REBECCA L. GOBEILLE, 3 WASHINGTON REAL PROPERTY DESKBOOK SERIES § 11.5(10) (4th ed. 2009 & Supp. 2015).

90. *See* WASH. REV. CODE § 64.34.364(5).

use of all tools available to collect delinquent assessments in order to preserve community services and amenities, including instituting judicial foreclosure actions that produced several precedential cases.

II. CRITIQUE: CURRENT ISSUES

A. Effects of Association Lien Enforcement Sales

Although the 2014 UCIOA amendments provided clarity for the enforcement of association lien priority, this topic is still part of intense debate and litigation due to the flood of foreclosures making their way through the judicial systems nationwide. The 2014 UCIOA amendments clarified that if an association forecloses its lien and the lender does not participate in the sale, the association's foreclosure would extinguish the lien of the first lienholder (just like foreclosure of a real estate tax lien would).[91] Thus, in UCIOA and other super-priority jurisdictions, an association's foreclosure sale, pursuant to its statutory super-priority lien, could extinguish a lender's lien if the lender does not act to redeem its interest by satisfying the association's limited-priority lien. This clarification tremendously alarmed lenders and title companies as states with existing super-priority statutes were likely to interpret the six-month priority provision as requiring true priority.[92]

Washington State was not influenced by these 2014 UCIOA amendments; rather, the decisions from Washington's courts seemingly influenced the amendments. A Washington case from 2012, *Summerhill Village Homeowners Association v. Roughley*,[93] was extensively analyzed in the Report of the Joint Editorial Board for Uniform Real Property Acts[94] and then affirmed in UCIOA's 2014 amendments as the correct understanding and application of association priorities.[95] In *Summerhill*, after a unit owner became delinquent on her assessments, the association filed a judicial action against her and her lender to foreclose its statutory lien, obtained default judgment, and sold the unit to a third-party buyer.[96] The Washington Court of Appeals held that the association's foreclosure sale on its 2008 assessment lien extinguished the 2006 deed of trust when the lender did not participate in the sale.[97] This decision is consistent with the common principle that the foreclosure sale of a property with a lien entitled to priority extinguishes that lien and any subordinate liens and

91. *See* UCIOA, *supra* note 16, § 3-116 cmt. 2.
92. *See infra* Part III.
93. *See* Summerhill Vill. Homeowners Ass'n v. Roughley, 289 P.3d 645 (Wash. Ct. App. 2012).
94. *See* JEB REPORT, *supra* note 5, at 8–9.
95. *See* UCIOA, *supra* note 16, § 3-116 cmt. 2.
96. *Summerhill Vill. Homeowners Ass'n*, 289 P.3d at 646–47.
97. *Id.* at 648.

consistent with the understanding that six-month, limited priority constitutes a true lien priority and not merely a payment preference. This view was later confirmed as proper and as originally intended by UCIOA 2014 amendments.[98]

B. Redemption Rights

A different issue in *Summerhill*, however, was the interpretation of the redemption statute, which permits foreclosed owners or lenders to redeem property for the price paid at the sale plus certain costs and interest when a foreclosure of a higher priority interest extinguishes their interests.[99] The purpose of a statutory redemption period is to ensure that bidders at the foreclosure sale will bid a fair price because a higher winning bid reduces the likelihood that the former owner or lender will redeem the property.[100] In practice, however, because the buyers must wait for the statutory redemption time to expire before they officially own the property, the redemption statutes may actually chill bidding at the foreclosure sale and thus reduce the sale price.[101]

As the statute was worded at the time of *Summerhill*, only creditors "subsequent in time" to liens being foreclosed could qualify as redemptioners.[102] The court held that the 2006 deed of trust was not subsequent in time to the association's 2008 super-priority lien.[103] Despite the lender's argument that the legislature intended to protect all junior lienholders, the court held that the lender was not the proper redemptioner and could not redeem from the buyer who had purchased the property at the sheriff's sale.[104] As a result, the condominium was sold free and clear of the lender's mortgage to the successful bidder at the sheriff's sale for \$10,302.[105] In direct response to *Summerhill*, the Washington State legislature changed the redemption statute and replaced the words

98. *See* UCIOA, *supra* note 16, § 3-116 cmt. 2.

99. *See* WASH. REV. CODE § 6.23.010 (2014). After judicial foreclosure, the usual redemption period is one year and, if a foreclosing party waives the right to deficiency in the complaint, then the redemption period is eight months. *See id.* § 6.23.020(1). Note that equitable redemption rights can refer to paying off the total debt *before* the sale in order to stop foreclosure. In all states, the foreclosed owner can redeem the property before the sale, but only certain states provide for a redemption period *after* the sale. In Washington, after nonjudicial foreclosure, redemption is not available and the deficiency judgments are not allowed.

100. *See* Amy Loftsgordon, *Right of Redemption Before Foreclosure*, NOLO, http://www.nolo.com/legal-encyclopedia/right-redemption-before-foreclosure.html [https://perma.cc/LLZ4-939F].

101. *Id.*

102. *See Summerhill Vill. Homeowners Ass'n*, 289 P.3d at 648.

103. *Id.* at 648.

104. *Id.* at 648–49.

105. *See id.* at 647–49.

"subsequent in time" with "subsequent in priority" in order to avoid such harsh results.[106]

C. Lien Creation, Perfection, and Enforcement

In the meantime, similar cases made their way through the judicial system. A 2014 case, *BAC Home Loans Servicing, LP v. Fulbright*, effectively overruled *Summerhill* on the issue of redemption statute interpretation.[107] After analyzing various acts, the court determined that while the recording of the declaration constitutes record notice and perfection of the lien for assessments,[108] the Washington Condominium Act (WCA) provides an exception to the recording act[109] by granting priority for mortgages recorded after the recording of declaration.[110] The WCA further creates an exception to its own exception by granting back priority to the association for six months of assessments.[111] The Washington Supreme Court held that the association established its priority to collect unpaid assessments at the time the developer recorded condominium declaration, even if the lien was not enforceable until the unit owner defaulted.[112] Therefore, the association lien was prior in time to the lender's subsequently recorded interest enabling the lender to benefit from the redemption statute.

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106. *See* 2013 Wash. Sess. Laws, ch. 53 § 1(1)(b) (S.B. 5541). It was argued that this change restores "certainty in the redemption process and preserves a healthy lending environment for condominiums moving forward." S.B. 5541 Rep., at 2 (Wash. Feb. 19, 2013). The redemption from sale statute now reads as follows:

> (1) Real property sold subject to redemption, as provided in RCW 6.21.080, or any part thereof separately sold, may be redeemed by the following persons, or their successors in interest:
>
> (a) The judgment debtor, in the whole or any part of the property separately sold.
>
> (b) A creditor having a lien by judgment, decree, deed of trust, or mortgage, on any portion of the property, or any portion of any part thereof, separately sold, *subsequent in priority to* that on which the property was sold. The persons mentioned in this subsection are termed redemptioners.
>
> (2) As used in this chapter, the terms "judgment debtor," "redemptioner," and "purchaser" refer also to their respective successors in interest.

WASH. REV. CODE § 6.23.010 (2014) (emphasis added).

107. BAC Home Loans Servicing, LP v. Fulbright, 328 P.3d 895, 900–01 (Wash. 2014).

108. *See* WASH. REV. CODE § 64.34.364(7) (2014).

109. The recording act provides that the interest first recorded is superior to any outstanding unrecorded conveyance of the same property unless the later lender or buyer had actual knowledge of prior unrecorded interest. *See* WASH. REV. CODE § 65.08.070 (2014). The purpose and effect of a recording act is to reverse the order of priorities in certain cases under Washington's "race-notice" type of recording system. *Fulbright*, 328 P.3d at 897.

110. *See* WASH. REV. CODE § 64.34.364(2); *Fulbright*, 328 P.3d at 898–900.

111. *See* WASH. REV. CODE § 64.34.364(3); *Fulbright*, 328 P.3d at 898–900.

112. *See Fulbright*, 328 P.3d at 899.

D. Super-Priority Liens in Other States

Several other states have interpreted their own similarly worded statutes to allow the first mortgage to be extinguished upon the association's foreclosure. The District of Columbia's Court of Appeals held that an association's assessment lien is superior to a first mortgage and that an association's foreclosure sale based on its super-priority lien could extinguish the lender's interest.[113] Furthermore, in December 2015, the Rhode Island Supreme Court, agreeing with these interpretations, held that when an association's super-priority assessment lien is foreclosed on, a first mortgage is extinguished.[114]

Similarly, even in a state without a super-priority statute, the Arkansas Supreme Court held that a first-mortgage foreclosure does not terminate an association's interest in unpaid assessments.[115] This holding effectively created an unlimited super-priority lien, imposed unlimited liability for the previous owner's assessment liabilities on the first-mortgage holder, and rendered Arkansas the first state to determine that a first-mortgage lender could face uncapped assessment liability through taking title to property in a foreclosure credit bid.[116]

In a seminal case, *SFR Investments Pool 1 v. U.S. Bank*, Nevada's Supreme Court shocked the lending industry when it held that the statutory super lien creates not a mere payment priority, but a true super-priority lien—which can be foreclosed even nonjudicially—and that proper foreclosure of the lien extinguishes a first deed of trust.[117] Subsequently, on May 27, 2015, Nevada's Governor signed into law Senate Bill No. 306, which took effect October 1, 2015, and fundamentally changed the foreclosure sale procedures. The law created a previously nonexistent 60-day redemption period for owners and lenders following a foreclosure sale; clarified the amounts that are included in the super-priority amount; and provided that associations must provide the notice of foreclosure to all junior lienholders.[118]

Recently, in *Bourne Valley Court Trust v. Wells Fargo Bank*, the Ninth Circuit Court of Appeals held in a 2–1 decision that Nevada's prior version of the statute violated the Due Process Clause of the Fourteenth

113. *See* Chase Plaza Condo. Ass'n, Inc. v. JP Morgan Chase Bank, N.A., 98 A.3d 166, 172–74 (D.C. 2014).

114. *See* Twenty Eleven, LLC v. Botelho, 127 A.3d 897, 902–03 (R.I. 2015).

115. *See* First State Bank v. Metro Dist. Condos. Prop. Owners' Ass'n, Inc., 432 S.W.3d 1, 6 (Ark. 2014).

116. *See* Andrea J. Boyack & William E. Foster, *Muddying the Waterfall: How Ambiguous Liability Statutes Distort Creditor Priority in Condominium Foreclosures*, 67 ARK. L. REV. 225, 269–71 (2014).

117. *See* SFR Invs. Pool 1, LLC v. U.S. Bank, N.A., 334 P.3d 408, 419 (Nev. 2014).

118. *See* 2015 NEV. STAT. 1331.

Amendment because it required lenders to "opt-in" to receive notice that the HOA intended to foreclose.[119] The court noted that before its 2015 amendments, the statute "impermissibly shifted the burden" from HOAs to lenders, requiring them to affirmatively request notice without regard for (1) whether the lender was aware that the homeowner had defaulted on the dues to HOA; (2) whether the lender's interest had been recorded such that it would have been easily discoverable through title search; or (3) whether the HOA made any effort to contact the mortgage lender.[120]

Although *Bourne Valley* does not affect HOA foreclosures performed after the 2015 amendments went into effect, it may affect the vast majority of pending quiet title actions in Nevada because most of them involve pre-2015 sales, which were governed by the pre-amendment version of the notice statute.[121] At the moment, the *Bourne Valley* decision is binding on all Nevada federal courts and has persuasive authority in Nevada state courts.[122] The decision has been criticized as "not address[ing] the fact that the Supreme Court of Nevada has already construed this Nevada state statute to require notice to the mortgage lenders"[123] in light of the fact that "[f]ederal courts are not free to reinterpret a state statute once it has been interpreted by that state's highest court."[124]

E. Rolling Liens

Another issue involves whether an association's super-priority liens are "rolling" or have a "one-time" priority over the same mortgage. This issue has two distinct aspects: (1) whether the super-priority lien may be enforced more than once against any particular first mortgage and, if so, (2) whether multiple lien enforcement actions may be maintained at the same time.[125] Connecticut modified its laws to clarify the "evergreen" nature of the priority[126] and permit associations to assert their

119. *See* Bourne Valley Court Tr. v. Wells Fargo Bank, NA, 832 F.3d 1154, 1156 (9th Cir. 2016).

120. *Id.* at *3–4.

121. Mortgage Banking Group, *Foreclosure of Nevada HOA Super Lien Cannot Extinguish Mortgage Lender's Security Interest*, BALLARD SPAHR LLP (Aug. 15, 2016), http://www.ballardspahr.com/alertspublications/legalalerts/2016-08-15-nv-hoa-super-lien-foreclosure-cannot-extinguish-lenders-security-interest.aspx [https://perma.cc/UY43-Q3C9].

122. *Id.*

123. Deutsche Bank Nat'l Tr. Co. v. SFR Invs. Pool 1, LLC, No. 14-001131, 2016 WL 4419285, at *1 (D. Nev. Aug. 18, 2016) (citing SFR Invs. Pool 1, LLC v. U.S. Bank, N.A., 334 P.3d 408, 417–18 (Nev. 2014)).

124. *Id.*

125. SAMUEL B. MOSKOWITZ, MASS. CONTINUING LEGAL EDUC., INC., MASSACHUSETTS REAL ESTATE LIENS § 4.9.3 (2014).

126. *See* CONN. GEN. STAT. ANN. § 47-258(b) (West 2016) (the following words were added: "In *all actions* brought to foreclose a lien under this section or a security interest described in subdivision (2) of this subsection, the lien is also prior to . . . .") (emphasis added).

super-priority lien in multiple actions; the lien is not limited to one use in one foreclosure action.[127] In Vermont, the courts held that priority extends to all assessments that accrued and remained unpaid during the pendency of the lien enforcement action in addition to amounts accrued during the preceding six months.[128]

Massachusetts now allows the lien to be a "rolling lien"—i.e., associations may seek super-priority liens of unpaid monthly common expenses for successive six-month periods and are not limited to one six-month period. In *Drummer Boy Homes Association, Inc. v. Britton*, the Supreme Judicial Court of Massachusetts recently overruled lower court decisions and held that associations may file successive legal actions to establish and enforce multiple contemporaneous liens on a condominium unit—each with a six-month period of priority over the first mortgage—for the recoupment of successive periods of unpaid common expenses.[129] The court noted that the first mortgagee would have little reason to assume responsibility for the payment of a unit owner's future common expenses if associations were limited to only one six-month period of lien priority.[130] Notably, even some lenders support the court's "rolling lien" interpretation.[131]

In light of Massachusetts' *Drummer Boy* decision, lawyers in all jurisdictions must carefully analyze all applicable jurisdiction's super-priority lien statutory provisions and not just the key terms upon which prior practice generally focused.[132] Attorneys now need to determine if there is a potential for a judicial finding that an association

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127. Chatsworth Vill. Homeowners Ass'n, Inc. v. Burke, No. HHDCV126030093S, 2013 WL 6038370, at *5 (Conn. Super. Ct. Oct. 22, 2013).

128. *See* Bank of Am., N.A. v. Morganbesser, No. 675-10-10, 2013 WL 9792479, at *3 (Vt. Super. Ct. Jan. 16, 2013).

129. *See* Drummer Boy Homes Ass'n, Inc. v. Britton, 47 N.E.3d 400, 406 (Mass. 2016).

130. *Id.* at 409.

131. *See* Thomas Moriarty, *Massachusetts Court Rules for Condos, Against Banks in Superlien Battle*, 27 SERVICING MGMT., no. 10 May 2016, http://www.mortgageorb.com/online/issues/SVM1605/FEAT_01_Massachusetts-Court-Rules-For-Condos-Against-Banks-In-Superlien-Battle.html [https://perma.cc/7LJP-8HHC].

132. *See* Adam M. Zaiger & Brian J. King, *Drummer Boy Makes Some Noise on Mass. Superpriority Liens*, LAW360 (June 14, 2016), http://www.law360.com/articles/806465/drummer-boy-makes-some-noise-on-mass-superpriority-liens [https://perma.cc/7Y89-6ELU]. Before *Drummer Boy*, attorneys would often limit their analysis to the following traditional key terms:

> (1) the type of super-priority statute (i.e., UCA or UCIOA); (2) the duration of the super-priority lien; (3) assessments eligible for super-priority status (i.e., just ordinary periodic assessments or special assessments as well); (4) whether the association's attorney's fees and costs have super-priority status; (5) the types of mortgage liens are subordinated to the super-priority lien (often limited to first mortgages); (6) the starting point for the super-priority lien period; (7) what lender notices may be required; and (8) whether any statutes of limitation are applicable.

Id.

may file multiple successive actions and establish a "rolling" super-priority lien.[133]

Notably, the Joint Editorial Board for Uniform Real Property Acts notes that the super-priority statute "does not (and was not intended to) authorize an association to file successive lien enforcement actions every six months . . . . Only one action is necessary to permit the association to enforce its lien . . . ."[134] In light of conflicting interpretations, the 2014 UCIOA amendments state that an association lien is entitled to six months of unpaid common expense assessments each year based on the periodic budget for the applicable year.[135] This interpretation is necessary to strike "a more appropriate and equitable sharing of the costs of preserving the value of the mortgagee's security."[136] Under the 2014 UCIOA amendments, if a lender paid an association its priority amounts, attorney fees, and costs just before the foreclosure sale and the association proceeded with its sale, such a foreclosure sale would not extinguish the lender's mortgage lien and the buyer would take the unit subject to the lender's lien.[137]

In Washington, although judicial decisions are lacking, the statutory language could be considered unambiguous in whether it allows priority to only one six-month lien.[138] However, the language of the statute referring to "assessments for common expenses . . . based on the periodic budget"[139] could potentially be interpreted to get the results consistent with the 2014 UCIOA amendments.

F. Federal Preemption Constitutional Challenges

The federal government insures many mortgages through programs sponsored by the Housing and Urban Development (HUD), the Federal Housing Administration (FHA), and the Veterans Administration (VA); additionally, many mortgages are owned by the Federal National

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133. *See id.*

134. *See* JEB REPORT, *supra* note 5, at 12–13.

135. *See* UCIOA, *supra* note 16, § 3-116(c)(1).

136. *Id.* § 3-116 cmt. 2.

137. *Id.*

138. Washington's statute states:

> [T]he lien shall . . . be prior to the mortgages . . . to the extent of *assessments* for common expenses . . . based on the periodic budget adopted by the association pursuant to RCW 64.34.360(1) *which would have become due during the six months immediately preceding* the date of a sheriff's sale in an action for judicial foreclosure by either the association or a mortgagee, the date of a trustee's sale in a nonjudicial foreclosure by a mortgagee, or the date of recording of the declaration of forfeiture in a proceeding by the vendor under a real estate contract.

WASH. REV. CODE § 64.34.364(3) (2014) (emphasis added).

139. *Id.*

Mortgage Associations (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and their conservator, the Federal Housing Finance Agency (FHFA).[140] The costly impact of wiped-out mortgages is unacceptable to these agencies, and they are contesting such foreclosures through litigation on the basis that federal law preempts state laws under the Housing and Economic Recovery Act (HERA).[141]

HERA states, "No property of the [FHFA] shall be subject to levy, attachment, garnishment, foreclosure, or sale without the consent of the [FHFA], nor shall any involuntary lien attach to the property of the [FHFA]."[142] On April 21, 2015, the FHFA asserted that it did not consent to association sales extinguishing or foreclosing Fannie Mae or Freddie Mac's first position interest and has publically stated in a press release that it will not do so. The FHFA declared that the law "precludes involuntary extinguishment of Fannie Mae or Freddie Mac liens while they are operating in conservatorships and preempts any state law that purports to allow holders of homeownership association liens to extinguish a Fannie Mae or Freddie Mac lien, security interest, or other property interest."[143] In testimony before the Nevada legislature, the FHFA also warned that, if lenders' collateral rights can be extinguished by associations, consumers "may face challenges in securing a loan to buy a unit or refinance."[144]

Several lenders have successfully argued that Nevada's super-priority lien statute undermines and impedes federal laws and policies regarding mortgage lending and thus violates the Supremacy Clause of the U.S. Constitution.[145] In *Washington & Sandhill Homeowners Association v. Bank of America, N.A.*, the U.S. District Court for Nevada limited application of the *SFR Investments* decision, holding that the Supremacy Clause barred foreclosure of an assessment lien on property insured by the FHA because such foreclosure would limit the effectiveness

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140. *See generally* FED. HOUS. FIN. AGENCY, OFFICE OF INSPECTOR GEN., A BRIEF HISTORY OF THE HOUSING GOVERNMENT-SPONSORED ENTERPRISES 2–3, http://fhfaoig.gov/Content/Files/History%20of%20the%20Government%20Sponsored%20Enterprises.pdf [https://perma.cc/F2KS-U5XA]. The housing Government-Sponsored Enterprises (GSEs) are Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (FHLBank System), which currently consists of twelve Federal Home Loan Banks (FHLBanks). *Id.* at 1.

141. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654.

142. 12 U.S.C. § 4617(j)(3) (2012).

143. Statement, Federal Housing Finance Agency, Statement on HOA Super-Priority Lien Foreclosures (Apr. 21, 2015), http://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-on-HOA-Super-Priority-Lien-Foreclosures.aspx [https://perma.cc/V8AB-KVPE].

144. Testimony, Statement of Alfred M. Pollard, General Counsel, FHFA, Before the Nevada State Legislature Judiciary Committee (Apr. 7, 2015), http://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-Alfred-M-Pollard-General-Counsel-FHFA-before-the-Nevada-State-Legislature-Judiciary-Committee.aspx [https://perma.cc/55TB-LMT8].

145. U.S. CONST. art. VI, cl. 2.

of remedies available to the United States.[146] By analogy, the *SFR Investments* decision also would not apply to VA-guaranteed mortgages.

On June 24, 2015, the same Nevada court held in *Skylights LLC v. Byron* that the association's foreclosure sale did not extinguish Fannie Mae's property interests, nor did it allow the property to be conveyed free of this encumbrance.[147] The court held that 12 U.S.C. § 4617(j)(3) "barred the HOA from foreclosing on the Property without the consent of the conservator, FHFA"[148] and preempted state law to the extent that an association's super-priority lien foreclosure "cannot extinguish a property interest of Fannie Mae or Freddie Mac while those entities are under FHFA's conservatorship."[149] While this decision is not controlling outside of Nevada, it provides a favorable precedent for lenders' arguments in other jurisdictions.[150]

However, in a contrary May 19, 2015, decision, *Freedom Mortgage v. Las Vegas Development Group*, the same court held that enforcing the priority statute on property with a HUD-insured mortgage does not violate the Property Clause[151] or the Supremacy Clause and that the "lender's interest is extinguished by the foreclosure, not HUD's."[152] Additionally, the court held that "the lender's inability to convey good and marketable

146. *See* Wash. & Sandhill Homeowners Ass'n v. Bank of Am., N.A., No. 13-01845, 2014 WL 4798565 at *6–7 (D. Nev. Sept. 25, 2014), *appeal dismissed* (Oct. 13, 2015) (holding that "in situations where a mortgage is insured by a federal agency under the FHA insurance program, state laws cannot operate to undermine the federal agency's ability to obtain title after foreclosure and resell the property") (citation omitted).

147. Skylights LLC v. Byron, 112 F. Supp. 3d 1145, 1159 (D. Nev. 2015), *appeal dismissed* (9th Cir. 2016).

148. *Id.* at 1151.

149. *Id.* at 1159. The court rejected the arguments that 12 U.S.C. § 4617(j)(3): (1) does not apply because it lacks express preemption language; (2) it violates procedural due process; and (3) because the Fifth Circuit court has held the operative similar language in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) protects the FDIC only from "taxation and liens by state and local tax authorities," and not from private entities like the HOA, HERA likewise should not apply to private entities such as the HOA. *See id.* at 1153–58.

150. There are other decisions agreeing with the result of *Skylights*. *See, e.g.*, Saticoy Bay, LLC Series 1702 Empire Mine v. Fed. Nat'l Mortg. Ass'n, No. 14-01975, 2015 WL 5709484 (D. Nev. Sept. 29, 2015); 1597 Ashfield Valley Tr. v. Fed. Nat'l Mortg. Ass'n Sys., No. 14-2123, 2015 WL 4581220 (D. Nev. July 28, 2015); My Global Vill., LLC v. Fed. Nat'l Mortg. Ass'n, No. 15-00211, 2015 WL 4523501 (D. Nev. July 27, 2015); Elmer v. JP Morgan Chase Bank Nat'l Ass'n, No. 14-01999, 2015 WL 4393051 (D. Nev. July 13, 2015); Premier One Holdings, Inc. v. Fed. Nat'l Mortg. Ass'n, No. 14-2128, 2015 WL 4276169 (D. Nev. July 13, 2015); Williston Inv. Grp., LLC v. JP Morgan Chase Bank Nat'l Ass'n, No. 14-02038, 2015 WL 4276144 (D. Nev. July 13, 2015), *appeal dismissed* (9th Cir. Oct. 13, 2015).

151. *See* U.S. CONST. art. IV, § 3, cl. 2. The Property Clause precludes states and private individuals from divesting the federal government, through state laws or otherwise, of title to property without congressional consent. *See id.*

152. *See* Freedom Mortg. Corp. v. Las Vegas Dev. Grp., LLC, 106 F. Supp. 3d 1174, 1184 (D. Nev. 2015). The court noted that in super-priority states, "the HUD-insured lenders' obligation to prevent foreclosure by satisfying HOA liens is not an aspirational goal; it's a requirement." *Id.* at 1185.

title to HUD results in a loss to the lender, not to HUD" and the "lender gets itself into this predicament only by ignoring HUD's directives."[153] The court further held that the lender or servicer lacks standing to make this constitutional claim, which must be asserted directly by the federal entity.[154] Another Nevada court decision noted that "to the extent that foreclosure of an HOA super-priority lien extinguishes a HUD contingent interest in the property, it does so because the lender did not satisfy the pre-conditions HUD put in place regarding how HUD manages its loan insurance program."[155]

Further, the state and federal courts in Nevada declined to rule in favor of the FHFA in several cases where they found no evidence that Fannie Mae was the beneficiary of the deed of trust.[156] A payee, endorsee, or assignee of a promissory note that is not also the beneficiary of an attendant deed of trust cannot foreclose, but may only sue on the note, and such a person therefore loses no legal rights via extinguishment of the deed of trust.[157]

There are four strong arguments that the FHFA's consent should not be needed in association super-lien foreclosures on properties related to federal agencies.[158] First, although the FHFA relies on the argument that the FDIC statute[159]—which is essentially identical to 12 U.S.C. § 4617(j)(3)—has been held to preclude foreclosure of super-priority state tax liens on lenders' property put into FDIC receivership, "there is a substantial difference between the FDIC's receivership of a failed bank and FHFA's conservatorship of the GSEs."[160] If HERA applied here, it would place undue burden on associations by causing foreclosure delays that could also be a deprivation of due process and a taking without just compensation.[161] Second, deprivation of due process results from lack of review procedure by which associations could obtain authority to foreclose on liens over the FHFA's objection in contrast to bankruptcy

153. *Id.*

154. *Id.* at 1179–80.

155. U.S. Bank, Nat'l Ass'n v. SFR Investments Pool 1, LLC, No. 15-00287, 2016 WL 1248704, at *2 (D. Nev. Mar. 28, 2016).

156. *See, e.g.*, LN Mgmt., LLC Series 5664 Divot v. Dansker, No. 13-01420, 2015 WL 5708799, at *3 (D. Nev. Sept. 29, 2015), *reconsideration denied*, 2015 WL 7069293 (D. Nev. Nov. 12, 2015).

157. *See* Edelstein v. Bank of New York Mellon, 286 P.3d 249, 254 (Nev. 2012).

158. R. Wilson Freyermuth & Dale A. Whitman, *Can Associations Have Priority over Fannie or Freddie?*, 29 PROB. & PROP. 4, July/Aug. 2015, 27, http://www.americanbar.org/publications/probate_property_magazine_2012/2015/july_august_2015/2015_aba_rpte_pp_v29_3_article_freyermuth_whitman_can_associations_have_priority_over_fannie_and_freddie.html [https://perma.cc/94QA-VKES].

159. 12 U.S.C. § 1825(b)(2) (2012).

160. *See* Freyermuth & Whitman, *supra* note 158, at 28.

161. *See id.*

stay, where such relief of stay could be secured.[162] Third, during recent years, the FHFA has evidenced its consent by specifically instructing loan servicers to pay off priority liens and promising to reimburse.[163] Finally, 12 U.S.C. § 4617(j)(3) might not apply to private parties but instead, if applied consistently with FDIC, only to local taxing authorities.[164]

To complicate matters even more, the FHFA has recently filed a putative class action seeking a permanent injunction against any Nevada association foreclosure sale that would extinguish any Fannie Mae or Freddie Mac lien in sales that took place after September 18, 2009.[165] However, the Nevada District Court denied such certification as not reasonably ascertainable because "[t]his issue is dependent upon a highly individualized factual inquiry" that "would result in countless hearings resembling 'mini-trials.'"[166] Because this decision also prohibited extinguishment of the lender's deed of trust because it was secured by the FHFA,[167] both sides to this suit—the FHFA and the investor that bought the property—have appealed this decision.[168]

In an interesting turn of events, several Senators and Members of the House sent a letter to the FHFA on May 12, 2016, asking it to delay the implementation of its categorical "no consent" policy until after the FHFA has solicited and considered public comments because "its new position could potentially affect millions of homeowners and thousands of loan servicers and community associations."[169] The letter also urged the FHFA to consider how its policy would advance its statutory purposes to ensure "the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets."[170]

In light of these developments, the Community Associations Institute is arguing that instead of suing to recoup Fannie Mae's losses from the pockets of association owners, the FHFA should sue loan servicers for breach of contract because their management did not comply with various loan servicing guides.[171] The organization also asserts that "[t]he practical

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162. *See id.* at 29–30.

163. *See id.* at 30–31.

164. *See id.* at 31–32.

165. *See* Fed. Hous. Fin. Agency v. SFR Investments Pool 1, LLC, No. 15-01338, 2016 WL 2350121, at *4 (D. Nev. May 2, 2016).

166. *Id.*

167. *Id.* at *7.

168. *See id.*

169. Letter from Several U.S. Senators and Members of Congress to FHFA 3 (May 12, 2016), http://www.warren.senate.gov/files/documents/2016-5-12_MA_delegation_ltr_to_FHFA.pdf [https://perma.cc/SN8B-85DL].

170. *Id.*

171. *See CAI: FHFA Move Threatens Associations & Owners*, CMTY. ASS'NS INST. (Dec. 23, 2014), https://www.caionline.org/PressReleases/Pages/FHFA-Move.aspx [https://perma.cc/YA4C-UE6L].

implication of the FHFA policy interpretation is that the federal government protects big banks at the expense of local community associations by compromising state priority lien laws that have been in place in many states for 20–30 years."[172]

Additionally, the FHA has recently proposed amendments to the Home Equity Conversion Mortgage program (HECM), which enables seniors to take out reverse mortgages—i.e., seniors who have equity in their homes can withdraw a portion of the accumulated equity.[173] The proposed change would require that reverse mortgages have full priority over association liens to be eligible for assignment.[174] Although the stated purpose of the HECM is to ease the financial burden on elderly homeowners facing increased health, housing, and subsistence costs at a time of reduced income, the proposed Section 206.136(a)(1) would likely make it impossible for four million seniors owning association property to get a reverse mortgage in super-priority lien states.[175] Notably, Freddie Mac, the FHA, and the VA were active participants in the initial drafting of uniform laws when association assessment lien priority was originally proposed.[176] Even the Mortgage Bankers Association requests that HUD remove this aspect of its rulemaking proposal.[177]

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172. Dawn Bauman, *Senator Warren (D-MA) Leads the Massachusetts Congressional Delegation to Question FHFA's Attack on Community Associations*, CMTY. ASS'NS INST. (June 2, 2016), https://www.caionline.org/Advocacy/GovernmentAffairsBlog/Pages/WarrenFHFA.aspx [https://perma.cc/V7M6-KQER].

173. Federal Housing Administration (FHA): Strengthening the Home Equity Conversion Mortgage Program, 81 Fed. Reg. 31,770 (proposed May 19, 2016) (to be codified at 24 C.F.R. pts. 30 & 206).

174. The proposed language of rule 24 C.F.R. § 206.136(a)(1) is as follows:

> § 206.136 Conditions for assignment.
>
> (a) In order for a HECM to be eligible for assignment, the following must be met:
>
> (1) *Priority of mortgage to liens*. The mortgage is prior to all mechanics' and materialmen's liens, homeowners association liens or condo association liens filed of record, regardless of when such liens attach, and prior to all liens and encumbrances, or defects which may arise based on any act or omission by the mortgagee except such liens or other matters as may have been approved by the Commissioner.

Federal Housing Administration (FHA): Strengthening the Home Equity Conversion Mortgage Program, *supra* note 173.

175. Cmty. Ass'ns Inst., Comment Letter to Dep't of Hous. & Urban Dev., at 1 (June 28, 2016), https://www.regulations.gov/contentStreamer?documentId=HUD-2016-0052-0013&attachmentNumber=1 [https://perma.cc/BW4N-MEH4].

176. Joint Editorial Bd. for Unif. Real Prop. Acts, Comment Letter to Dep't of Hous. & Urban Dev., at 4 (July 8, 2016), https://www.caionline.org/Advocacy/TakeAction/HECM/Documents/JEBcommentsFHAproposedrulefinal.pdf [https://perma.cc/CX5E-H8K2].

177. Mortg. Bankers Ass'n, Comment Letter to Dep't of Hous. & Urban Dev., at 5–6 (July 18, 2016), https://www.regulations.gov/contentStreamer?documentId=HUD-2016-0052-0069&attachmentNumber=1 [https://perma.cc/ELV3-A3Y8] (suggesting an alternative provision for HUD to instead expressly prohibit the extinguishment of its otherwise superior HECM mortgage lien interests by HOA super-priority liens).

The FHFA's continued success in Nevada courts could eventually impact the validity of super-priority lien statutes in other states as they apply to the properties that are bought through federally sponsored mortgages. Similarly, a proposed FHA rule would fail to honor state laws granting association lien super priority and could disqualify seniors in almost half of the states from getting a reverse mortgage.

G. Proposed Adoption of the UCIOA in Washington

Recently, Washington State's legislature has considered adopting the UCIOA to unify regulation for the formation, management, and termination of any association form.[178] Washington State proposed to introduce the UCIOA by Senate Bill 5263 (WUCIOA) in the 2015–2016 session[179] based on a 2007 legislative taskforce that found substantial defects in the Homeowners' Association Act.[180] Although the WUCIOA was based on the UCIOA, the proposed law was modernized to make it appropriate for Washington State.[181] As originally drafted, the WUCIOA would be applicable to the following: (1) common interest communities—which include condominiums, cooperatives, and planned communities—created after the effective date, and (2) pre-existing common interest communities that do not vote to opt out of WUCIOA.[182]

The proposed law requires a minimum of three months' overdue assessments before associations could start foreclosure; the current law does not have such a provision.[183] This proposed bill is modeled after the 2008 UCIOA version and includes costs and reasonable attorneys' fees in the super-priority amount.[184] However, the WUCIOA does not include the 2014 UCIOA amendments that clarify the super-priority lien provision and provide for "evergreen" liens of six months for each calendar year.[185] Although the 2016 legislative session of Washington State adjourned *sine die* on March 29, 2016, without passing the WUCIOA Bill, it is likely that a similar bill will be introduced in the next legislative session. The

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178. Connecticut, Delaware, and Vermont enacted the recent 2008 version of UCIOA. *See* CONN. GEN. STAT. § 47-258 (West 2013); DEL. CODE ANN. tit. 25, § 81-316 (West 2009); VT. STAT. ANN. tit. 27A, § 3-116 (West 2015).

179. Wash. Uniform Common Interest Ownership Act, S.B. 5263, 64th Leg., 2015 Reg. Sess. (Wash. 2015–2016).

180. *See* S.B. Rep. No. 5263, at 4 (Wash. Feb. 6, 2015).

181. *See id.* at 5.

182. *See id.* at 1.

183. *Compare* WUCIOA § 318(21)(a), S.B. 5263, 64th Leg., 2015 Reg. Sess. (Wash. 2015–2016), at 89, *with* WASH. REV. CODE § 64.34.364 (2014).

184. *See* WUCIOA § 318(3)(a)(ii), S.B. 5263, 64th Leg., 2015 Reg. Sess. (Wash. 2015–2016), at 83; UCIOA, *supra* note 16, § 3-116(c).

185. *Compare* WUCIOA § 318(3)(a)(1), S.B. 5263, 64th Leg., 2015 Reg. Sess. (Wash. 2015–2016), at 83, *with* UCIOA, *supra* note 16, § 3-116(c)(1).

legislature should consider taking advantage of the balance achieved nationwide and incorporate the 2014 UCIOA amendments into the new version of the uniform bill.

This single, retroactive bill would provide advantages to associations, consumers, and developers and would lessen litigation.[186] It was proposed that the rights of secured lenders may be specified in the declaration, such as approval rights for certain actions.[187] Opponents, such as the Washington Bankers Association, argued that the proposed Section 318, which provides for the super-priority lien, would place association lien rights in an expanded superior position to financial institutions and would expand the cost added to the association's lien, thus, going against decades-long protection to the banking industry.[188] On the other end of the spectrum, the Community Associations Institute argued that the super-priority lien should be extended to twelve months.[189]

While the original WUCIOA draft included the super-priority lien for all associations, the banking lobby was successful in narrowing the draft super-priority lien provision for only condominium owners' associations, which would have invalidated any current super-priority provisions in homeowners associations' governing documents.[190] The Legislature should consider the interests of people living in all communities and include the assessment priority for all associations in the final version of the bill.

III. Potential Solutions in Balancing and Protecting the Interests of Parties

A. Potential Consequences of "True Priority" Regime

Several years ago, lenders were seemingly unaware of the possibility that their mortgages could be extinguished by association foreclosure sales, and third-party bidders were rarely willing to pay much more than the amount owed to the association.[191] In the aftermath of the Great Recession, the large volume of foreclosures and significant number of "underwater" homes—homes valued less than the amount of loans secured by liens on the property—sparked the priority contest that was previously

186. *See* S.B. Rep. No. 5263, at 5 (Wash. Feb. 6, 2015).

187. *See id.* at 4.

188. *See id.* at 5.

189. *See id.*

190. *See* Marlyn Hawkins, *Good, Bad and Still a Little Ugly, UCIOA is Dead for Now*, BARKER MARTIN (Feb. 26, 2015), http://www.barkermartin.com/blog/condo-hoa-blog/post/good-bad-and-still-a-little-ugly-ucioa-is-dead-for-now [https://perma.cc/NT3X-RKWK].

191. *See* Waite, *supra* note 78, at 26–27 (stating that houses in Nevada typically sold for a price between $3,000 and $12,000).

dormant, or even nonexistent because, generally, asset values had previously covered the full amount of all liens.[192] The Mortgage Bankers Association and several other trade groups released a statement of principles declaring their opposition

> to policy initiatives that seek to give priority lien status to one private party ahead of another private lienholder that has followed proper procedures to record their lien. These initiatives run contrary to the very heart and nature of secured lending, and can destabilize the entire real estate finance system by undermining the value of the collateral securing a loan—resulting in higher costs that will ultimately be borne by consumers.[193]

They state that, consequently, millions of Americans living in common interest communities could potentially face much tougher underwriting and higher interest rates when they apply for a mortgage in super-priority lien states.[194] Buyers could face higher loan fees, larger down payments, and time-consuming examinations of association finances.[195] Some lenders may decide to avoid doing business in communities subject to super-priority liens altogether.[196] Although super-priority liens are crucial to associations, difficulties in securing a desirable loan might impact property sales and decrease buyer demand,[197] which in turn could lead to lower prices for association homes.

Notably, even if the case law ultimately concludes that association super-priority liens are unable to extinguish the FHFA and FHA's property interests, loans made with private capital will still be vulnerable to extinguishment.[198] And investors will still not have as much of an incentive to invest, affecting the ability of consumers to purchase homes.[199] Importantly, even mortgage-free homeowners are vulnerable to inadvertently losing their homes in the event of disputing assessments with

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192. *See* Andrea Boyack, *Lien Priority Rules!*, PRAWFSBLAWG (Aug. 14, 2015), http://prawfsblawg.blogs.com/prawfsblawg/2015/08/lien-priority-rules.html [https://perma.cc/4PP6-LGK3].

193. *See* AM. BANKERS ASS'N ET AL., STATEMENT OF PRINCIPLES ON HOA SUPER PRIORITY LIENS, 1 (2015), http://mba-pac.informz.net/mba-pac/data/images/PolicyDocuments/StatementofPrinciples—HOASuperLiens.pdf [https://perma.cc/YJ43-VBFL]. In super-priority states, lenders would prefer the lien as a payment priority with clearly defined limits and capped at one percent of the mortgage amount. *Id.* at 1–2. They propose that an association's super-priority lien should lose the priority if the association sells its lien interest to a third party. *Id.* at 2.

194. Kenneth R. Harney, *Homeowner Association Liens Pose Perils for Condo Buyers*, L.A. TIMES (May 17, 2015), http://www.latimes.com/business/la-fi-harney-20150513-story.html.

195. *Id.*

196. *Id.*

197. *See* AM. BANKERS ASS'N ET AL., *supra* note 193, at 4.

198. *Id.* at 5.

199. *Id.*

associations or being sick or out of town for an extended period of time.[200] The Mortgage Bankers Association and other trade groups are urging the federal banking agencies to consider implementing standards to "prevent HOA 'super-priority' liens from having the capacity to extinguish the prior perfected and recorded non-federally related mortgage liens—preempting any state law that purports to allow such an extinguishment."[201]

Whether the federal government will take action and potentially pass a law preempting all state laws relating to association super-priority liens is unclear; however, this development should be alarming for associations nationwide, especially in light of the fact that since the *SFR Investments* decision, some lenders in Nevada are moving more quickly to finalize their own foreclosures, and more lenders are paying association assessments.[202] Moreover, many community banks support super-priority liens, acknowledging their historical benefits to common interest communities, homeowners, and lenders.[203] Preservation of associations' ability to foreclose is essential to avoid the damaging effects on all parties during the next economic downturn.

B. Arguments for Challenging Association Sales

Clarification is desperately needed on the issue of whether federal HERA law preempts state priority laws for properties insured by the FHA or the FHFA. Conflicting court decisions produce uncertainty; we should expect that the Ninth Circuit Court of Appeals will ultimately have to decide this issue.

The 2008 UCIOA amendments added a provision stating, "Every aspect of foreclosure, sale, or other disposition under this section, including the method, advertising, time, date, place, and terms, must be *commercially reasonable*."[204] This language comes from Article 9 of the Uniform Commercial Code, which is applicable to personal property

200. *Id.* at 4–5.

201. Letter from Am. Bankers Ass'n et al., to Office of the Comptroller of the Currency, Fed. Deposit Ins. Corp., and Board of Governors of the Fed. Res. Sys. 3 (Nov. 10, 2015), https://www.mba.org/Documents/Comment%20Letters/JointTradesHOASuperLienLetter(11-10-15).pdf [https://perma.cc/H6MM-VBWH].

202. *Mortgage Bankers vs. Local Communities: Protecting Homeowners and America's Neighborhoods*, CMTY. ASS'NS INST. 2, https://www.caionline.org/Advocacy/FederalAdvocacy/PriorityIssues/Documents/2014%20Statement%20on%20Priority%20Lien%20-%20Response%20to%20Nevada%20Supreme%20Court.pdf [https://perma.cc/6T6J-TX69].

203. *See* Wesley Blair, *Some Banks are Siding with Condos in the Battle over Super Liens*, NAT'L MORTG. NEWS (June 14, 2016), http://www.nationalmortgagenews.com/news/voices/some-banks-are-siding-with-condos-in-the-battle-over-super-liens-1080034-1.html.

204. *See* UCIOA, *supra* note 16, § 3-116(q) (emphasis added).

foreclosures in all states.[205] Although a similar provision is not in the WCA, it was proposed in the WUCIOA in Section 318(23). Lenders could try to use this provision to invalidate sales for a fraction of the property's value when interests of lenders were extinguished.

Another route worth trying is the good faith argument incorporated in the UCIOA that states, "Every contract or duty governed by this [Act] imposes an obligation of good faith in its performance or enforcement."[206] Several courts have analyzed the commercial reasonableness and good faith requirement in the context of association foreclosure sales. The Vermont Supreme Court found that "the official comment to § 1-113 expresses in unequivocal terms the Legislature's intent to import the commercial reasonableness standard into the UCIOA."[207] Thus, the court held that "the enforcement mechanisms provided for in § 3-116 must be conducted in good faith as defined in § 1-113, that is, in a commercially reasonable manner."[208] The court voided an HOA super-priority foreclosure sale, holding that sale of the property for $33,510.10 was not commercially reasonable when the property had a fair market value of $70,000.[209]

In setting forth equitable arguments and focusing on the economic impact of decisions, lenders could rely on the Restatement language suggesting that courts may invalidate a foreclosure sale when the foreclosure price is grossly inadequate—i.e., it fails to produce at least 20% of the property's fair market value.[210] Courts usually avoid setting any precise formula for gross inadequacy or a shocked conscience.[211] In certain association foreclosure actions, a foreclosure sale price below 20% of the property's fair market value at the time of the sale might be just what lenders need to dispute foreclosures for a nominal amount that seem extremely unfair to lenders. However, the Supreme Court of Nevada noted that, although courts in Nevada possess the inherent power "to grant

205. U.C.C. § 9-610(b) (AM. LAW INST. & UNIF. LAW COMM'N 2010) ("Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable.").

206. UCIOA, *supra* note 16, § 1-113. The WCA lists it under WASH. REV. CODE § 64.34.090 (2014); it is also under Section 112 of the proposed WUCIOA.

207. Will v. Mill Condo. Owners' Ass'n, 848 A.2d 336, 341 (Vt. 2004).

208. *Id.* at 342.

209. *See id.* at 342–43.

210. *See* RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 8.3 cmt. b (AM. LAW INST. 1997) (stating that although "'[g]ross inadequacy' cannot be precisely defined in terms of a specific percentage of fair market value[, g]enerally . . . a court is warranted in invalidating a sale where the price is less than 20 percent of fair market value and, absent other foreclosure defects, is usually not warranted in invalidating a sale that yields in excess of that amount"); Shadow Wood HOA v. N.Y. Cmty. Bancorp, Inc., 366 P.3d 1105, 1112 (Nev. 2016).

211. *See* Steven W. Bender, *Equity in Times of Mortgage Crisis*, 48 REAL PROP. TR. & EST. L.J. 543, 552 (2014).

equitable relief from a defective foreclosure sale when appropriate,"[212] "demonstrating that an association sold a property at its foreclosure sale for an inadequate price is not enough to set aside that sale; there must also be a showing of fraud, unfairness, or oppression."[213]

It is ironic that the major lenders are the ones arguing the unfairness of foreclosure, especially nonjudicial foreclosure. Because lenders are in a better position to safeguard their interests, any unfairness should not be placed on a bona fide third-party buyer by invalidating the sale.[214]

C. Potential Approaches for Lenders to Adapt to True Priority Association Liens

The recent clarifications in case law require lenders to adapt to new risk factors in situations that sometimes can produce absurd and damaging results. Lenders need to develop procedures to minimize loss of collateral and consider them as another cost of doing business. This section provides some of the recommendations for how lenders can best protect their interests.

First, one way of securing lien priority for lenders is to require prepayment of assessments to the extent allowed by RESPA in an escrow account, similar to the processing of real estate taxes by lenders or, alternatively, to be used only when the owner is overdue.

Lenders should also consider monitoring association dues and requesting notices from associations when payments are overdue. Because Washington's super-priority lien of six months may be reduced by up to three months if the lender requests a notice of delinquency and the association fails to provide such notice,[215] lenders should always give written request for a notice of delinquent assessments. Lenders could also make an agreement with associations in the form of an estoppel certificate, which would include a clause that the lender relies on such agreement in making the loan and under which associations would provide notice to the lender of any default and a certain period for the lender to cure.[216] Such

212. *Shadow Wood HOA*, 366 P.3d at 1110.

213. *Id.* at 1112.

214. *See* Kylee Gloeckner, Note, *Nevada's Foreclosure Epidemic: Homeowner Associations' Super-Priority Liens Not So "Super" for Some*, 15 NEV. L.J. 326, 345–46 (2014). Additionally, the Nevada Supreme Court noted that a foreclosure-sale purchaser without knowledge of a pre-sale dispute between a lender and an HOA could be a bona fide purchaser. *Shadow Wood HOA*, 366 P.3d at 1115.

215. *See* WASH. REV. CODE § 64.34.364(4) (2014).

216. *See* Barbara Anne Spignardo, *What's a Second Priority Lien to Do?*, LAW360 (Sept. 11, 2015), http://www.law360.com/articles/701949/what-s-a-second-priority-lien-to-do [https://perma.cc/CPJ4-SX7U].

procedures could prevent associations from having foreclosable liens in the first place.

Next, lenders could try protecting their interests by working with title insurance companies to get an ALTA condominium endorsement.[217] Before court decisions confirmed that association foreclosures could extinguish lenders' mortgages, title companies were more flexible in insuring over the priority of any association lien by ALTA form 4-06.[218] Most title companies are now avoiding risk by limiting the offered endorsement coverage by using a different form—ALTA form 4.1-06—which limits coverage to unpaid assessments only as of the date of the policy, which is the date of the recording of the mortgage loan.[219] Moreover, title companies will not insure title of third-party bidders based on foreclosure of an association lien without taking exception to all unsatisfied association mortgages because "these types of scenarios are highly likely to generate future litigation."[220]

When associations start to foreclose their liens, lenders can also protect their interests by either purchasing the property or prepaying the assessments to prevent extinguishment of the lenders' mortgage. It is likely that offering to pay the correct super-priority amount preserves the priority of the senior lien interest.[221] For lenders litigating quiet title actions, it is important to assert claims against the associations and their

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217. The American Land Title Association (ALTA) is the national trade association for the title industry representing 2,000 abstracters, title insurance agents, and title insurance underwriting companies. *See Title Insurance: A Comprehensive Overview*, AM. LAND TITLE ASS'N 2, http://www.alta.org/about/TitleInsuranceOverview.pdf [https://perma.cc/8636-XPTD]. Throughout the years, ALTA has developed title insurance policy forms that provide coverage for the standard type of real estate transactions. *Id.* at 12. To help the title industry tailor the ALTA forms so they are even more useful in larger and complex conveyancing and financing transactions, ALTA has created various endorsements—additions or limitations of coverage attached to a title insurance policy—including coverage for condominiums and planned unit developments. *Id.* By requesting an endorsement to the title insurance policy, an insured owner or lender may be able to insure against the risk of suffering loss because of a matter that is beyond the coverage of the standard policy. *Endorsement Guide: A Brief Overview of ALTA Title Insurance Endorsements*, FIRST AM. TITLE INS. CO., http://www.firstam.com/assets/commercial/endorsement-guide/ncs-endorsement-guide.pdf [https://perma.cc/RLT7-DNS7].

218. *See* Spignardo, *supra* note 216.

219. *See id.* ALTA Form 4.1-06 endorsement covers "any charges or assessments provided for in the condominium statutes and condominium documents due and unpaid at Date of Policy" but, unlike ALTA Form 4-06, it does not insure over the priority of any association lien. *Id.*

220. *See, e.g.*, *National Underwriting Bulletin*, WFG UNDERWRITING DEP'T 2 (Oct. 21, 2014), http://wfgunderwriting.com/download/national/bulletins/WFG%20National%20Bulletin%20National%202014-09-%20CondoHOA%20Super-Priority%20Liens-Issuance%20of%20Series%204%20and%205%20Endorsements.pdf [https://perma.cc/Z89D-P84S].

221. *See* J. Hunter Robinson, *Mortgage Industry Scores Big Nevada Supreme Court Win in Continued Battle over HOA Super-Priority Liens*, FIN. SERVS. PERSPECTIVES (Apr. 29, 2016), https://www.financialservicesperspectives.com/2016/04/mortgage-industry-scores-big-nevada-supreme-court-win-in-continued-battle-over-hoa-super-priority-liens/ [https://perma.cc/F667-K767].

collection agents when the lender tenders the super-priority amount prior to the sale.[222] Recently, the Nevada Supreme Court, in an unpublished opinion, held that a lender's tender to the HOA of the super-priority amount of the HOA's lien extinguishes the super-priority lien, even if the HOA wrongfully rejects the tender.[223]

Additionally, in states like Washington that allow statutory redemption, lenders have "another bite of the apple." That is, they have a second opportunity to keep their interests by redeeming the property during the statutory redemption period, which can vary in different states from two months to two years depending on the jurisdiction.[224] Moreover, lenders should promptly update public records with the name of the most current party who has interest in the mortgage and should receive notice when the association starts foreclosure action.[225] Furthermore, lenders should create procedures to prevent internal errors, similar to the lender's error in *BAC Home Loans Servicing, LP*, which can cause complaints to go unanswered and lead to default judgments.[226] If they do so, they can avoid the need to use the redemption statute.

Finally, lenders should closely monitor developments in the super-priority lien laws for unpaid assessment liens because these laws are amended often. According to Community Associations Institute, banker associations backed by federally sponsored entities are heading initiatives to nullify the lien priority laws in at least nine states.[227] As one example, Tennessee recently amended its statute, which had been in place since 2008, to ensure that associations have a mere payment-priority lien and not a super-priority lien.[228] Lenders should support any proposal giving them redemption rights after foreclosure. Notably, the extinguishment of a lender's mortgage does not eliminate the debt, only the security for the debt; thus, the former owner can be sued for the rest of the debt. However, it is unlikely that lenders would be successful in collecting the amounts owed under such judgments. There is also a possibility that anti-deficiency laws would prevent such recourse.

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222. *See id.*

223. *See* Stone Hollow Ave. Tr. v. Bank of Am., Nat'l Ass'n, No. 64955, 2016 WL 4543202, at *1 (Nev. Aug. 11, 2016).

224. 5 TIFFANY REAL PROPERTY § 1530, Westlaw (database updated Sept. 2016) (3d ed.).

225. The creation of Mortgage Electronic Registration Systems, Inc. (MERS) in the 1990s, in order to avoid the mortgage assignment recordation fees, potentially has been part of the problem. MERS acts as another intermediary causing delays and confusion as to who holds the beneficial interest in the promissory note and the underlying mortgage. *See* Bender, *supra* note 211, at 571.

226. *See* BAC Home Loans Servicing, LP v. Fulbright, 328 P.3d 895, 896 (Wash. 2014).

227. *See* Matthew Green, *2016 Legislative Update: Five Months in*, CMTY. ASS'NS. INST. (May 6, 2016), https://www.caionline.org/Advocacy/GovernmentAffairsBlog/Pages/2016Update.aspx [https://perma.cc/RP5B-APHY].

228. 2016 Tenn. Pub. Acts Ch. 866.

To provide clarity and necessary balance, the Washington State legislature should adopt UCIOA together with its most recent 2014 amendments, which emphasize the evergreen nature of association liens granting six months' of assessments for every year. The new law should clarify that when a lender pays off an owner's delinquent assessments before the association's foreclosure sale to protect its own interests, a lender is entitled to collect that amount from the owner so that the owner would have a strong incentive to pay the assessments timely.

While it looks like the super-priority lien is here to stay, at least in Washington, lenders should be cautious and take measures to protect themselves while still being comfortable enough to proceed with financing transactions secured by association property. Given the backlash that started when lenders' mortgages were extinguished by association foreclosures, it may take some time before Washington adopts the UCIOA.[229]

CONCLUSION

For decades, financially stable associations have been protecting the interests of lenders as well as the interests of the common interest communities. The recent court decisions in Washington, Nevada, Massachusetts, Rhode Island, and the District of Columbia, holding that the statutes provide a true super-priority lien to associations, mean that not only can such liens survive the lender's foreclosure, but that an association itself could foreclose on its interest and extinguish the lender's security interest.

Although court decisions in super-priority states highlight the tensions between associations and lenders, lenders are in a better position to protect their interests. Lenders need to be proactive, not ignore delinquent assessments and notices they receive concerning association properties and not "sleep" on their rights, thereby risking extinguishment of their mortgage rights. If available, the right of redemption may also provide sufficient protection for lenders when used within the required time limits.

It remains uncertain whether the federal HERA law will be deemed to preempt state priority laws. The Circuit Courts of Appeals or the Supreme Court of the United States will eventually have to clarify the preemption argument. Alternatively, Congress could amend HERA to specifically exempt common interest community loans from the provision

229. Indeed, the Mortgage Bankers Association has "defeated or currently halted consideration on every proposal" in other states considering adoption of super-priority liens. *See* Mike Sorohan, *Statement of Principles Aims to Neutralize HOA "Super Lien" Ruling*, MBA NEWSLINK (July 30, 2015), http://apps.mba.org/tools/FullStory.aspx?ArticleId=59525 [https://perma.cc/54BE-7CDF].

requiring Fannie Mae and Freddie Mac to maintain a priority position on loans they purchase. In the meantime, associations should take caution when foreclosing properties that are federally insured.

Finally, Washington State, as well as other states, could benefit from unified regulation of various forms of common interest communities. All states could provide more clarity and balanced protections to both the common interest communities and lenders if they adopted the UCIOA, together with its most recent 2014 revisions, clarifying various aspects of association super-priority liens.