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Community Associations Newsletter

The Changing Face of Assessment Collection

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At this point, we are approximately three years into a stagnant economy with virtually no signs of improvement on the horizon. It seems like a decade ago that so many owners would simply refinance their homes in order to pay off their delinquent assessments. “Short sales” were unheard of, and the association was paid even when the property foreclosed. In short, it was considerably easier to collect a delinquent account than it is now. And while the number of delinquencies has leveled off, most associations still have record numbers of delinquent accounts that are not likely to be brought current any time soon.

The Well Has Gone Dry

Many owners are in difficult financial situations due to loss of employment in the shape of reduction in hours, cut-backs on overtime and bonuses, and massive layoffs. Escalating housing and fuel costs have also increased financial pressure on owners, while the pool of available credit has evaporated. Foreclosures and bankruptcies remain at historic levels, and creditors of every walk of life are scrambling to collect what is

owed to them. As a result, the average homeowner’s ability to pay his or her delinquent account is severely restricted. Simply put, there is very little cash for creditors to collect.

The “foreclosure meltdown” has been particularly challenging. Obviously, a homeowner will not pay the assessments when he or she cannot pay the mortgage. However, in light of the recent scrutiny of the foreclosure process, there is evidence to suggest that there is a chill on the foreclosure market itself. The foreclosure moratoriums have been well publicized, but our recent experiences lead us to believe that the banks are taking longer and longer to actually foreclose on delinquent mortgages. In some cases, owners have told us that they haven’t paid the mortgage in 18 months, or haven’t lived in the property in almost a year. The federal refinance programs that were adopted have made no noticeable effect, and it appears that very few people qualify for these programs. Until real estate values improve or the market is allowed to correct itself, assessment collection will be difficult.

For these reasons, associations should view the collections process with a long-term perspective. If it appears that we cannot collect a delinquent account soon (due to unemployment, foreclosure or multiple other factors), the Board should focus on taking steps that will secure the debt and hopefully lead to recovery in the future. Judgments are particularly effective in this regard, as they survive foreclosure, remain enforceable for 10 years, and are routinely reported to the credit bureaus. As a result, the association may be able to collect years later once the owner's financial situation improves, rather than incur costs and attorney's fees chasing money that the owner simply doesn't have.

Increased Scrutiny

As you have probably heard, one of the repercussions of the foreclosure meltdown has been increased scrutiny of creditors from the judiciary. Across the country, creditors are reporting a stricter level of review from the bench. The courts are taking the position that it is their duty to ensure that creditor's attorneys are following every technicality of the law, and that the results are fair to consumers.

Here in Virginia, the State Bar deemed it unethical for an attorney to obtain a default judgment based on an affidavit signed by that attorney. Consequently, most of the local courts have expressly stated that they will no longer enter a default judgment in cases where the affidavit relied upon was signed by the attorney. For this reason, we recently informed you that we can no longer

sign affidavits on your behalf, and that they must be signed either by a member of the Board or your managing agent.

In Maryland, a recent Court of Appeals decision has caused some difficulties in recovering legal fees. The case involved an appeal of three suits filed on behalf of homeowners associations where the courts awarded attorney's fees based on a percentage of the principal balance sued for. While the Court of Appeals agreed that it was inappropriate to award legal fees this way, its decision gave the lower courts even greater latitude to give even smaller awards of attorney's fees. We remain hopeful that the situation will correct itself as the lower courts become comfortable with the decision and understand how it is to be applied.

In general, the courts are being very careful in entering any default judgments and are quickly dismissing any element of the claim that may be problematic. In addition, the courts remain backlogged as a result of the significant increase in debt collection lawsuits. These two factors together have caused considerable delays in the courts, but thankfully, it has not created any problems that cannot ultimately be fixed.

Rules, Rules, Rules

The biggest challenges we face are (1) increasingly aggressive and sophisticated consumer's rights attorneys; (2) consumer statutes designed to offer very broad protections to consumers; and (3) a hostile legislative atmosphere.

The U.S. District Court, Eastern Division, at Richmond reported a 44% increase in the number of consumer lawsuits last year. Across the country, there were more consumer lawsuits filed in 2009 than in any year prior. Actions brought under the Fair Debt Collection Practices Act (FDCPA) and the Fair Credit Reporting Act (FCRA) open the collector to significant liability in the form of statutory penalties, damages and attorney's fees. Just recently, the U.S. District Court, Eastern Division, at Richmond awarded \$72,000 in attorney's fees to a consumer in a case brought under the Fair Debt Collection Practices Act. In addition, there is the constant threat of potential federal claims under these Acts turning into class action lawsuits potentially worth millions of dollars. Consumer's rights attorneys are filing more suits than ever before, many of which are filed purely for their nuisance value – the collector will pay some amount simply to make it go away.

Unfortunately, many of these claims are not completely without merit. As noted above, the FDCPA and the FCRA create the most exposure for our firm. These statutes and the supporting caselaw are complex and confusing, and yet contain open-ended prohibitions against things such as “unfair practices.” Many collectors feel that a violation is almost inevitable, given how broadly the statutes are construed. Of the two, the FDCPA is the most worrisome, as violation of the other statutes is almost a de facto violation of the FDCPA. This is where the Servicemember's Civil Relief Act (SCRA, formerly the Soldier's and Sailor's

Civil Relief Act) comes in – if you obtain a default judgment against a servicemember and failed to exercise due diligence, you have violated the SCRA. In turn, you have then possibly violated the FDCPA because you have taken legal action that is prohibited by law. Meanwhile, we also have to be careful not to violate various federal laws regarding people's privacy and their sensitive personal information. Taken together, complying with these statutes requires unrelenting vigilance.

Unfortunately, the immediate future does not offer much good news. Among others, Senator Franken has gone on record to state that he believes collectors and creditors should face heavier penalties and tighter regulation. In light of the practices uncovered in the foreclosure meltdown, it is doubtful that he would receive too many objections. However, we remain cautiously optimistic that Congress' focus will be elsewhere in the coming months. Unfortunately, many states are also considering tighter regulation of lawyers and agencies that collect consumer debts, although we are unaware of any pending legislation in Maryland, Virginia or the District of Columbia.

While the current atmosphere is truly daunting, we believe that educating ourselves and our clients will supply the answers and resolve many of these difficulties. As always, we will continue to keep our clients apprised of any new developments in the law, but please do not hesitate to contact us if you have any questions.