

# Why Aren't We Getting Paid?



**Rory K. Nugent, ESQ.**

After years of exploding real estate prices, it appears that the market in the DC metro area is now heading in the opposite direction. As you may have recently heard, foreclosure rates are at historic highs. Many people who purchased or refinanced their homes within the last two years, are now faced with these declining values and are unable to sell their homes. As a result, we have seen a dramatic increase in the number of foreclosures by the mortgage holders. Unfortunately, these foreclosures often

have a significant impact upon both condominium and homeowners associations for the simple reason that owners who do not pay their mortgages typically do not pay their assessments.

In the not too distant past, a first trust foreclosure usually resulted in the property being sold to a third party at a price significantly higher than the balance due on the mortgage. As a result, any unpaid assessments, legal fees, and costs were paid from the excess proceeds of the foreclosure. Now,

however, it is common that third parties are not willing to bid more at the foreclosure sale than the value of the mortgage. Consequently, the mortgage holder is taking title to the property.

In Maryland and Virginia, when a property is foreclosed by the mortgage holder, the first trust mortgage is paid first and then all other claims against the property are either paid in the order of priority or extinguished. In other words, if there are no proceeds from the foreclosure to payoff an

association's liens, those liens are extinguished and the association's claim against the property is wiped out. An exception applies to condominium liens in the District of Columbia whereby a lien may have priority over the first deed of trust in limited circumstances.

After the first trust forecloses and the association's lien is extinguished, the association's only option to collect the debt is to pursue a personal judgment against the former owner. Otherwise, the unpaid assessments will have to be reclassified by the board of directors as bad debt.


Once the first trust mortgage holder begins the foreclosure process, the association cannot do anything to stop the process. At a minimum, the association and management should take extra care in ensuring that accounts are promptly referred for collection and that liens are being executed and returned for recordation as quickly as possible. That way, the debt will at least be secured in the event that there are excess proceeds available or the owner files for bankruptcy in an effort to stop or postpone the foreclosure.


From time to time, clients have informed me that they are interested in attending a

sale and bidding on a particular property that is scheduled for foreclosure. Board members may certainly bid on their own behalf, but the board should carefully consider this course of action if it is interested in purchasing the unit on behalf of the association. The association's documents may require the board to allocate specific funds in its budget for this purpose or pass a special resolution authorizing the board to purchase the property. In addition, the purchase may require a significant investment of association funds in not only purchasing the property, but also preparing it for sale or rent.

If a property is foreclosed and the mortgage holder takes title to the property, the association and the managing agent need to begin billing the bank for any assessments that come due from the date of foreclosure. Unfortunately, deeds reflecting the change in ownership of the foreclosed unit or lot are often not recorded promptly. This makes it difficult to ascertain the identity and contact information of the new owner. In many cases, the bank will neglect to pay the assessments as they come due, which will require the association to record another lien against the property. Typically, the

bank will look to make payment arrangements shortly before it sells the property, which means that months may pass before the account is paid. If a property within your association has been foreclosed, the board and management should pay particular attention to any requests for resale disclosure packages for the foreclosed unit or lot.

Financial experts predict that the number of foreclosures may increase before they begin to decline. While this region's real estate market has proven over the years to be more stable than other areas of the country, associations should still take whatever precautions they can. 



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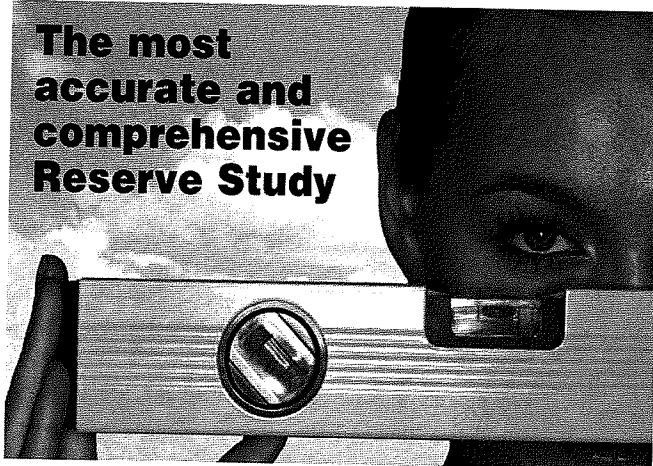
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