



**SWEDELSON
GOTTLIEB**

www.lawforhoas.com // www.hoalawblog.com
800-372-2207
slg@sghoalaw.com

Current Issues Affecting the Sale of Units and Lots in California Community Associations

***Presented for the Orange County Escrow Association on
Behalf of the California Association of Community
Managers
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**Presented By:
Sandra L. Gottlieb, Esq., Managing Partner, SwedelsonGottlieb**

I. A BRIEF OVERVIEW OF COMMUNITY ASSOCIATIONS

- A community association (also known as a homeowners associations or, simply, an association) is the entity formed to manage, administer and operate a common interest development, such as a condominium project, planned development or stock cooperative.
- A community association is governed by a board of volunteer directors elected, for the most part, by the members/homeowners of the association.
- The members of the association are those persons and entities who are on record title to a unit/lot.
- The rights and obligations of the association and its members and board are established in the association's legal/governing documents and applicable state and federal statutes.

- The CC&Rs (also known as the “declaration”) are the primary governing document of an association.
 - Use, aesthetics and architectural control of the association
 - Assessments and other financial obligations of the members
 - Rights of and restrictions on the association’s members and residents
 - Rental restrictions, pets, nuisances, view obstructions, maintenance and repair of units and the common area, association and member insurance requirements, assessment obligations and association lien rights and the board’s rights to enforce the association’s governing documents.
 - *Nahrstedt v. Lakeside Village Condominium Association* (1994) 8 Cal.4th 361 - The use restrictions contained in an association’s CC&Rs are presumptively enforceable.
 - CC&R amendments typically require the approval of a super-majority of the membership.

- The Davis-Stirling Common Interest Development Act (California Civ. Code § 1350, *et seq.*) governs common interest developments in California.
 - Other Civil Code provisions (such as Cal. Civ. Code § 2924, *et seq.* regarding enforcement of liens), certain provisions of the California Corporations Code, the California Vehicle Code and the California Health and Safety Code, state and federal fair housing laws and certain federal statutes (such as the Federal Telecommunications Act) also apply to associations.
 - AB 711 and SB 150, discussed below, are two recent amendments to Davis-Stirling.

- Failure to comply with governing documents is a violation of the governing documents.

- The board is required to uniformly enforce the association’s governing documents against all members.
 - No disparate treatment.
 - Renters/tenants cannot be treated differently than other residents, but they have no privity of contract with the association.
 - Consistent enforcement of assessment collection provisions.

II. THE NEGATIVE IMPACT SHORT SALES & FORECLOSURES HAVE ON ASSOCIATIONS

- Today’s economic climate continues to be hard for many Californians.
 - High unemployment.
 - Debt overload and increases in the cost of living; “strategic defaulters”
 - Other expenses paid first before assessments for some owners.
 - Housing price decline continues, homes still “under water”.
 - Foreclosures and short sales.

- When an owner is in default on debt owed with respect to his/her property, the owner is subject to a foreclosure action, pursuant to statutory requirements.
 - Two types – foreclosure by the association for an owner’s delinquent assessments, and foreclosure by an owner’s lender for delinquent mortgage payments.
 - For nonjudicial foreclosure, foreclosure is the actual act of the trustee sale, and not the recording of the lien or the Notice of Default.
 - In judicial foreclosure, the foreclosure process commences when judgment is rendered in favor of the association.
 - The foreclosure process is driven by state statutory requirements for nonjudicial foreclosure, and state and federal fair debt collections practices acts control collection activities by associations, lenders and other parties having a security interest in a property.

- Foreclosures by associations.
 - Property may revert to the association.
 - Each type of foreclosure process may be expensive.
 - When the association becomes owner of a unit/lot, it incurs the following liabilities:
 - The association must insure, maintain and repair the property.
 - May have to pursue eviction.
 - May need special assessment to cover shortfall in cash flow.
 - Rent out the unit/lot?
 - Vacancy drawbacks.
 - Board’s fiduciary duty to pursue collection, possibly including foreclosure, despite the negatives.
 - Association has no responsibility to pay mortgage, but the mortgagee can foreclose at any time after the association’s foreclosure.

- Foreclosures by owners’ lenders.
 - Lender becomes responsible for ongoing assessments for the property but are difficult to contact and often don’t pay assessments until they sell.
 - Foreclosures by lenders negatively impact the appearance of financial viability of an association.
 - Lenders typically don’t perform maintenance; the association will need to exercise its right of entry to perform necessary maintenance and repairs (after conferring with association legal counsel).
 - The REO department of a lender will often sell the unit/lot below market.
 - Lenders will engage local real estate agents or brokers to market the property.

- Short sales.
 - A third party offers to buy an owner’s property for less than the amount owed, and the owner’s lender agrees.
 - Lenders are increasingly more receptive to considering a discount on a mortgage.

- A short sale does not necessarily release the borrower from the obligation to pay the remaining balance of his/her loan.
 - Association usually asked to reduce amount due the association so the short sale can occur; advantage to the association is to avoid the possibility of having its lien wiped out; better than nothing.
 - Several factors to consider:
 - Is the home occupied by the owner or a tenant? Assignment of rents allowed by CC&Rs?
 - Does the owner have other assets or the ability to pay the assessments despite the lack of equity in the property?
 - What is the status of the property? Has the owner defaulted on their mortgage(s), and has the lender started the foreclosure process? How far along is the association in its collection process?
 - Record a lien quickly. California law requires that before the lien can be recorded, a pre-lien letter must be sent to all owners of the property in compliance with the Civil Code. Once the letter is sent, the association must wait thirty (30) days before the lien can be recorded.
 - An association does not have to agree to a proposed short sale; however, this may lead to the lender foreclosing on the property with the association not recovering any money.
- Consider the amount that is being offered to the association as part of the short sale.
 - What is the amount of money that the owner is willing to pay to the association to enable the short sale to close? Is the association being asked to accept the same discount as other secured creditors? Will the owner pay out of pocket to close the short sale and avoid a lawsuit from the association?
 - A short sale could be a win-win for the association. “Cut out the cancer”
 - If the association has already decided to go forward with its foreclosure sale, knowing that the property will revert to the association, and that the association will not net any proceeds, accepting some cents on the dollar when an owner is negotiating a short sale with his/her lender may make good business and economic sense for the association.
- In a short sale, the owner, or perhaps the owner’s realtor, might pay the association in order to make the deal happen.

III. HOW REO LENDERS MANIPULATE ASSOCIATIONS

- Ways that lenders manipulate associations with respect to their REO properties:
 - Delay recording the Trustee’s Deed Upon Sale.
 - Refuse to pay assessments to the association.
 - Convince the association to release without any payment a lien recorded against the property for the prior owner’s delinquent assessments.

- Make it difficult for the association to get in contact with the appropriate lender department.
- Refuse to properly maintain and repair the unit/lot.
- Place a lockbox on the common area gate or fence which allows unknown persons to enter the common area to inspect the unit/lot.

IV. BILLS AB 711 & SB 150 – HOW THEY WILL AFFECT ESCROWS IN 2012

- AB 771 (Butler):
 - The general purpose of this bill is to itemize and provide disclosure of fees charged to an owner for providing hard copies of association documents to a prospective purchaser of a unit/lot in escrow.
 - The following changes to Civil Code Section 1368(b), will occur as a result of this new legislation:
 - An association will be required to provide the selling owner, upon receipt of a written request, a written or electronic estimate of the fees that will be assessed for providing the requested documents; this billing disclosure must be provided on the form included in new Civil Code Section 1368.2.
 - The disclosure documents required under subsection (a) of Civil Code Section 1368 may be maintained in electronic form, and may be posted on the association’s website; an owner has the option of receiving the documents electronically or by hard copy.
 - The association may collect a reasonable fee for the procurement, preparation, reproduction and delivery of the documents requested; no additional fees may be charged for electronic delivery of the documents requested.
 - The association may not withhold delivery of the requested documents for any reason or subject to any condition, except the payment of the fees permitted.
 - An association may contract with any person or entity to facilitate compliance with the document requirements on behalf of the association.
 - The association is required to provide to a recipient authorized by the selling owner a copy of the completed 1368.2 form with the delivery of the requested documents.
 - There are certain other new requirements as well.
- SB 150 (Correa):
 - The general purpose of this bill is (1) to preserve the right of an owner to lease his/her property, as those rights existed at the time the owner acquired his/her property, and (2) require a prospective purchaser to be provided minutes for the prior 12 months’ open session board meetings.
 - The application of this bill will result in certain leasing restrictions not being applicable to existing owners when such restrictions are adopted by the association on or after January 1, 2012, resulting in a grandfathering of existing owners:

- Any amendment to an association's CC&Rs instituting or lowering a cap on the number of units/lots that may be leased at any one time.
- Any amendment to an association's CC&Rs instituting or increasing a limit on the amount of time an owner must own his/her unit before the owner leases his/her property.
- Any other amendment to an association's CC&Rs that would affect the ability of an owner to lease his/her unit.
- Any leasing restriction adopted and recorded on or before December 31, 2011 will be applicable to all owners, both future and existing.
- This bill includes changes to statute (Davis-Stirling) affecting escrow demands:
 - Civil Code Section 1368(a)(9) – If there is a provision in the governing documents that prohibits the rental or leasing of any of the separate interests in the association's development to a renter, lessee, or tenant, a statement describing the prohibition and its applicability must be provided to the prospective purchaser.
 - Civil Code Section 1368(a)(10) – If requested by the prospective purchaser, a copy of the minutes of the meetings, excluding meetings held in executive session, of the association's board of directors, conducted over the previous 12 months, that were approved by the association's board of directors must be provided to the prospective purchaser.

V. CONCLUSION

- There are potentially many negative impacts to an association when a unit or lot is in foreclosure (by either the association or a lender), or when the association is presented with a short sale proposal. An association's board of directors needs to carefully evaluate the association's options related to foreclosures and short sales, and be aware of the potential impacts stemming from same.
- An association needs to keep track of the status of lender foreclosure activities and maintain open and regular communication with REO lenders to protect itself from the potentially manipulative practices of those lenders.
- AB 771 and SB 150 are effective as of January 1, 2012, and associations, their boards and management companies, owners and prospective purchasers, and escrow companies need to be aware of the new requirements related to this legislation.