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Unpaid Assessments: An Alternative To Writing Off Unpaid Debts

Creating condominium or homeowner association documents that permit the association to maximize collections of assessments in an economic downturn is important to any developer. Fortunately, it is not difficult or costly to achieve. Without effective remedies to collect unpaid assessments, the association will have reduced revenues and will need to cut services or increase assessments to the remaining owners.

Most declarations (the governing document for condominium and homeowner associations) provide that the lien of unpaid assessments has priority over all liens other than real-estate taxes and the first mortgage. This is usually necessary to induce lenders to loan money to purchasers. The result, however, is that the foreclosure of the first mortgage eliminates the lien for unpaid assessments, and the association loses any ability to collect those funds.

But the governing documents for the association can provide protection. One way is for the declaration to make the obligation to pay assessments a personal obligation of the original owner, even if the owner loses the home due to foreclosure. This gives the association the right to pursue collection of the unpaid assessments from the original owner after foreclosure. While this may not be helpful if the original owner is truly without assets, there are circumstances where owners "give the keys" to their lenders because their homes have dropped in value below the mortgage amount, but not because of the owners' ability to pay. In those circumstances, an association may decide to pursue collection against the original owner.

As a second modification to the typical association documents, a subsequent purchaser must pay the unpaid assessments of the prior owner, even if the lien for those unpaid assessments was extinguished by a foreclosure of the prior first mortgage. Thus, when the new owner buys the home from the first-mortgage holder (who has foreclosed), the new owner must pay the unpaid assessments to avoid a default with the association.

This second modification is more controversial. It has the immediate effect of decreasing the price that the first-mortgage holder can obtain for the home (because purchasers know they must pay the past due assessments). That may ultimately diminish the willingness of mortgage lenders to lend on that particular property. In the current climate where credit is very tight, a developer may not want to further restrict the ability of its potential customers to obtain credit.

Implementing the changes noted above in an existing association requires the association's counsel to examine the association documents and, in particular, the requirements for amendment. Often, amendment of an association's documents requires consent of first mortgagees, if the change affects their interests, and counsel should evaluate that requirement in this context. In addition, while some state courts have reviewed these types of provisions and upheld them, other states are not bound by those decisions. Thus, consultation with counsel to review the relevant state law and court decisions before moving forward on these types of changes is necessary.

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