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THE COMMUNITY ASSOCIATION LAW
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Assessment Collection:

The Do's and Don'ts Regarding Assessment
Collection

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I. UNFORESEEN COLLECTIONS ISSUES.

A. First Mortgage Holder Foreclosure.

As a result of the recent volatility in the credit markets, a number of community associations are experiencing an increased number of homes being foreclosed upon by banks and other holders of first mortgages. This phenomenon, unfortunately, is beginning to affect not only a community association's ability to collect delinquent assessments, but the community association's ability to provide vital services to its clients.

The first question that comes to mind concerning first mortgage holder foreclosures is "when does a community association know a house is being foreclosed by a first mortgage holder?" Pursuant to law, first mortgage holders, prior to conducting a trustee sale (which is where the property will be foreclosed and sold to remedy the delinquent mortgage), must send the community association a "Notice of Trustee Sale." The Notice of Trustee Sale must also be recorded in the county where the property is located. The Notice of Trustee Sale must be sent to anyone who has a recorded interest or lien (such as a community association) in the property.

Once the association has received the Notice of Trustee Sale, the community association should determine whether the owner is delinquent in their assessments. If the owner is delinquent in their assessments, the community association may make a claim to the Trustee for any excess proceeds if the property is sold at a Trustee's sale. Excess proceeds are monies obtained by selling a property at a Trustee Sale that are over and above the amount owed to the first mortgage holder. Since, in most cases, a community association's lien for delinquent assessments is second in priority to that of the first

mortgage holder, any excess proceeds should go to the community association to satisfy any delinquent assessments and other statutorily collectible amounts owed.

In order to secure excess proceeds, the community association, pursuant to A.R.S. §33-812 must make a written claim to the Trustee (whom is the person who will be holding the money once the Trustee Sale takes place) requesting that the Trustee release any excess proceeds gained to satisfy the owner's delinquency with the community association. The letter should include:

1. The amount of the delinquency and proof of the delinquency (a customer ledger will usually suffice as proof of the delinquency);
2. A statement as to the community association's lien priority;
3. A statement showing the association is entitled to excess proceeds (reference to the CC&Rs or appropriate statute regarding the assessment lien of the association should suffice).

If the Trustee, after receipt of the above notice letter, fails to deliver any excess proceeds to the community association, the community association's right to collect attorney's fees should it have to institute legal action to collect the excess proceeds will be saved. It is because of this that the above notice letter is so important and should be sent upon receiving a Notice of Trustee sale.

In the event that after the Trustee Sale there are no excess proceeds and the property has reverted to a third party, then the association's lien will be extinguished. Consequently, the association would not be entitled to collect any assessments or attorney fees incurred prior to the date of the Trustee Sale from the new owner. Nonetheless, the association may still pursue the previous homeowner in justice court by obtaining a money judgment in the hope that the homeowner will obtain future assets that the association could garnish in order to recover what it is owed.

Finally, it is important to understand that when a property is sold at Trustee Sale, the new owner is responsible for assessments from the date of the sale forward. You can determine who the new owner of the property is by looking at the Trustee Sale Deed. Thus, if the property reverts back to the first mortgage holder, the first mortgage holder will be responsible for assessments from the date of sale forward. The first mortgage holder is also responsible for complying with all of the restrictions of the association whether the property is occupied or not.

First Mortgage Holder Foreclosure Do's and Don'ts

Do know what a Notice of Trustee Sale looks like;

Do immediately act on a Notice of Trustee Sale when you receive it by either acting on it or sending it to the association's attorney for appropriate action;

Don't forget to obtain the Trustee Sale Deed and begin to bill the new owner for all assessments and charges that occur after the date of the Trustee Sale.

B. Bankruptcy.

Another unexpected collections issue occurs when an owner declares bankruptcy and ceases paying their assessments. When an owner declares bankruptcy, the association must cease all collections activities, including the sending of collection demand letters and filing of Notices of Claim of Lien.

It is important to remember that bankruptcy affects any money owed to the Association prior to the filing of the bankruptcy. A bankruptcy filing does not necessarily affect assessments incurred after the bankruptcy has been finalized.

Upon the receipt of a Notice of Petition for Bankruptcy (typically a Chapter 7 filing or a Chapter 13 filing), the association should prepare a statement concerning the declaring owner's account. Once the statement has been prepared, it should be sent to the Association's attorney.

At this point, the association's attorney will intervene on behalf of the association by filing a Notice of Appearance with the Bankruptcy Court informing the Court that the attorney is representing the association. The attorney will also file a Proof of Claim with the Bankruptcy court that substantiates the debt owed by the owner to the association.

If the owner files a Chapter 7 bankruptcy and decides to keep their home, the association does have the opportunity to collect the delinquent assessments from the owner. If the owner refuses to pay the delinquent assessments, the association may petition the bankruptcy Court to lift the bankruptcy stay of collections enforcement and foreclose on the property. If the owner decides to not keep the property, then the Association may not be able to recoup its delinquent assessments.

If the owner files a Chapter 13 bankruptcy, the association may petition the court to include the association's delinquency in the payment plan created by the Bankruptcy Court. Because a Chapter 13 bankruptcy creates a payment plan, it is important that the association immediately petition the court to be included in the payment plan.

Bankruptcy is a complicated matter. Because of this, it is important that the Association rely on the advice of its attorney to aid in navigating the process.

Bankruptcy Do's and Don'ts

Do know what a Notice of Petition for Bankruptcy looks like;

Do prepare a customer ledger;

Do immediately contact the association's attorney when you receive a Notice of Petition for Bankruptcy.

II. THE BASIS OF ASSOCIATION COLLECTIONS – THE ASSOCIATION'S ASSESSMENT LIEN.

Without assessments, an association would be unable to function. An association's rights and abilities to collect assessments are provided in both the association's CC&Rs and Arizona statutes. As an operation of law, community associations have automatic, statutory liens pursuant to A.R.S. §§ 33-1256(A) (condominiums) and 33-1807(A) (planned communities). They also have a lien under the restrictive covenants of the association. This section will explain the difference between the statutory lien and the contractual lien as well as discuss lien priority.

A. The Statutory Lien

A.R.S. §33-1256 (the Arizona Condominium Act) and A.R.S. §33-1807 (the Arizona Planned Community Statute) define what charges constitute an association's lien and its rights to foreclose. For example, A.R.S. §33-1807 of the Planned Community Statute, which, in relevant part mirrors A.R.S. §33-1256 of the Condominium Act, provides:

The association has a lien on a unit for any assessment levied against that unit from the time the assessment becomes due. The association's lien for assessments, for charges for late payment of those assessments, for reasonable collection fees and for reasonable attorney fees and costs incurred with respect to those assessments may be foreclosed in the same manner as a mortgage on real estate but may be foreclosed only if the owner has been delinquent in the payment of monies secured by the lien, excluding reasonable collection fees, reasonable attorney fees and charges for late payment of and costs incurred with respect to those assessments, for a period of one year or in the amount of one thousand two hundred dollars or more, whichever occurs first. Fees, charges, late charges, monetary penalties and interest charged pursuant to section 33-1803, other than charges for late payment of assessments are not enforceable as assessments under this section. If an assessment is payable in installments, the full amount of the assessment is a lien from the time the first installment of the assessment becomes due. The association has a lien for fees, charges, late charges, other than charges for late payment of assessments, monetary penalties or interest charged pursuant to section 33-1803 after the entry of a judgment in a civil suit for those fees, charges, late charges, monetary penalties or interest from a court of competent jurisdiction and the recording of that judgment in the office of the county recorder as otherwise provided by law. The association's lien for monies other than for assessments, for charges for late payment of those assessments, for reasonable collection fees and for reasonable attorney fees and costs incurred with respect to those assessments may not be foreclosed and is effective only on conveyance of any interest in the real property.

There are several differing portions of this statute to consider regarding the Association's lien:

- The lien arises when “the assessment becomes due”. This does not necessarily coincide with when the delinquency arises. If you have an annual assessment “payable in installments, the full amount of the assessment is a lien from the time the first assessment installment becomes due. (Annual assessments? Quarterly assessments? Monthly assessments? Or annual assessments payable in quarterly or monthly installments? This may be document specific.)
- The assessment lien includes “assessments, for charges for late payment of those assessments, for reasonable collection fees and for reasonable attorney fees and costs incurred with respect to those assessments” incurred in connection with collecting on the unpaid lien. These charges all comprise the lien and are, therefore, subject to foreclosure.
- The assessment lien may only be foreclosed “if the owner has been delinquent in the payment of monies secured by the lien, excluding reasonable collection fees, reasonable attorney fees and charges for late payment of and costs incurred with respect to those assessments, for a period of one year or in the amount of one thousand two hundred dollars [\$1,200] or more, whichever occurs first.”
- Subsection H of this statute mandates: “A judgment or decree in any action brought under this section shall include costs and reasonable attorney fees for the prevailing party.” A frequent argument raised by defendants is that attorney fees are not recoverable unless and until a principal amount owing is reduced to judgment. From a practical standpoint, this argument does not make sense because subsection A provides that reasonable attorney fees and costs are a part and portion of the lien, which may be foreclosed. The statute does not say that the lien amount must be first adjudicated and attorney fees may only be awarded upon receipt of a final judgment. Following that

argument, an association would have no incentive or reason to conclude its foreclosure action short of securing a final judgment and would, therefore, be forced to incur additional attorney fees for which the homeowner would eventually be liable to pay, so long as such fees are reasonable. The apparent conflict between the language of these provisions seems to resolve in favor of a common sense understanding that fees are included in the lien without securing a judgment, but the fees are limited by a reasonableness standard. Arizona case law identifies the factors for determining the reasonableness of attorney fees. *See Schweiger v. China Doll Restaurant, Inc.*, 673 P.2d 927, 138 Ariz. 183 (Ariz. App. 1983). In *China Doll*, specific guidelines are enumerated for courts considering attorney fee applications in cases where the parties have agreed, by contract, that the prevailing party is entitled to recover "reasonable" attorneys' fees.

B. The Contractual Lien.

In addition to the statutory lien, an association has a "consensual" or contractual lien pursuant to its Declaration of Covenants, Conditions and Restrictions (the "CC&Rs"). The CC&Rs are a contract under Arizona law, regardless of whether an owner reads or signs them. The contractual lien includes those fees and charges specifically listed in the CC&Rs. By example, those fees and charges could include assessments, late fees, collections costs, attorney's fees and costs of enforcement. Normally, one may determine what fees are included in the CC&Rs contractual lien by looking at the Assessments Section of the CC&Rs.

C. Lien Priority.

In Arizona, an association's lien is second in priority to the following liens:

1. Liens and encumbrances recorded prior to the recordation date of the CC&Rs;
2. Recorded first mortgages or contracts for sale;
3. Liens for real estate taxes and other governmental assessments directly related to the property; and
4. Property taxes.

Mechanics' and materialmens' liens and liens of other associations are exceptions from this priority scheme. See A.R.S. §33-1256(C) and A.R.S. §33-1807(C).

Association Lien Do's and Don'ts

Do understand the difference between the Statutory Lien and the Contractual Lien;

Do understand the association's lien priority.

II. COLLECTION OF ASSOCIATION ASSESSMENTS - ENFORCEMENT OF ASSOCIATION LIENS.

When an owner in a community association fails to pay their association assessments, the association has several means to effectuate collection of the delinquent assessment. All collections options are based on the fact, as discussed above, that the association has a lien regarding the assessments.

There are several options concerning assessment collection. Each option will be discussed below.

A. Pre-attorney Collection Options:

i. Association Initial Collection Demand Letter;

The association, or the association's managing agent, may send owners an initial collection demand letter when owners are delinquent in paying their assessments. Most associations send an initial collection demand letter when owners are more than thirty (30) days delinquent in paying their assessments.

In addition to sending an initial collection demand letter, an association may also impose a late fee for late payment of assessments. Pursuant to A.R.S. §33-1803 (Planned Communities) "[A] payment by a member is deemed late if it is unpaid fifteen or more days after its due date, unless the community documents provide for a longer period. Charges for the late payment of assessments are limited to the greater of fifteen dollars or ten per cent of the amount of the unpaid assessment." Regarding late fees for condominiums, A.R.S. §33-1242 provides an association with the ability to impose late fees but does not limit the amount of late fees. As such, condominiums must look toward their CC&Rs to determine the amount of the late fee.

ii. Subsequent Collection Demand Letters;

The association may send subsequent collection demand letters if it so desires. The association, however, must determine whether subsequent demand letters are effective versus other collections tools.

iii. The Filing of a Notice of Claim of Lien.

Although Arizona law does not require an association to record a lien or “Notice of Claim of Lien,” filing a “Notice of Claim of Lien” is nonetheless a widespread practice and an effective collections tool.

An association’s lien arises automatically and is deemed “recorded” as of the recording date of the CC&Rs. However, recording a “Notice of Claim of Lien” when a delinquency arises does not adversely affect the automatic lien, and can be an effective collection tool. Recording a “Notice of Claim of Lien” also provides additional notice to title companies insuring transfers of title and providing contact information for lien payoff requests

Recording the notice of claim of lien is also an effective tool for ensuring that any payoff requests will be supplied to the proper address.

Some older CC&Rs require 30 days notice before acting to enforce a lien or may require the association to first send a “notice of intent to lien letter”. CC&Rs should be carefully examined for these procedural requirements before commencing with any lien enforcement action.

B. Attorney Collections Options:

i. Pre-Litigation Demand Letter;

Pre-Litigation Demand Letters are sent when an owner’s account is generally three to four or more months delinquent or when directed by the association’s Board of Directors. Pursuant to the U.S. Federal Fair Debt Collection Practices Act, the delinquent owner must be given thirty-five (35) days to either pay their account in full, set up some sort of payment agreement or dispute the debt.

ii. Personal Money Judgments Lawsuits;

If the Pre-Litigation Demand Letter does not result in payment of the debt owed or the institution of a payment arrangement between the association and the debtor, the association may seek to collect the debt through court action.

Under general CC&R provisions, an owner is personally liable for unpaid assessments and the association may file a lawsuit against the owner to collect the delinquency. For collection of relatively small delinquencies (i.e., less than \$1,000.00), many associations choose to file personal judgment lawsuits in Justice Court, which has a jurisdictional limitation for disputes of less than \$10,000. Justice Court can provide a less expensive and more efficient means of obtaining a personal money judgment against an owner, as opposed to the more costly route of filing in Superior Court.

Once the personal judgment lawsuit is filed and served, the defendant has twenty (20) days (or 30 days if served out of state) to file an answer. If the defendant fails to file an answer, the association may file an Application for Entry of Default. The defendant then has ten (10) days from the date the Application for Default was filed to respond with an answer or responsive pleading. If no answer is filed within this timeframe, “default” is automatically entered in the case and the association may then request a default judgment in the association’s favor.

In the event of default, judgment can generally be obtained in as little as two to three months. If the defendant appears and contests the personal judgment lawsuit, the association must then prosecute the lawsuit to conclusion by either filing a Motion for Summary Judgment or, in rare circumstance, proceeding with a trial.

Personal judgment actions are generally less expensive than a foreclosure suit in both attorney fees and costs because of the differing level of complexity. However, an association is entitled to recover its reasonable attorney fees and costs in the case.

A judgment is an official declaration by the Court that the money is owed. Once recorded, the judgment becomes a lien on any real property (not just the property located within the association) in any county in Arizona where the judgment is recorded. This “judgment lien” may be subject to the statutory homestead exemption and is generally dischargeable in bankruptcy. However, an association may utilize the money judgment to pursue wage garnishments and bank garnishments to collect on the judgment. Additionally, if the association finds its collection efforts on the money judgment unfruitful, it is not precluded from proceeding with foreclosure.

iii. Foreclosure Lawsuits:

In addition to the owner’s personal responsibility, unpaid assessments are secured by a lien against the owner’s property, which may be foreclosed. In Arizona, associations do not have the “power of sale” to conduct foreclosures in the same way that mortgages are foreclosed (i.e., through a “trustee’s sale”.) An association must proceed with “judicial foreclosure”. In other words, the association must file a lawsuit in Superior Court seeking a judgment on foreclosure.

Because the lawsuit affects title to the property, a “Notice of *Lis Pendens*” (literally meaning “a suit pending”) must be filed and recorded. This informs any potential buyer or transferee that he/she will take the property subject to the pending foreclosure lawsuit and any final judgment entered in that case, unless the litigation is satisfied and a “Release of *Lis Pendens*” is recorded. This also notifies title companies

that may be handling a sale or refinance of the property that the lien must be cleared before transferring title.

Unlike a personal money judgment lawsuit, a foreclosure lawsuit may typically name several defendants, including the record title owners and any junior lien holders (i.e., a second mortgage, judgment liens, liens for unpaid income taxes, etc.). If the record owners are possibly deceased, the unknown heirs and devisees may also be named and would be served by publication. The association's lawsuit would seek a judgment foreclosing all interests in the property that are junior to the association's lien interest in the property. (See "lien priority" above.) It is not unusual for a junior lien holder with a sizable interest in the property (such as a second mortgage) to contact the association and pay the full balance of the delinquency, including attorney fees and costs, to protect its interest from the threat of foreclosure.

Similar to the money judgment lawsuit, the defendants must appear and file an answer within 20 (or more) days after they are served. A default judgment may be secured if the defendants fail to appear and contest the lawsuit. If a defendant appears and answers, the matter is generally resolved promptly on a Motion for Summary Judgment in the association's favor. Very few cases require a trial and, therefore, associations generally secure judgments on foreclosure if the case is not resolved by payment in full or settlement. The judgment will generally include an award of the principal amount of unpaid assessments, together with the attorney fees and costs incurred and interest.

After a judgment has been awarded, in order to recover the delinquency, the county Sheriff's office may be instructed to sell the property to satisfy the judgment. A

“writ of special execution” is issued by the Court instructing the Sheriff to conduct the sale. After posting and publishing notice of the sale, the property is auctioned off to the highest bidder at the Sheriff’s offices, or any other place designated in the notice. If no one bids on the property, the association will take title to the property for the amount of its bid. With title to the property, the association may sell the property in an effort to satisfy the amounts owing.

If a purchaser outbids the association at the auction, the purchaser must deliver cash or a cashier’s check to the Sheriff’s office within five (5) days from the sale. Upon receipt of the sale price, the Sheriff will issue payment to the association in the amount of its judgment, interest and costs incurred in connection with the sale. The association is also responsible for payment of a commission to the Sheriff for successfully selling the property and satisfying the delinquency.

After the sale, the owner’s interest is foreclosed, but he/she still has time to redeem the property. The owner has a statutory redemption period (generally six (6) months unless the property is abandoned, then thirty (30) days) in which the owner can redeem the property and regain full title to the property by paying the total amount of the sale price, plus interest and an 8% penalty. Following the owner’s redemption period, junior lien holders in their order of priority may also redeem the property and secure title to the property by payment the full redemption amount. The redemption payoff is generally provided by and handled through the Sheriff’s office that conducted the sale. If the property is redeemed within the redemption period, the owner takes back all rights and interest in the property as if the foreclosure and sale never occurred; however, the association is paid in full.

If the owner or any junior lien holder fails to redeem the property within the redemption period, the purchaser (including the association if it was the successful bidder at the sale) may then request and the Sheriff must issue a “Sheriff’s Deed” to the purchaser, subject to any liens that were not foreclosed through the foreclosure process or liens that may have attached during the redemption period. With a recorded Sheriff’s Deed in hand, the purchaser is generally considered to hold good and marketable legal title as owner of the property.

This document is intended to provide general information. It does not and cannot provide specific legal advice. For specific legal advice, you should contact an attorney. For additional information or answers to questions, you may contact Augustus H. Shaw IV, Esq. or Mark E. Lines, Esq. at 480-456-1500 or send questions to ashaw@shawlines.com.