

## **OUR FIRM'S GUIDE TO THE COLLECTIONS PROCESS**

The process by which communities go through the collection of assessments is more important than ever. Community associations are more heavily impacted than at any time since the passage of the Condominium Act in 1963. Likewise, homeowner associations also face unprecedented rounds of foreclosures. Unlike the federal government, community associations cannot run deficits. Thus, assessment shortfalls cause harm to paying members by creating disarray within the community, and may result in the need for increased assessments.

The following outline details the rights and remedies of associations in Florida. This presentation is limited to entities governed by Chapter 720, Florida Statutes, (with a few references to condos) and will be referred to as "HOAs."

### **MYTHS & FACTS ABOUT THE COLLECTIONS PROCESS**

There are a number of fundamental misunderstandings that must be cleared before discussing the matter in detail. The most fundamental misunderstanding is as follows: "We don't want to foreclose because if we take title, we don't want to have to pay the first mortgage!"

To understand the collections process, we must understand the nature of the obligation to pay assessments and, for that matter, to pay a lender when property is purchased.

When an owner purchases property, the owner signs a note, which is a contract between the lender and the buyer. The contract provides that if the note is not paid, the lender may sue the owner and obtain a money judgment against the borrower if the note is not paid. This is a contract solely between the borrower and the lender. The Association is not a party to the contract, and therefore, there is no promise to pay the lender.

When an owner borrows money to buy a property, that owner is almost always required to sign a mortgage. The mortgage is a security interest in the property. It is not a promise to pay, and it does not involve the Association or any other party. It simply puts the world on notice that somebody borrowed money. The note is typically referred to in the mortgage and states that in the event that the note is unpaid, a remedy of the lender is to foreclose.

Similarly, when someone buys property in an HOA, the Declaration is a contract between the Association and the owner. The Declaration sets the rights of the parties and generally provides that if an owner does not pay assessments, the Association may sue the owner and obtain a money judgment, or file a lien and foreclose against the owner.

The law and just about every Declaration provides that a first mortgage holder is superior to any claim of lien against the property that may be filed by the HOA. Why is that? Because no lender would lend, and real estate commerce would come to a halt, if lenders knew that their security interests could be affected by the foreclosure of a lien for unpaid assessments.

So, to dispel that notion, the Association is not obligated to pay anybody anything if it forecloses and takes title! In the vast majority of cases, a third party takes title and the Association is paid in full.

## **WHAT ARE THE STEPS IN THE COLLECTION PROCESS?**

### **WHAT IS THE TIME LINE, AND WHAT ARE THE RIGHTS OF THE PARTIES?**

First, it is vital to note that every Association needs to follow its own budgeting requirements. Strict compliance with the budget provisions set forth in the Governing Documents and notice requirements of law must be followed to the letter. If a mistake is made in the adoption of an increase in the budget or a special assessment, that mistake could be fatal to the ability of the Association to collect payment. Courts do not look kindly on Associations that do not “dot their i’s and cross their t’s,” as it is a violation of the contract between the owner and the Association.

In the collection process, enforcement of unpaid assessments is enforcement of a contract. Failure to do so may result in significant issues, including denial of the ability to collect payment and the award of prevailing party's attorneys' fees. What is the moral of the story? Make sure that assessments, budgets, and special assessments are properly noticed, levied, and that proper minutes, notices and records exist.

We have developed an aggressive approach to collections to ensure our clients are protected. The steps, in no particular order, are as follows:

**1. Adopt a uniform collection policy.** The rules must be crystal clear assessments are due on a certain date, and that notification of unpaid assessments will be sent by regular mail within a certain relatively short time period (10 or 15 days) after the due date as a “friendly reminder.” The start of the formal collection process will begin as soon as allowed under the Governing Documents. It is vital that owners are aware that this is one bill they must not ignore. Under Florida law, the holder of a money judgment cannot sell homestead property to satisfy that judgment. On the other hand, a Condominium Association or HOA can sell homestead property for unpaid assessments. Many do not realize that power can lead to sale of their home on the courthouse steps.

**2. Actual costs may be recovered.** The burden on management companies in tracking all of these delinquent owners is severe. They are forced to hire personnel, invest in new computers, software programs, and

incur a number of costs in order to keep up with the crushing number of delinquent owners. Perhaps in recognition of this, in 2007, the legislature changed the law so that costs incurred by the Association can be recovered as part of the initial demand.

We urge our clients to discuss this with management in order to authorize imposition of a cost recovery system for management to offset its internal costs in providing these additional delinquent tracking services to Associations. Without such provisions, managers are caught between a rock and a hard place. They must either pass on these increased costs in the form of higher “per door” fees, which means that people who pay their assessments on time will be forced to pay for the costs of keeping track of delinquents, or delinquent owners can pay for the costs that they impose on the management company, allowing management companies to forgo such costs to paying owners.

### **EXPLANATION OF STEPS IN THE COLLECTION PROCESS**

The first formal action taken is commonly referred to as the “45-day letter” for an HOA, and a “30-day letter” for a Condominium Association. While this letter is not required to be sent by a lawyer, the law provides that, in connection with this letter, the Association may recover legal fees, interest, late fees, and actual costs the HOA incurred in the preparation and sending of the letter. Such letters often result in payment of delinquent assessment, and thanks to ability to recover fees, costs the Association nothing.

Given that most managers and management companies are not set up to handle this type of payment, the vast majority of our clients have authorized management to send a preliminary “friendly reminder” referred to above, then have our firm send the “45/30-day letter.” A practical reason for this is that managers who send their own letters out must be able to account for the monies collected. The actual costs need to be deducted and distributed to the management company, while the assessment, late fees and interest are disbursed to the Association. Management must avoid commingling the Association’s money with their own, as they may find themselves in a real legal predicament if they are not careful. Traditionally, about 1/3rd to 2/3rds of delinquent owners pay, in full, upon receipt of this initial demand letter, or lien, discussed below.

The second step is to prepare a Claim of Lien along with another 45-day demand letter. This will include additional interest, costs, late fees, and attorneys' fees. This letter must be sent by certified mail, return receipt requested, as well as by regular mail. A Claim of Lien is then recorded in Official Records and provides notice the Association claims a property interest in the lot subject to the Declaration. This letter warns that if the amounts due are not paid, the HOA may foreclose the Claim of Lien, or seek a money judgment against the delinquent owner.

When a tenant resides in a unit in the collections process we have the ability to seek a receiver to be appointed to collect the tenant's rent and forward it to the Association. This money pays all legal fees and costs incurred by the Association until paid in full. Naturally, we love well behaved tenants, as they are the source of

payment for the Association. In a condominium, where a unit is “abandoned” as defined by law, a receiver may be appointed to enter the unit and rent it pending lien or mortgage foreclosure. The Tankel Law Group's historical average for collections being paid in full at this point are about 2/3rds of the delinquent owners.

### **ENFORCEMENT OF THE LIEN AND OBLIGATION TO PAY**

When a delinquent owner has not paid in full after the expiration of the lien demand period, legal action is required. Several steps must be taken before a legal action may be filed in court.

To begin, a title search is required. The report must be analyzed because the Association must sue everyone with an inferior interest in the unit; otherwise, it will not obtain “clean” title with respect to inferior encumbrances on the property. Additionally, the proper persons need to be named in the suit. Frequently, owners will take title in the name of a trust or a corporation. In a legal action, everyone must be named and their proper name must appear in the body of the lawsuit.

When a Complaint is prepared, the Association may seek two remedies: The first remedy is the foreclosure of the lien. This is the remedy our firm almost universally seeks. It results in the sale of the property on the courthouse steps if the owner does not pay before the lawsuit concludes. Foreclosure is what is known as an “action in equity.”

The second remedy available is an “action at law” for money damages. Our firm rarely seeks money damages. A money judgment must be executed, and substantial additional legal work needs to be done with regard to determining what assets might be available to satisfy the judgment. Remember, the lien right is superior to homestead, so a foreclosure can divest the owner of title, even to a homestead property, while enforcement of a money judgment cannot be used to sell homestead property. Thus, because the Association must choose between its remedies, foreclosure results in the greatest and most efficient recovery.

Once the unit is sold, if the former owner is in possession the sheriff can eject the owners from the property in a writ of possession action. Such an action has resulted in payment to the Association. Once a unit is vacant, it can be rented (pending foreclosure of the first mortgage).

### **FORECLOSURES - OFFENSE AND DEFENSE**

Prior to the crash, our firm routinely stopped prosecuting the Association’s action to collect when there was a first mortgage foreclosure. This is because the foreclosure of a first mortgage will wipe out the claim of lien the Association has in the property. The theory was, “why throw good money after bad?”

Despite the relative economic recovery, our process has changed since the crash. Mortgage foreclosures that formerly took six months may now take two years. Big lenders who file first foreclosures frequently may take months to move ahead just one step in the process. Many lawyers take such foreclosures to the point of sale, then

stop. These lenders are overburned with repossed property. No mortgage holder wants more property to have to pay assessments on, insure, maintain and repair. This is why the collections process is a “race to the courthouse steps.” Quick acting Associations beat the mortgage holder to the foreclosure, take title, and either selling or rent the property.

### **THE CORAL LAKES CASE AND “REVERSE FORECLOSURES”**

In 2010, a seminal case held that Section 720.3085 Florida Statutes, which requires a first mortgage holder who forecloses pay 1 year or 1% of the mortgage, is unconstitutional as a retroactive impairment of contract. **Thus, many HOA’s will receive no past-due assessments when a first mortgage forecloses.** As stated above, the Declaration is a contract and cannot be retroactively affected by future law changes. The 2008 Safe Harbor Law will not apply to pre-2008 Declarations unless they incorporate changes in the law, or are amended to do so. The law only applies to foreclosure of mortgages that were entered into after July of 2008.

Based on this case, it is more important than ever HOA’s move as quickly as possible to collect assessments from delinquent owners. If they do not, a lender may drag out the foreclosure process, take as long as two or three years before it fully forecloses, and finally finish when and if it has a buyer for the property. Collection of past assessments may be put into jeopardy. HOA’s can no longer count on receiving a year of assessments upon foreclosure.

### **WHAT’S THE MORAL OF THE STORY?**

The Board has a fiduciary duty to collect assessments. If homeowners in a community decide there is no hazard for avoidance of assessments, the unpaid assessments problem will worsen. Homeowners who do pay will feel the brunt of the impact and grow frustrated. The Board needs to be proactive, and take prompt and effective action to collect unpaid assessments. Many pay upwards of \$200 a month for cable or satellite television, high speed internet, cell phones, Netflix, Hulu, and other unnecessary items yet neglect their assessments which causes harm to others. Ensuring these funds are collected enables communities to remain healthy.