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President's Luncheon & Annual Meeting

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**Legal Options for the Nevada Homeowner
Trustee's Sale Process in Nevada • HOA Foreclosure and Priority
Remembering Our Colleagues: Attorney Memorial Service
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The HOA Foreclosure and Priority: Who Is In First?

By Melissa Waite

Many of us own or rent a home in a Common Interest Community, commonly referred to as a Home Owner's Association ("HOA"). Many others have strategically attempted to avoid a neighborhood subject to the various restrictions an HOA puts in place, particularly the requirements of complying with the Declaration of Covenants, Conditions and Restrictions ("CC&Rs") and paying association dues to fund the operation of the HOA, maintenance of the common area, and enforcement of the CC&Rs. In 1991, Nevada adopted, with certain modifications, the provisions of the Uniform Common Interest Ownership Act (1982) and today HOAs in Nevada are governed by NRS Chapter 116 known as the Nevada Uniform Common Interest Ownership Act ("NUCIOA").

HOA Super priority lien

Prior to the downturn in the real estate market, the incidence of foreclosure and the implication of the foreclosure provisions applicable to HOAs in the NUCIOA were not frequently encountered. When Nevadans began defaulting on their home loans, more frequently than not, they also stopped paying their HOA association dues. Following the rampant defaults on home loans, banks began to foreclose on their deeds of trust, which in turn triggered applicability of the HOA's "super priority lien." This is a statutory lien created by NRS 116.3116(2), which essentially provides that the HOA's lien is prior to all other liens, except (i) liens recorded against the property before the CC&Rs, (ii) first deeds of trust, and (iii) real estate taxes or other governmental assessments. NRS 116.3116(2) also sets forth an exception to these exceptions, which makes a portion of the HOA lien (the amount of 9 months of assessments) prior to the first deed of trust, hence the name "super priority."

First position bank foreclosing on its deed of trust

Until recently, the most common scenario was a first position bank foreclosing on its deed of trust, after which the bank would voluntarily pay to the HOA the amount equal to the nine months of assessments to "extinguish" the HOA's lien, resulting in clear title to the third party bidder

or the bank, as the case may be. If this amount is not paid after the foreclosure sale, it would arguably remain a lien on the property which itself could subsequently be foreclosed.

Wave of HOA initiated foreclosures

Due to market forces and new legislation, banks slowed or in some cases altogether halted their foreclosure proceedings. A corresponding impact to HOAs was that they stopped receiving payment from the foreclosing bank for the nine month super priority lien. This put HOAs into a difficult financial position and led to the next wave of foreclosures—foreclosures initiated by the HOA. The frequency of third party bidders successfully purchasing a property at an HOA foreclosure sale has increased drastically in the last two years. According to statistics published by the State of Nevada Department of Business and Industry-Real Estate Division, there has been a marked increase in both the number of foreclosures initiated by HOAs and the number of properties sold to a third party at an HOA foreclosure sale. For the fiscal year ending June 30, 2012, there were a total of 2,913 Notices of Sale reported by HOAs and 244 properties were sold to a third party bidding at the sale. For the fiscal year ending June 30, 2013, there were a total of 3,811 Notices of Sale reported by HOAs and 1,151 properties sold to a third party bidding at the sale. The HOA foreclosure sales prices are very low in relation to the fair market value of the property being sold and investors typically pay slightly more than the amount owed to the HOA, with a typical sales price being between \$3,000-\$12,000.

Historic & customary conduct in Nevada

Historically, banks have ignored HOA foreclosure sales, relying on the customary course of dealing in Nevada, which suggested that the primary threat of extinguishment of their deed of trust would come from a borrower's failure to pay property tax. Title companies routinely issue to banks a lender's title insurance policy insuring a first position security interest subject to few exceptions and not specifically including amounts payable to an HOA. The banks also relied on subordination or mortgagee protection clauses in the CC&Rs as a "belt and suspenders" protection. Banks were

seemingly unaware of any ambiguity in the NUCIOA, as were third party bidders who historically were rarely willing to pay much more than the amount owed to the HOA, presumably because it was understood they would not be acquiring the property free and clear of liens. However, all of those concepts which historically seemed to be so widely accepted and never before questioned, are now being examined in great detail.

Current litigation

In an instance where the HOA initiates and completes a non-judicial foreclosure and there is a first position deed of trust on the property, the question has now become: is the super priority lien a right to payment or is it a senior lien that will cut off the rights of the first position bank? Who is really in first? Is it the bank that has a “first position” deed of trust? Or is it the HOA who has a “super priority lien” that can cut off the rights of a bank that would otherwise be in first position? This issue has led to a spike in litigation in both the Nevada and federal courts. Third party bidders and banks have filed requests for injunctions to halt the other parties’ pending foreclosure and actions for declaratory relief or quiet title requesting that courts rule on this issue. Currently it is estimated that there are over 50 appeals pending in the Nevada Supreme Court on the issues related to

the effect of an HOA foreclosure. Countless cases have been stayed in the lower courts pending a binding decision by the Nevada Supreme Court.

Non-binding authority

A majority of the arguments from both the third party bidders and banks relate to statutory construction of various provisions of the NUCIOA and are far too complex to detail in this article. The center of the debate revolves around NRS 116.3116(2) which states that the HOA’s super priority lien arises at the time of “institution of an action to enforce the lien.” NRS 116.3116(2). There are numerous arguments based on the canons of statutory construction as to when the lien arises and whether the term “action” refers only to a judicial action or whether it also includes a non-judicial foreclosure action. Both sides have also looked to various instances of non-binding authority to support their position, including decisions from other jurisdictions and from federal court judges here in Nevada. For example, in *Summerhill Village Homeowners Association v. Roughly*, 166 Wash. App. 625, 270 P.3d 639 (2012), the court ruled that an HOA’s judicial foreclosure of its super priority lien completely extinguished a first deed of trust. Banks have attempted to distinguish this case by arguing that in Nevada, almost all HOA foreclosures

HOA Foreclosure Priority *continued on page 28*



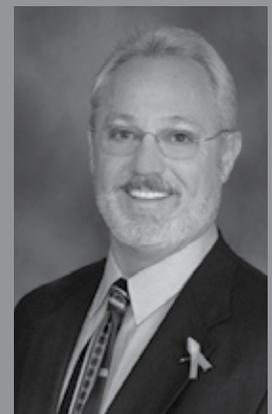
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HOA Foreclosure Priority *continued from page 27*
 are done nonjudicially and NUCIOA does not require notice to a first position bank in order for an HOA to foreclosure non-judicially. There are also several federal district court decisions that have found in favor of the first position bank holding that the HOA's super priority lien does not extinguish a first position deed of trust. *Diakonos Holdings, LLC v. Countrywide Home Loans, Inc.*, 2:12-cv-00949-KJD-RJJ, 2013 WL 531092 (D.Nev. Feb. 11, 2013); *Bayview Loan Servicing, LLC v. Alessi & Koenig, LLC*, 2:13-cv-00164-RCJ, 2013 WL 2460452 (D. Nev. June 6, 2013); *Weeping Hollow Ave. Trust v. Spencer*, 2:13-cv-00544-JCM-VCF, 2013 WL 2296313 (D.Nev. May 24, 2013); *Kal-Mor-USA, LLC v. Bank of America, N.A.*, 2:13-cv-0680-LDG-VCF, 2013 WL 3729849 (D.Nev. July 8, 2013); *Premier One Holdings, Inc. v. BAC Home Loans Servicing LP*, 2:13-CV-895 JCM GWF, 2013 WL 4048573 (D. Nev. Aug. 9, 2013). Banks are also setting forth equitable arguments and have focused on the economic impact a decision wiping out their interest would have on the lending industry in Nevada, as well as setting forth some of the practical obstacles they face. It has been reported that in Nevada, certain HOA's will not cooperate with providing payoffs to lenders and in some instances, will not accept a payment in satisfaction of a past due balance unless the lender obtains written approval of the borrower.

Third party bidders have relied on Nevada Attorney

General Opinion AG13-01, which addresses which costs an HOA can include in the calculation of the dollar amount of its super priority lien. Dep't of Business and Indus., Real Estate Div., Adv. Op. No. 13-01 (Dec. 12, 2012). In the course of the analysis set forth by the Attorney General's Office, the opinion offers the following language, albeit not accompanied by any citation to authority or other analysis, "The ramifications of the super priority lien are significant in light of the fact that superior liens, when foreclosed, remove all junior liens. An association can foreclose its super priority lien and the first security interest holder will either pay the super priority lien amount or lose its security." This opinion, although not binding on the courts, has bolstered the claims of third party bidders who are relying on this language to suggest that a bank would in fact lose its security interest following an HOA foreclosure. While there are no known Nevada district court decisions where a judge has ruled in favor of a third party bidder and extinguished a first position deed of trust, there are many instances where the courts have stayed the actions or refused to grant a bank's motion to dismiss a quiet title action and are now requiring that the parties proceed to discovery or to an expedited trial.

Until the Nevada Supreme Court clarifies the status of the law on this issue, it is anticipated that third party bidders will continue to acquire properties at HOA foreclosure sales and continue to attempt to quiet title to the property and cut off the rights of the first position bank. Banks will continue to defend against these suits and attempt to avoid a scenario where their first position deed of trust is extinguished. We can only hope that we will soon have an answer to the pressing question, "Who is in first?"

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