



Collections Lawsuit

In late January of 2010, a group of plaintiffs sued many associations, collection companies and law firms in two separate actions, seeking reimbursement for amounts they were required to pay to the association in connection with their purchase of a foreclosed home.

All of the plaintiffs in this case were limited liability companies that purchased homes at auction. The plaintiffs did not occupy the homes and many of the homes were sold at huge profit within weeks or months of the auction. The plaintiffs generally did not provide for the upkeep or restoration of the landscaping or improve the property in any way. As a rule, the plaintiffs did not pay any assessments until either the homes were sold to a third party or they were forced to pay through collection proceedings. The suit alleges many things, but the underlying issue is plaintiffs believe that the association does not have the right to charge late fees, interest and collection costs to owners who have acquired the home through foreclosure.

Association Liens and Assessments

NRS 116.3102 (2) empowers an association to assess homeowners for common expenses. The association has lien rights for assessments through the CC&Rs. Other liens can be attached to a home through a mortgage, second mortgage, home equity line of credit, or other methods. All liens are typically extinguished when a first mortgage forecloses (except tax liens, etc). The subordinate lien holders are foreclosed from collecting debts owed to them if a lien with a greater priority forecloses. However, by law, associations are granted what is known as a super-priority lien. This lien is not extinguished when the first mortgage forecloses. The super-priority lien is limited in amount to nine months of assessments. This is where the plaintiffs are trying to create an issue. What is an assessment? What assessments are included in the lien? NRS 116.3116 (1) defines the lien to include:

The association has a lien on a unit for any construction penalty that is imposed against the unit's owner pursuant to [NRS 116.310305](#), which states that *any assessment levied against that unit or any fines imposed against the unit's owner from the time the construction penalty, an assessment or fine becomes due (emphasis added).*

This section of NRS 116.3116 (1) defines three types of charges for which an association may have a lien against a unit. They are construction penalties, any assessment levied against the unit and fines. Further, the rest of section one NRS 116.3116 describes charges that are included in the term assessments.

Unless the declaration otherwise provides, any penalties, fees, charges, late charges, fines and interest charged pursuant to paragraphs (j) to (n), inclusive, of subsection 1 of [NRS 116.3102](#) are enforceable as assessments under this section.

And NRS 116.3102 (j) to (n) includes:

(k) Impose charges for late payment of assessments.

Based on the above, it appears that late fees, interest and collection fees are enforceable as assessments. This is important because the association only has a lien for assessments. Only charges that are included in the lien can be included in an action for foreclosure by the association.

The plaintiffs argue that even though these costs might be assessments, they are not included in the super-priority. This may be an interesting argument, but it is not supported by NRS, or case law. NRS 116.3116 (2) states:

2. A lien under this section is prior to all other liens and encumbrances on a unit except:

It then lists the three exceptions, which include 2(b), a first security interest. However, the section then goes on to state an exception to the exceptions, which creates the super-priority lien as follows:

The lien is also prior to all security interests described in paragraph (b) to the extent of the assessments for common expenses based on the periodic budget adopted by the association pursuant to [NRS 116.3115](#) which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien.

Common expense is a defined term. In NRS 116.019, it states:

“Common expenses” means expenditures made by, or financial liabilities of, the association, together with any allocations to reserves.



Therefore, a common expense is any valid expenditure or liability of the association. Clearly, collection costs are a financial liability of association. If the association cannot collect the collection costs from the delinquent owner, then every owner will have to pay them through their assessments.

This is a convoluted way to say that the association assessment lien is wiped out except for a nine-month portion commonly referred to as the “super-priority” lien. That nine-month portion is prior to or has priority over the first-trust deed. This is a vitally important point and we will discuss this a little later. Some argue that the super priority only relates to items included in the budget as NRS 3116 states it is for: “assessments for common expenses based on the periodic budget adopted by the association pursuant to [NRS 116.3115](#).” Section 116.3115 describes the procedures and requirements surrounding association budgets and assessments to owners. While collection costs are not typically included in an association budget, section 116.3115 (6) states:

6. If any common expense is caused by the misconduct of any unit’s owner, the association may assess that expense exclusively against his unit.

An association cannot predict with any accuracy when a homeowner or how many homeowners will become delinquent. Therefore, it would be difficult if not impossible to estimate the amounts in the association budget. Since the association assesses the cost to the delinquent homeowner directly, it would be inappropriate to include the amounts in the budget. If they were included, the budget would have to include both the collection expense and the assessment revenue. The net effect to the budget would be zero; both revenue and expense would be increased by the same amount. One could argue that the budget for common expenses assessed to individual homeowners is created at the same time the amounts are assessed.

Case Law

In addition to the legal arguments against this case, there is also case law. In *Korbel vs. Spring Mountain Ranch*, a December 2006 Clark County district court case, the judge found as follows:

- “IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the amount of the Association’s super-priority claim shall include the following amounts:
- (a) Six (6) months of the assessments for common expenses;
 - (b) Six (6) months of late fees imposed for non-payment of the assessments for common expenses;
 - (c) Interest on the principal amount of six (6) months of the unpaid assessments for common expenses, as set forth in the Association’s governing documents;
 - (d) The Association’s costs of collection, which may include legal fees and costs, that accrue prior to the date of foreclosure of the first deed of trust; and
 - (e) The transfer fee for conveyance and change of ownership of the property foreclosed pursuant to the first deed of trust...”

This language is very clear and unequivocal. Interest, late fees and collection costs are all included in the super-priority. There are similar decisions in cases in other jurisdictions. Notably, a Connecticut Supreme Court case, *Hudson House Condominium Association, Inc. v. Brooks*, 611 A.2d 862 (Conn. 1992), has virtually the same fact pattern and the statute is virtually identical to the Nevada statute. Another case in Colorado is on point as well. In October 2009, the Nevada statute was amended from six months to nine months. That is why the judge references six months instead of nine in the decision.

Collection Costs

When a homeowner is sent to collection in Nevada, it usually means that the association has referred the account to an attorney or collection company for collection. In Nevada, a licensed collection agency or an attorney must perform the collection of HOA debt. NRS 649.020 3 (a) states:

- “3. “Collection agency”:
 - (a) Includes a community manager while engaged in the management of a common-interest community or the management of an association of a condominium hotel if the community manager, or any employee, agent or affiliate of the community manager, performs or offers to



perform any act associated with the foreclosure of a lien pursuant to NRS 116.31162 to 116.31168, inclusive...”

So in order for a community manager to perform collection, they would be required to have a license. This section was added in 2005, and the cost of collecting has risen as a result. Collection companies are subject to state and federal laws and the Fair Debt Collection Practices Act and must take steps to ensure that they are in compliance. Usually, homeowner association debt is collected through a non-judicial foreclosure procedure. Each collection must go through the same procedure regardless of the amount to be collected. The board of directors is responsible to select the attorney or collection company that will aid the association in the collection of past-due assessments. In most situations, the board will take bids from a few firms or collection companies and select the best combination of price and service offered.

Because NRS 116 outlines the procedure that must be followed to perform a non-judicial foreclosure for an association lien, collection costs are set according to a schedule determined by the attorney or collection company. The statutory procedure has many steps, and if performed in a timely manner, takes a minimum of 190 days. The cost charged to the homeowner increases with each step in the process. The largest charges are near the end of the process. Since the cost of collection is tied to the process and not to the amount to be collected, this sometimes produces odd results. The cost of collecting \$50 in assessments will be the same as collecting \$500 or \$5,000. The total cost for the collection typically starts at about \$150 and can exceed \$2,000 or more depending on how far into the process it is when homeowner decides to pay or when the foreclosure occurs. About one-third to one-half of the cost is out-of-pocket expense.

In Nevada, many collection agencies and some attorneys do not charge the association up front for their fees. They will wait to be paid at the same time the association is paid. This means that the collector will front the money to do the collection and record a receivable for their fees. This is significant for association, who otherwise would have to pay the collection companies and then be reimbursed often months later.

In consumer debt situations, the creditor may only recover a portion of the debt and costs charged to the delinquent account. Because late fees, interest, and collection are included in the association lien and are therefore secured, the association usually recovers the full amount. In cases where there is a foreclosure, the association will only recover nine months of assessments, late fees and costs.

Association Finance and Budgets

It is important to realize how collection works and who bears the cost because in an association the budget is prepared from the bottom up. In other words, the association determines its expenses and then creates an assessment to meet its needs. Associations are not-for-profit organizations and by design do not maintain extensive cash reserves. If owners do not pay their assessments, the association does not have other resources to replace that revenue. The only revenue source for most associations is the assessments charged to the homeowners. Whether the assessment is large or small, each assessment is critical for the association to meet its obligations.

Therefore, when an assessment becomes uncollectible, that amount has to be collected from every other homeowner. Uncollectible assessments are budgeted through the “bad debt” line item in the budget. **If collection costs were not allocable to the delinquent homeowner, then they would have to be included as assessment in the budget and paid by every homeowner. This could drastically increase the assessment for all homeowners. This would create a situation that would have responsible homeowners paying the way for a few bad actors.**

The assessment problem could actually be worse. Because collection costs are essentially fixed, the collection cost could be greater than the amount to be collected. It would make no sense to authorize the



collection of assessments in these situations. These assessments would go uncollected and further increase the burden on the responsible homeowners.

Summary

In closing, here are the key points to consider:

1. With high delinquency rates, homeowner associations are already struggling financially. Pushing this cost to the homeowners will further strain an already fragile industry. If implemented, financially devastated associations could become a burden to municipalities to whom they would turn to for services.
2. If successful, this lawsuit would represent a major shift in public policy. Under current practice, collection costs are payable by those who are delinquent. If the suit is successful, the costs for collecting delinquent assessments will be borne by all of the homeowners in the association. It is poor policy for a number of reasons to shift this cost to the homeowners of the association.
3. These plaintiffs are simply suing to increase their own personal profits. They do not intend to own, occupy and improve the homes they are buying, but rather are real estate speculators seeking to change existing state laws to favor their own purposes.