Effects of the Foreclosure Crisis on Homeowners Associations

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Homeowners associations, condominium associations and other common interest communities take different forms, but all rely on payments by homeowners to provide services. For some HOAs these may be limited to street care and some landscaping, while in the case of townhouses and condos, the homeowner only owns the sheetrock in and the rest of the structure and all outside amenities are the responsibility of the HOA, which every home owner owns a share of. Home foreclosures are problematic for HOAs since the owner has likely stopped paying dues before the foreclosure and once foreclosure starts they are certainly not paying dues. Once the foreclosure is complete the lender is responsible for the dues, but may be unwilling to despite their obligation (Perkins, 570). Ordinary foreclosure rates can cause hardship on HOAs with less money saved in comparison to their financial needs, but most are able to handle the occasional foreclosure with little hardship. During the foreclosure crisis, large shares of HOA homeowners were not paying dues. This caused immediate hardship for HOAs, and many have yet to recover financially. With 60% of new construction in 2000 included in a HOA or Common Interest Community, and many municipalities only allowing new residential development in HOAs, to delegate responsibility for streets, garbage and other services, the problem is sizeable.

HOA budgets are prepared annually in conjunction with the regular dues and assessments for the year. HOAs are required to not levy more than what is needed to fulfil the functions of that HOA. Together these limitations make it difficult for a HOA to cover expenses when homeowners default. They are able to levy special assessments between budgets, but are typically reserved for emergency situations, which many associations resorted to during the foreclosure crisis. HOAs dealing with significant loss in revenue can either increase regular assessments (following the terms in their governing documents), levy a special assessment, which may discourage potential buyers from purchasing as it suggests financial trouble, and cut expenses, also limited by the services guaranteed by their governing documents and fear that lower service levels will deter potential buyers. (Newton, 370-373). All of the potential options but the burden on the homeowners not in default. In general HOAs have found little success filing for bankruptcy, since some solvent members remain and the HOA has the ability to cover its debts through additional assessments (Newton 381).

Raising dues or one time assessments was a common choice for HOAs, but it has a potential domino effect. Two thirds of Florida HOAs acknowledged the need to raise dues in 2008. The larger the lost revenue, the greater the increase needed. Large increases create hardship for owners previously in good standing, potentially leading to more delinquencies. Out of fear of the domino effect, associations often chose to reduce services (Perkins, 572). Some service changes have little long term effect, such as requiring homeowners to shovel drives if the snow is less than 2 inches, but cutting reserve capital funding and delaying maintenance for a long period of time can have significant effects on home values. HOAs often chose not to address the vacant properties, since they are short on revenue, which results in disrepair and prevent quick purchases, which would allow for dues collection (Perkins 575).

While HOAs have the power to foreclose, it is rare that they use the power, since legal expenses from foreclosure often exceed the dues not received, especially when the HOA foreclosure triggers the lending institution to foreclose and the length of time for foreclosure proceedings to be finished. Instead, the power of foreclosure is powerful as a tool to prevent missed payments our of fear of foreclosure (Giantomasi, 2522). In San Francisco, 15 percent of foreclosures were initiated by HOAs, but few went through, since the homeowners legal expenses would have been greater than the amount due to the association (2524). Advocates for HOA foreclosure argue that with out the power homeowners will be less liklely to pay the required assessments (Ehlers, 205). Those opposed argue that HOAs have few checks and balances, that HOAs have greater ability to take action against delinquent homeowners, than homeowners have when the HOA does not meet its obligation, and the threat of foreclosure can lead to homeowners incurring legal expenses greater than the amount due (208).

Some states have protections against foreclosure by HOAs. These protections have been born out of stories of unjust foreclosure on the part of HOAs. Florida and California require alternative dispute resolution methods (such as arbitration or mediation) before foreclosure can be filed (Ehlers, 218). These methods are lower cost than litigation and allow for the development of a payment plan or payment in full prior to foreclosure. California also has a threshold requirement of $1,800 of default, or a year long delinquency for foreclosure to be initiated. To get around the requirement, HOAs are refusing to take payment for anything other than the full amount, in order to reach the threshold (223). Texas requires disallows foreclosure for fines imposed by the HOA or for legal expenses (Giantomasi, 2529). Alternative options for HOAs, not mandated by any state government, are the use of small claims court (a cheaper alternative to formal litigation) and collection agencies. Collection agencies may be better equipped to navigate legal options and to establish a payment plan (Ehlers, 220). Giantomasi suggests requirements for written notice to be given to the homeowner that foreclosure is being started and allow for a hearing in front of the HOA board, requiring HOAs to stop foreclosure for homeowners who pay all liens and costs within ninety days (2537).

HOA liens typically fall after the first mortgage, which in case of foreclosure is typically larger than the amount garnered through foreclosure. The HOA lien is wiped out in foreclosure. The Uniform Common Interest Ownership Act grants super-priority status for a portion of the HOA lein, typically six months of dues. Twenty-one states have adopted some form of UCIOA, including Minnesota, which adopted it in 1982. While the super-priority status allows associations to get some portion of the lien, it is well below the amount due. Foreclosure times vary greatly based on state laws and active lending institutions, but averaged 24 months during the peak of the foreclosure crisis. Lenders were so swamped with foreclosures that new staff had to be brought on to handle them, and the low sale prices of foreclosed homes did not incentivize lenders to act quickly. HOA properties with significant services were a smart choice to delay foreclosure on as the property would be maintained by the association, with no cost to the lender (Newson, 380). There is no incentive for the lender to foreclose after six months (Goldmitz, 269)

UCIOA could be amended to offer greater protections for HOAs. In its current form UCIOA does not give attorney's fees or other collection costs super-priority status. This would be good for the HOAs, but would reduce the cost of the HOA in foreclosing on its own lien, prior to the bank, increasing foreclosure rates. As a remedy, Perkins suggests a revision giving all unpaid assessments super-priority status, so long as the HOA does not foreclose on its own lien (580). Goldmitz argues that the six-month super-priority made sense when written, but the length of foreclosures was much higher during the foreclosure crisis, and to best prevent future hardship for HOAs, the entire delinquency should be a priority lien (269). Alternatively, a flexible cap, based on the length of the foreclosure could be adopted (Gloekner, 350)

Lenders have a greater ability to carry the losses from HOA dues than the HOA. In addition to the protections of a larger portfolio of revenue opportunities, lenders can better mitigate anticipated risk. HOAs can only approve or deny purchasers, while lenders are able to demand a larger down payment, higher interest rate or points, or mortgage insurance (Goldmitz, 284). Lenders argue that if HOAs are given priority lien position above lenders, they will be unwilling to lend to buyers purchasing homes in HOAs (285). In order for states to extend the super-priority period, or give HOAs full priority over lenders, purchasing requirements of Fannie Mae and Freddie Mac must be changed. They are currently unable to purchase mortgages for homes with super-priority status over six months (290).

Newson suggests a penalty for lenders based on the belief that lenders receive unjust enrichment when waiting to foreclose on HOA properties. Lenders receive unjust enrichment, since they would otherwise hire a manager to care for the property, take out insurance and pay for repairs. Current legislation does not allow for lenders to pay assessments prior to becoming the owner of the property. She suggests that legislation provide HOAs with cause of action in case of foreclosure delay and that payment from the lender should be based on a case by case analysis incorporating the cost of divisible services and the actions of the mortgagee. (388-399).

Beginning in 1994, future association dues are not discharged during bankruptcy, so long as the debtor continued to reside in the property. This was expanded in 2005 to include all future dues, regardless of the occupancy. Sitzer argues that the new provision places the fate of debtors in the hands of the bank, who may choose not to foreclose due to the current real estate market (1399). This is to protect associations who typically have less ability to handle the losses during bankruptcy than other creditors. While potentially better for associations, this can leave a sizable debt to the homeowner.

The characteristics of homeowner's associations impact the effects of foreclosure. Cheung, et al. studied the effects of foreclosure on HOA properties relative to nearby properties. HOAs less than five years old mitigated the effect of foreclosure on nearby properties better than those older than fifteen years (83). Younger HOAs spend primarily on services, while older HOAs spend on capital improvements and repair. Larger HOAs were more able to preserve property values than smaller HOAs, likely due to the greater resources.

Home Owners Associations are able to borrow for renovations. Typically, HOAs do not have sufficient collateral to borrow with. If they do 67% of owners must agree to use it as collateral (Garfield, 51). They are also able to pledge future income as collateral, depending on the bylaws of the HOA. If homeowners are in default on their assessments, the lender then has the power to foreclose (54).

Minnesota offers an alternative to bank loans for HOAs in need of funds for improvements to common elements. Housing Improvement Areas are granted by cities to associations, requiring 50% approval, through the advancement of funds recovered by additional property tax assessments, or by issuing bonds and charging fees to repay the bonds (Biggerstaff and Dyson). There is limited information about the prevalence of HIAs, since they are not reported to the state government.

To compile a list of the HOAs in Carver County with significant common ownership areas (townhouses and condos), I began with lists provided by the municipalities. When addresses were provided I simply retrieved the age and number from property tax records. When not, I search for plats with similar names and used real estate listings. Additionally, I used satellite imagery to find additional townhouses and condos. For management addresses, when a portion of the land was in the name of the association, I used the taxpayer address from the property records. When this conflicted with information provided by the municipality, both are provided.

My research into the effects of the foreclosure crisis suggests that HOAs that are small or over 15 years old suffered the greatest loss in property value. That may be a helpful starting point, but individual financial situations are the real determinant. There are many HOAs that have additional units platted, most with existing units being built in 2006-2008. In some cases, they are now held by the city, while others remain in the hands of the builders. These units may be in a worse situation since the HOA was charted with the plan of more units than were actually constructed.

I identified a total of 55 active townhouse or condo associations in Carver County, outside of Chaska. Thirty-two were built before 2001, and are now fifteen years old. Twenty-one have twenty or fewer units. That suggests there is sufficient need for HIAs to pursue state approval for the CDA to grant HIAs.

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