

# Condominium Foreclosures - Unsolvable Crisis?

by

**D. Douglas Alexander, Esq.**

**ALEXANDER, ZELMANSKI, DANNER & FIORITTO PLLC**



## **The Problem**

Nationwide, mortgage foreclosures have increased drastically since 2006. Michigan, in particular, has suffered a staggering increase since the beginning of 2007. Foreclosures of condominium units are at an all time high at three to four times the normal rate of 3% to 5%. Simultaneously, home prices are plummeting. Adjustable rate mortgages have adjusted far above their initial “teaser rates”, leaving many borrowers with zero or negative equity in their homes.

The Michigan Condominium Act provides that the Association’s lien for unpaid assessments is secondary to a first mortgage recorded prior to the lien. When such a lender forecloses, the Association’s lien is extinguished. In this situation, the Association can only hope to recoup the debt by means of a money judgment against the former co-owner, which will have to be collected out of assets other than the condominium unit.

Is the Association’s situation hopeless? Is there anything that can be done to minimize the bad debt losses that must otherwise be shouldered by the co-owners who are paying their assessments? Answers to these questions appear below as we examine strategies that are successful, as well as some that are not only failures, but may actually worsen the Association’s situation.

## **Effective Solutions**

Condominium foreclosure losses may be minimized. Effective solutions will depend on the text of the governing documents, the provisions of the Condominium Act and simple common sense.

## **Lender Assessment Liability**

Every mortgage lender that acquires title to a condominium unit will become liable to pay assessments to the Association. Determination of when this liability commences depends in part on the provisions of the Condominium Bylaws, usually

Article II Section 6. The terms to look for are “possession” and “acquisition of title”. If the Bylaws defer lender liability until the foreclosing lender actually takes possession of the unit, the Association will stand to lose about a year’s worth of assessments, at a minimum. If the text imposes liability when the lender acquires title to the unit, liability will commence as of the date of the foreclosure sale, which occurs just a few months into the debt in most cases.

- Solution #1: Check the Bylaws; if they impose liability upon possession, amend them to impose liability when title is acquired. Since the lenders are quite collectible, this solution can save the Association thousands of dollars per foreclosure.

The last round of revisions to the Condominium Act, which occurred in 2001 and 2002, imposed a new legal duty on foreclosing lenders. MCL 559.208 (9) now requires that the lenders send notice of the commencement of their foreclosure proceedings to the Association via certified mail to the Association’s resident agent at its registered office. Failure to do so provides the Association with “legal recourse”. We have used this law to recover the entire delinquent balance owed by the co-owner, plus all legal expenses whenever we can show that the lender failed to issue the proper notice.

- Solution #2 First verify that the Association’s resident agent and registered office information on file with the State of Michigan is correct. If a lender fails to issue the required notice, legal counsel should pursue the entire debt against the lender.

### **Updated Condominium Bylaws**

We have already shown the critical importance of how Bylaws are worded regarding imposing liability on foreclosing lenders. Much more can be done to improve the Association’s prospects of recovery, especially if the Bylaws are old. First, determine if the Bylaws allow late charges and give the Board of Directors the power to increase them. To be legal, the amount has to be reasonable. “Reasonable” is a function of the amounts of the late charges relative to the unpaid assessments. Generally speaking, something on the order of \$50.00 may be the maximum; consult your legal counsel for advice on this important point. Watch out for text calling for fines on late payments. The Act requires that the Board give notice and the opportunity for a hearing in front of the Board before any fines can be levied, which usually makes fines an unworkable tool for collection cases.

- Solution #3 Update the Bylaws to provide for reasonable late charges and avoid fines clauses that will not work.

Second, do the Bylaws allow the Association to accelerate unpaid installments of the annual assessment? This can be a very effective remedy to deter chronic late payment, as it allows the Association to declare that owing to a late payment, all the rest of the monthly assessments for that fiscal year are immediately due and payable. This

remedy requires some caution, as it may backfire in a bankruptcy situation; again, consultation with legal counsel is a must.

- Solution #4 Consider amending the Bylaws to add the remedy of acceleration, but always consult legal counsel before exercising it.

Third, do the Bylaws indicate that both land contract sellers and buyers are liable for Association assessments? We are seeing some resurgence in the popularity of land contracts. Many poorly worded Bylaws actually exempt the land contract seller (vendor) from all assessment liability unless the buyer (vendee) forfeits its interest. This is absurd, given the fact that the seller retains legal title until the land contract is paid off.

- Solution #5 Double the number of parties liable to the Association in land contract transactions by amending faulty land contract vendor liability text in the Bylaws.

### **Miscellaneous but Effective Solutions**

Does the Board have a formally adopted Collections Policy? If not, it should. This Policy will establish a timeline for managing co-owner debts, as well as parameters for payment plans that will keep management and the Board on track with each case as it moves forward. Standardizing activities and their triggering dates will avoid charges of special treatment and help assure a fair process.

- Solution #6 Adopt a reasonable Collections Policy to guide management, legal counsel and the Board regarding the pursuit of debts. No amendment to the Bylaws is usually necessary, as most Boards are free to adopt policies so long as they do not contradict the Bylaws.

Does the Association have a direct payment program whereby the co-owners' monthly payments are automatically deducted from their bank accounts and wired into the Association's account? If not, the Board should consider doing so. If nothing else, it will speed up the inflow of cash and avoid payments being missed because someone "forgot" or was out of town.

- Solution #7 Set up a direct payment program between the Association and the co-owners and encourage 100% participation.

Is the Board doing everything it should to maintain and enhance property values, or is it instead focused on "saving money" via false economies? Too many Directors misperceive their duties when it comes to spending Association money. Except for the creation of reserve funds, governing documents seldom if ever mandate that the Board "save money".

In a falling real estate market, a special effort must often be made to preserve values by performing needed maintenance and repairs instead of putting them off. The

Directors would be wise to put themselves into the perspective of would-be buyers and take a look at what can be done to improve curb appeal. Overly restrictive sign regulations, weedy common plantings, dead trees and shrubs, peeling paint, cupping shingles, dead grass and crumbling pavement all evidence a failure by the Association to properly maintain the project and can have a negative impact on potential sales that may in turn trap a seller and turn him or her into a delinquent co-owner.

Some Associations are also opening dialogues with local realtors for help on these issues and how to improve their Association's reputation with potential buyers. Creating marketing materials (informative, colorful brochures) is another relatively easy and inexpensive step. The Association that fails in these efforts will lose out to more competitive neighbors.

- Solution #8 Maintain the property to a high standard and avoid false economies that hurt sales. Consider working with realtors to enhance the marketability of units.

## **Ineffective Solutions**

### **Screening Buyers**

Most modern condominium documents make no provision for the Association to screen potential buyers. Even if they do, enforcement will be difficult and dangerous. Refusing a buyer is apt to trigger a lawsuit by the disappointed seller and by the potential buyer who may make a claim for illegal discrimination. Some of these liabilities may not be insured by the Association's policy. Overall, screening potential buyers just does not work and it exposes the Directors and the Association to too many liabilities.

### **Publishing Names of Delinquents**

There are only two main reasons why co-owners fail to pay what they owe: they will not pay or they cannot pay. "Will nots" are scarce; "cannots" are becoming more numerous. Publishing the name of a "will not" is apt to increase animosity, not lessen it. Publishing the names of "cannots" will do nothing to solve the underlying inability to pay. Publishing names of delinquents is also very likely to lead to lawsuits for libel, false light and/or intentional infliction of emotional distress. We have never seen this tactic work and we have defended several lawsuits that resulted from publishing names of delinquents.

### **Directors Contacting Delinquents**

While it is true that every delinquent co-owner is a neighbor to their Directors, it is most unwise for unpaid, volunteer Directors to attempt personal contact with delinquents. They lack objectivity, training and will usually make collection more problematic. Leave this job to the professionals.

## **Hiring a Collection Agency**

Remember those two reasons why folks do not pay? No amount of nasty grams or telephone demands will convert a “cannot” pay into a current account. Most of these agencies work on a contingent fee basis, whereby they only get paid if they collect. That may sound attractive until we consider that the net result to the Association will *never* be payment in full.

The Act allows Associations to recover their actual reasonable attorney fees in collection matters but it makes no specific provision for recovering contingent fees imposed by collection agencies. Further, given the complexities of the condominium collection laws, especially as they relate to the mortgage lenders, one must ask whether or not it is wise to employ a collection agent who is very likely not an attorney and may have no education or experience whatsoever other than the ability to issue form demands and make annoying calls.

Some collection agencies will only pursue collection if there is no mortgage foreclosure and no bankruptcy involved. These are precisely the situations when a skilled attorney is needed to protect the Association. Accordingly, we universally recommend to our Association clients that all collection services be performed *only* by licensed Michigan attorneys, not phone bank operators, secretaries, paralegals or clerks.

## **In Closing...**

The mortgage foreclosure crisis is here to stay for quite some yet. Every Association needs to take stock of how they are handling collections and consider improving their efforts to minimize the losses that must ultimately be paid by the rest of the membership that faithfully pays.

Associations can take action to cope with the foreclosure crisis. Losses can often be contained and minimized by employing the effective solutions discussed above while avoiding the unworkable ones. The collection process cannot be viewed in isolation, since it involves so many disparate areas of the law (Condominium Act, Fair Debt Collection Practices Act, foreclosure law and the bankruptcy laws). Skillful and experienced legal counsel, along with professional management, is needed to assist the Board and protect the interests of the Association. If your Association is not using *all* of the effective solutions and/or is using *any* of the unworkable ones, it is time to consult with the Association’s legal counsel before matters worsen.