BATTLES CONTINUE TO RAGE OVER HOA LIEN PRIORITY

In 2014, the Nevada Supreme Court ignited a firestorm when it held that a non-judicial foreclosure sale by a homeowners' association (HOA) can extinguish a mortgage lender's previously-recorded first deed of trust on a condo property if that foreclosure is employed to recover assessments categorized as "super priority amounts" (nine months of regular assessments, plus any amounts required for abatement) under the Nevada statutes. *SFR Investments Pool I, LLC v. U.S. Bank, N.A.*, 2014 Nev. LEXIS 126 (Nev. 2014). Since that decision by the Nevada Supreme Court, the battles between secured lenders and HOAs over issues related to lien priority have continued to rage in Nevada's lower courts, and elsewhere around the country.

The Nevada Supreme Court recently issued its first opinion on HOA "super priority" lien status since its 2014 decision. The decision is helpful to secured lenders. In *Shadow Wood Homeowners Association, Inc. v. New York Community Bancorp, Inc.*, 132 Nev. Adv. Op. 5 (January 28, 2016), the court opened the door for setting aside HOA foreclosure sales (in the form of trustee's sales) under equitable principles. The court also reaffirmed its holding on the nine-month super priority HOA lien, and held that a lender who obtains title to property at its foreclosure sale is responsible for paying all HOA dues and assessments which become due after it takes title. For secured lenders, the new case is not really a "win" on the lien priority issue and demonstrates the dire consequences which can result from ignoring delinquent assessments both before and after a lender obtains title by foreclosure.

The penny-wise and pound-foolish secured lender. In the new decision, the owner of the condominium at issue defaulted under the first-priority mortgage loan held by New York Community Bank (NYCB) and on her monthly HOA dues. In 2008 and 2009, the HOA filed notices of delinquent assessment liens, two notices of default and election to sell and one notice of sale against the property. NYCB also initiated a trustee's sale under its deed of trust and acquired the property at the foreclosure on May 9, 2011 with a with a $45,900 credit bid. (At the time of the NYCB trustee's sale, the note securing its first deed of trust had an outstanding balance of $142,000.)

NYCB did not pay off any of the original homeowner's delinquent assessment lien. Therefore, when it acquired title to the property via its credit bid, it took title subject to the HOA's superpriority lien (for nine months of regular monthly dues plus any amounts required for abatement), but the remaining subpriority portion of the HOA's lien was **extinguished**. After acquiring title, NYCB not only failed to pay off any portion of the superpriority lien amount to which it was subordinate, but also failed to pay the ongoing HOA dues as they became due.

Not surprisingly, in July of 2011 the HOA recorded a new notice of delinquent assessment lien listing NYCB as the owner. Additionally, counsel for the HOA sent NYCB a certified letter enclosing a copy of the notice of delinquent assessment. The letter stated that the total amount due may differ from the amount shown on the enclosed lien and that the amount owed would be assumed valid if no notice of dispute was received within 30 days. NYCB chose to ignore the letter and notice of lien and did not respond. In early October 2011, the HOA recorded a notice of default and election to sell (the "NOD") which complied with the statutory requirements.

After receiving the NOD, NYCB requested a detailed statement and W-9 from counsel for the HOA and the HOA's management company. In response, the HOA officials sent NYCB various, seemingly conflicting documents, which included account history ledgers for the original homeowner and NYCB that listed the monthly assessments and late charges and summaries that broke down the fees and costs associated with the current and prior lien foreclosure processes which were not included on the account history ledgers.

The HOA caused a notice of sale ("NOS") to be issued scheduling the HOA's lien foreclosure sale for February 22, 2012. On January 31, 2012, NYCB sent the HOA a check in an amount less than stated in the NOS as being required to cure the default. The check was rejected by the HOA as being insufficient to pay the amount owed. NYCB did nothing further and the HOA's lien foreclosure sale proceeded, as scheduled, on February 22, 2012. NYCB did not attend or try to halt the sale. The Gogo Way Trust ("Gogo Way") purchased the property at the HOA trustee's sale for $11,018.39 in cash.

The ensuing litigation. Realizing the gravity of the situation after it was too late to prevent the loss of the property, NYCB pursued its only remaining alternative—initiating suit against the HOA and Gogo Way seeking declaratory relief and a quiet title. NYCB alleged that it remained the owner because the HOA did not conduct the sale in good faith and the sale price was commercially unreasonable. The HOA and Gogo Way counterclaimed with their own declaratory relief and quiet-title claims, alle-ging that the HOA properly foreclosed (based on NYCB's failure to pay assessments) and performed all statutory and contractual obligations in conducting the sale.

After discovery, both sides moved for summary judgment. The district court held that the Nevada statute (NRS 116.3116(2) (2013)) limited the HOA lien to nine months of common expense assessments; that the HOA acted unfairly and oppressively in insisting on more than that sum to cancel the sale; that the bid price was grossly inadequate; and that the foreclosure-sale buyer was a vulture investor who did not qualify as a bona fide purchaser for value. On these grounds, the district court set aside the HOA's sale and declared title vested in NYCB. The HOA and Gogo Way appealed.

Could the secured lender set aside the HOA deed based on equitable principles? NYCB claimed on appeal that the HOA acted unfairly, oppressively and perhaps even fraudulently by overstating its lien delinquency, rejecting a valid tender of the amount due, and selling the property at foreclosure for a grossly inadequate price. The HOA and Gogo Way argued that NRS 116.31166 (2013), which states that certain recitals in an HOA trustee's sale deed are "conclusive proof of the matters recited," rendered such deeds unassailable.

The Nevada Supreme Court rejected the argument by HOA and Gogo Way that the conclusive recitals in the trustee's deed upon sale precluded a quiet title action by the secured lender. Both history and basic rules of statutory interpretation confirmed its view that courts retain the power to grant equitable relief from a defective foreclosure sale when appropriate despite the fact that the statute in question provides for the conclusiveness of the recitals. At common law, courts possessed inherent equitable power to consider quiet-title actions, a power that required no statutory authority. Additionally, prior precedent of the court established that courts retain the power, in an appropriate case, to set aside a defective foreclosure sale on equitable grounds. The recitals made conclusive by operation of the statute at issue implicated compliance only with the statutory prerequisites to foreclosure. Equitable relief remained available, in the face of conclusive recitals, in cases where the appropriate showing of fraud, unfairness or oppression was made by the party seeking to quiet title.

However, the court determined that NYCB had not demonstrated sufficient grounds to justify the district court in setting aside the HOA's foreclosure sale on a motion for summary judgment, and the Supreme Court left these issues for the district court to determine on remand. The opinion contains a lengthy discussion of what the appellate court wanted the trial court to address on this issue. In its remand order, the court, citing a treatise as persuasive authority, noted that 20 percent of a property's fair market value is generally the benchmark for determining if a sale price is grossly inadequate as a matter of law. Based on the record before the court the sale price at issue was 23 per-cent of the property's fair market value, which did not meet this standard. According to the court, NYCB also failed to show as a matter of law that the HOA acted "unfairly and oppressively" in seeking to collect more than the nine months' of assessments that accrued prior to the HOA sale; the court ruled that the HOA was entitled to the nine-month superpriority, as well as all of the assessments that came due after NYCB took title to the property.

Can a vulture qualify as a "bona fide purchaser?" Unresolved factual issues also remained surrounding Gogo Way's putative status as a bona fide purchaser and its bearing on the equitable relief requested. A subsequent purchaser is bona fide under common law principles if it takes the property for a valuable consideration, without notice of the prior equity, and without notice of facts which upon diligent inquiry would be indicated, and from which notice would be imputed to him, if he failed to make such inquiry. In the court's opinion, the record reflected that Gogo Way paid valuable consideration for the property. The court also rejected the argument presented by the secured lender with respect to notice. The lender argued that "the simple fact that the HOA trustee is attempting to sell the property, and divest the title owner of its interest, is enough to impart constructive notice to the purchaser that there may be an adverse claim to title."

In the court's opinion, the fact that the bank retained the ability to bring an equitable claim to challenge HOA's foreclosure sale was not enough, in itself, to demonstrate that Gogo Way took the property with notice of any potential future dispute as to title. There was no other evidence in the record indicating that Gogo Way had notice before it purchased the property, either actual, constructive, or inquiry, as to the secured lender's attempts to pay the lien and prevent the sale, or that Gogo Way knew or should have known that the HOA claimed more in its lien than it actually was owed. In short, the secured lender did not meet its burden to show that no genuine issues of material fact existed regarding Gogo Way's bona fide status and this issue was also remanded to the district court for further proceedings.

The big takeaways

**Secured lenders can't sit on their hands.* Nothing in the recent Nevada decision eviscerates the court's holdings in 2014 case, and the opinion demonstrates that there is a high burden of proof to meet in order to be successful in an equitable action by a secured lender to set aside an HOA foreclosure sale. The opinion reinforces the lesson that secured lenders should not "sit on their hands" or ignore delinquent HOA dues and assessments before or after a lender forecloses.

**New Nevada statute helps secured lenders to some degree.* One bright spot for lenders in Nevada is that, thanks to Senate Bill 306 enacted in the 2015 bi-annual legislative session, Nevada law now provides for additional procedural protections for lenders and a 60-day redemption period after an HOA foreclosure sale for the property owner or a holder of a security interest to redeem the property by paying certain amounts to the purchaser. Under the new legislation, the person redeeming the property must pay the purchaser: (1) the amount of his or her purchase price, with interest at the rate of one percent per month; (2) the amount of any assessment, taxes or payments toward liens that were created before the purchase and which the purchaser may have paid after the purchase; and (3) any reasonable amount expended by the purchaser which is reasonably necessary to maintain and repair the condo unit in accordance with the standards set forth in the governing documents. If the purchaser is also a creditor having a lien prior to that of the redemptioner (other than the HOA's lien under which the purchase was made), the redemptioner must also pay the purchaser the amount of such lien. If the redemptioner is the holder of a recorded security interest on the unit, it must pay the amount of any lien before his or her own lien, but the HOA's lien under which the unit was sold is not required to be paid as a lien.

**Look for more litigation between HOAs and secured lenders.* There are also additional issues with respect to the interplay with Nevada's superpriority HOA lien status and federal law which remain to be determined, such as federal statutory rights given to federal-agency lenders like Fannie Mae or Freddie Mac. Under 12 U.S.C. §4617, federal law probably prohibits wipe-out of the mortgage through an HOA foreclosure sale without the consent of the federal agency. *See, e.g., Skylights LLC v. Byron,* 2015 U.S. Dis. LEXIS 82048 (D. Nev. 2015). Moreover, Nevada is not the only state that has seen heavy-duty priority litigation. *See, e.g., Chase Plaza Condo Ass'n. v. JP Morgan Chase Bank, N.A.*, 93 A.3d 166, 2014 D.C. App. LEXIS 317 (D.C. Cir. 2014) (first-priority mortgage wiped out by HOA fore-closure sale) and *Summer Hill Village Homeowners Ass'n. Roughley*, 289 P.3d 645, 2012 Wash. App. LEXIS 339 (Wash. Ct. App. 2012) (same). For further analysis of these cases, see the September 2015 issue of this newsletter. Bottom line: expect more substantial litigation and challenges to secured lenders in this area.

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