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FORECLOSURE AS A COLLECTION TOOL

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FORECLOSURE AS A COLLECTION TOOL

Board members have a fiduciary duty to ensure the association collects assessments. If your association has ever experienced a high delinquency ratio, repeat delinquent owners, or uncollectible delinquent accounts, then you should consider a judicial foreclosure action. The foreclosure option should be evaluated regularly and used aggressively when appropriate to do so. In order to properly evaluate the foreclosure option, boards and managers must fully understand the foreclosure process. This article is intended to outline the basics of the judicial foreclosure process.

Most declarations grant the association a lien against an owner's unit for unpaid assessments. In addition, the Colorado Common Interest Ownership Act (CCIOA) also grants associations a lien for all unpaid assessments coming due after July 1, 1992. An association's lien can be foreclosed just like any other lien on real property. However, it must be done through a judicial foreclosure process and not the standard public trustee foreclosure process used for typical deeds of trust.

WHEN SHOULD YOU FORECLOSE?

The association should consider foreclosing its lien if the following apply:

- The owner is chronically delinquent in paying assessments.
- The delinquent assessments cannot be collected through a county court collection lawsuit. (For example, the owner cannot be located for service, or the owner is judgment-proof.)
- There is equity (market value versus balance of first mortgage) in the home in excess of approximately 15,000.
- The home is not already involved in foreclosure by the lender.

THE LAWSUIT

The Association must have a lien for the delinquent assessments.

- A Complaint is filed in the county where the property is located naming the association as plaintiff and all persons who have an interest in the property as defendants. (The defendants include the owner, all occupants, the lender, and anyone else with a lien against the property.)
- All defendants are served with a Summons and the Complaint. If we cannot determine the identity of all persons with an interest in the property, they are identified as "unknown persons" in the complaint and are served by publishing notice in a local newspaper weekly for 5 weeks. Additionally, if the owner or any other defendant cannot be located for personal service, they may also be served through the publication notice.
- The purpose of the lawsuit is to obtain an order from the court granting the association the right to foreclose its assessment lien.
- Following personal service with the Summons and Complaint, the owner has 20 days to file an Answer with the court if served in Colorado; if served out-of-state, the owner has 30 days to file an Answer. If service is through publication, the owner must file an Answer within 30 days of the last date of publication.
- Frequently, the owner does not respond to the Summons and Complaint, so an order for foreclosure can be obtained by "default."
- If the owner files an Answer, the judicial foreclosure is considered a "contested matter" and will be set for trial in the same manner as any other lawsuit. The issue at trial will be whether the owner is delinquent and, if so, by how much.
- If the owner does file an answer to the complaint, an order for foreclosure can frequently be obtained by "summary judgment" without having to go to trial, if the association can

show the default in payment of the assessments and its right to foreclose the assessment lien granted in the Declaration.

THE SALE

This part of the lien foreclosure process is very similar to the public trustee foreclosure process for mortgages used by lenders.

- After the court order is obtained, it is forwarded to the Sheriff of that county.
- The Sheriff schedules a sale date, publishes notice of the sale in a local newspaper, and sends notices to all persons who have an interest in the property.
- The owner has 110-125 days to "cure" the default after the foreclosure has been initiated. In order to cure, the owner must pay the amount that is in default to the foreclosing party. If the owner cures, the foreclosure sale must be withdrawn.
- Prior to the time of the sale, we will submit a bid on behalf of the association to the Sheriff. The association does not have to come up with any cash to bid at the sale. The association need only bid the lesser of the debt owed for the assessments (including the attorney fees and costs incurred in the foreclosure) or the value of the property. For example, if the property is worth \$100,000, has an \$80,000 balance on the first mortgage, and the association is owed \$6,000, the association will bid \$6,000. If the property is worth \$100,000, has a \$95,000 balance on the first mortgage, and the association is owed \$6,000, the association need only bid \$5,000 (the value of the property over and above the first mortgage.)
- If the association is outbid at sale, it will be paid in full from the proceeds. If there are no other bidders at the sale, the Association will be given a certificate of purchase from the Sheriff.
- Junior lienholders have the right to pay all the amounts owing to the association (i.e. delinquent assessments, attorney fees, and costs incurred in the foreclosure process) to "redeem" the property. Lienholders must file their intent to redeem with the Sheriff within 8 days after sale. The first lienholder must redeem within 15-19 days after sale. Each subsequent lienholder would have an additional 5 days within which to redeem.
- If no lienholder redeems the property, the Sheriff will issue a deed for the property to the holder of the certificate of purchase (i.e. whoever was the high bidder at sale).
- The new owner can then evict the former owner, and either sell or retain the property and lease it to a tenant, keeping the net rental proceeds after paying any mortgage on the property.
- Usually, the property will remain subject to the first mortgage. (Most Declarations contain a provision which specifically makes the assessment lien subordinate to the first mortgage).
- If the property remains subject to a first mortgage, the new owner must make the mortgage payments or refinance if it wants to keep the property. If the new owner fails to do so, which it may choose to do if there is no equity in the property, the lender may foreclose its lien and the lender would then become the owner. When the property is subject to a mortgage, it is important that a forbearance be negotiated with the lender to allow time to sell the property without the lender foreclosing.
- When the new owner obtains the Sheriff's deed to the property, any liens that may have attached to the property after the lien which was foreclosed will be extinguished or wiped out.

WHAT CAN THE ASSOCIATION DO ONCE IT HAS A DEED?

The association can then evict the former owner or occupants and either lease or sell the home. If the association sells the home, the association is entitled to keep the net proceeds following payment of the first mortgage and closing costs.

WHAT ABOUT THE FIRST MORTGAGE?

- Usually, the home will remain subject to the first mortgage following the sale and issuance of a deed. (Most Declarations contain a provision which specifically makes the assessment lien subordinate to the first mortgage.)
- If the home remains subject to a first mortgage, the association must attempt to negotiate a forbearance with the lender to prevent the lender foreclosing. If the mortgage goes into default, the lender may foreclose its lien. If the Association does not cure or redeem from the lender foreclosure, the lender will take over ownership of the property. When the home is subject to a mortgage, it is imperative for the Association to communicate with the lender and let it know the Association's intent with respect to the property (i.e. whether the Association intends to refinance or sell the property).

GENERAL COMMENTS

Judicial foreclosure is an effective collection tool, because it serves as additional pressure to get the owner to pay. Further, it "reminds" the owner that the repercussions of choosing not to pay assessments are both serious and expensive, and could potentially lead to the loss of their home. A crucial component of the effective use of foreclosure is the board's commitment to not accepting marginal payment plans and not accepting payment plans once a sale date is set. These commitments will serve the association well in decreasing delinquent assessments and utilizing foreclosures effectively.