



HOAs VS. BANKS VS. HOMEOWNERS:

NEVADA SHIFTS GROUND ON SUPERPRIORITY HOA LIENS

BY MARK GARDBERG, ESQ.

If Superman were a real estate lender, then a “superpriority” HOA lien would be about as super as a gift basket full of Kryptonite. On the other hand, for homeowner associations (HOAs), such liens can be gold mines, providing them with windfalls that might make Lex Luthor blush. Under the right circumstances, a Nevada HOA could foreclose on a lien for \$500 and take title to a home worth \$5 million—free and clear of all other interests, including previously-recorded deeds of trust, mortgages and other liens.

In a statutory amendment last year, the Nevada Legislature reduced the possibility of HOAs reaping this type of windfall, shifting

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the balance in favor of lenders and, to a lesser extent, homeowners.

What Is a Superpriority HOA Lien?

In Nevada, if a homeowner doesn't pay his/her HOA dues, the HOA has a statutory lien over the homeowner's property. (NRS 116.3116.) If the account remains delinquent, the HOA can foreclose on that lien and take title.

The key legal question has been whether or not the HOA's lien is superior or subordinate to other property liens, including the deed of trust held by the homeowner's lender. In 2014, the Nevada Supreme Court issued a momentous (but relatively unnoticed) answer to that question. For statutory reasons, part of the HOA's lien does have superpriority status, trumping all previously-recorded liens. *SFR Investments Pool 1 v. U.S. Bank*, 334 P.3d 408 (Nev. 2014) (*en banc*). More specifically, NRS 116.3116(2) grants the HOA "true lien priority," not merely "payment priority," equivalent to nine months of HOA assessments.

As a result, an HOA foreclosure will typically eliminate all deeds of trusts and other liens. The HOA's windfall can be extreme; as one investor said in the press, "This is one of the greatest returns in real estate that I've ever seen."

There has been some debate as to whether or not federal law would allow such windfalls in the vast majority

of cases. The federal government has hinted that if the relevant bank loan is a federally-backed Fannie Mae or Freddie Mac loan, it cannot be wiped out.

SFR understandably set off bank alarms. If a lender cannot stop an HOA foreclosure, it will lose its security. That would be particularly costly—and inequitable—in the hypothetical situation above, where the bank's deed

of trust secures a \$5 million loan, and the HOA's superpriority lien covers \$500 in delinquencies. The loan would become unsecured, and if the homeowner files a Chapter 7 bankruptcy, the entire debt may be discharged.

The HOA sale also spells disaster for homeowners who cannot file in Chapter 7 (possibly because their net worth is too great, filing would sabotage other business interests or they recently received a discharge.) That is because the bank can still sue them for the unpaid debt, and the homeowner will get no offsetting credit for the home's value. Consider, for example, a situation in which the homeowner owes the bank \$5 million on a \$4 million home. If the bank forecloses,

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the homeowner is only liable for the \$1 million difference. But, if the HOA forecloses, the bank cannot offset its debt with the home, meaning the homeowner owes the bank the entire \$5 million.

The Nevada Legislature's Response

Last year, the Nevada Legislature amended the laws to shift the balance among HOAs, lenders and homeowners. The new laws, SB 306 and AB 141, went into effect on October 1, 2015. Notably, the Legislature did not overturn *SFR*'s core holding: if an HOA forecloses on its superpriority lien, all junior liens are extinguished. It even allowed an HOA to add in some enforcement costs (subject to a tight cap). However, the Legislature also imposed new, important safeguards protecting other stakeholders.

1. Notifications

The amendments require an HOA to send all relevant foreclosure notices to any lienholder who has recorded a deed of trust, mortgage or other lien. The HOA must then record an affidavit, certifying to whom it sent those notices.

To facilitate the notifications, the legislation required lenders to provide Nevada's Division of Financial Institutions with the name, address and other contact information of the person to whom foreclosure notices should be sent, by October 1. Those contact details are public information and appear on the division's website at <http://fid.state.nv.us/>.

2. Payoff Option

The most important provision in the new law allows first-lien lenders to exercise a payoff option. When the HOA sends out a notice of default, it must specify the amount of its lien with superpriority status. The lienholder then has a specific period of time—until five days before the

foreclosure sale—to pay off the superpriority lien. Upon doing so, the HOA may still foreclose (on the portion of its lien, if any, not having superpriority status), but the lender's lien will not be extinguished.

If it receives payment, the HOA must record a notice of satisfaction at least two days prior to the foreclosure sale. Note that if the lender pays off the superpriority amount, the homeowner does not indirectly profit. By statute, the homeowner then owes that debt to the lender, not the HOA.

3. Redemption

If a lienholder fails to pay off the superpriority lien by the deadline, leading to a foreclosure sale and termination of its lien, the new laws give it a last-ditch, hail-Mary throw. SB 306 allows the lienholders (and, by the way, the homeowner) a 60-day right of redemption. The redeeming party can pay off the foreclosure-sale buyer (with interest and certain charges) and take title to the property.

4. Foreclosure Procedures

HOAs must also adhere to many of the same procedures governing foreclosure sales conducted by deed-of-trust holders under NRS Chapter 104. This includes, for example:

- i. Publication and posting-of-notice requirements,
- ii. Sale location requirements, and
- iii. An obligation to participate in Nevada's Foreclosure Mediation Program if the homeowner does not opt out.

Best Practices

Given how much there is to lose, a lender or other lienholder must act carefully and quickly to protect its interests. It will want to:

- Send its contact details to the Division of Financial Institutions;
- Promptly record its deed of trust or other lien;
- Frequently check its publicly-listed mailbox;
- Immediately contact the HOA to pay off the superpriority lien upon receiving an HOA foreclosure notice; and
- If it failed to make that pay-off, exercise its redemption rights within the 60-day timeframe.

Homeowners must also be vigilant. They will want to assess early on whether or not they can file a Chapter 7 bankruptcy. If yes, and if a foreclosure sale (by the HOA or bank), is inevitable, then it may not matter much which conducts the sale. But if not, the homeowners will want to monitor the process and loudly prod the lender into action before any HOA foreclosure sale takes place.

The HOA, meanwhile, will want to proceed as planned with foreclosure. It still has a potential windfall coming, and even if the lender or homeowner pay off the superpriority lien and the windfall goes away, the HOA may still be able to foreclose, take title and collect rents until the bank gets around to foreclosing on its deed of trust. **NL**



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