

Assessment collection is one of the more confusing aspects of an association's operations, especially when trying to understand whether your association should use non-judicial or judicial foreclosure in its assessment collection efforts. Assessment collection firms provide a wealth of information and articles highlighting the advantages of their preferred foreclosure process compared to the disadvantages of the other. However, it is rare that an association manager or board will have access to unbiased information discussing some of the primary advantages and disadvantages associated with each process and how they may be impacted by certain economic factors.

The goal of this article is to provide our readers with this information thanks to the assistance of two industry-leading assessment collection firms from both the non-judicial and judicial foreclosure "camps." Sandra Gortleib, Esq. of Association Lien Services ("ALS") and Janet L.S. Powers, Esq. and Erin A. Maloney, Esq. of Fiore Racobs & Powers ("Fiore") supplied us with excellent information and answers to key foreclosure and assessment collection questions. ALS specializes in non-judicial foreclosure while Fiore specializes in judicial foreclosure actions.

Note: The timelines for each procedure are on the Chapter website at www.caio.org.

It is important to note that the overwhelming majority of assessment delinquencies are resolved before an association needs to complete a non-judicial or judicial foreclosure action. The initial collection steps associated with each foreclosure process are similar (e.g., a pre-lien demand and recordation of a delinquent assessment lien against the delinquent homeowner's property). Therefore, in resolving the overwhelming majority of assessment delinquencies, each process typically provides the same outcome in the same amount of time and for generally the same cost.

The differences between the two foreclosure processes come into play when the delinquent homeowner fails to bring his or her account current and a formal action is instituted to foreclose the delinquent assessment lien. With the non-judicial foreclosure process, a "Notice of Default" is recorded against the delinquent homeowner's property. If the delinquent homeowner fails to bring his or her account current within roughly three (3) months, the property can be foreclosed and sold at a public auction without the association or collection firm ever setting foot in court. Once the association forecloses non-judicially, California law precludes the association from then seeking to recover the debt from the delinquent homeowner. Thus, if the association

forecloses on the property non-judicially and the proceeds from the sale are insufficient to satisfy the debt owed to the association, the association is prohibited from taking further action to recover money from the delinquent—now foreclosed—homeowner.

Judicial foreclosure is a court proceeding. It involves the filing of a lawsuit against the delinquent homeowner and thus requires the use of attorneys. If the delinquent homeowner responds to the complaint, the matter is litigated and a judgment in favor of the association is obtained either at trial or by motion if it is not settled. According to Fiore, most delinquent homeowners fail to respond to the complaint and the association is able to seek a default judgment after thirty (30) days. The judgment is then enforced via a court-ordered sale of the property (judicial

foreclosure sale) or through collecting on the judgment through tools such as levying the delinquent homeowner's bank account or garnishing his or her wages.

What then are the primary advantages of non-judicial foreclosure? According to ALS, "non-judicial foreclosure is a less expensive procedure than judicial foreclosure allowing, in most part, for the same result. Non-judicial foreclosures typically proceed at a much faster pace than judicial foreclosures. Since there is no court involve-

ment, the statutorily authorized non-judicial foreclosure can proceed without first initiating a lawsuit against a delinquent owner, keeping the association out of court, controlling its own destiny, as opposed to relying on the whim of a judge."

If the delinquent matter results in the non-judicial foreclosure sale of the property, the cost savings and quicker pace of non-judicial foreclosure actions are certainly real. However, is it ultimately beneficial for the association to stay out of court? The California Civil Code requires strict compliance with the collection steps leading up to the non-judicial foreclosure sale. Therefore, a deficiency in some of those steps (e.g., an error in the lien) may require the association to correct the deficiency and to restart the non-judicial foreclosure process over again. Judicial foreclosure, by contrast, allows for deficiencies to be "addressed in the litigation, and adjudged to be non-material, or corrected, therefore allowing a sale to proceed." (Fiore).

Judicial foreclosure litigation is not without its potential drawbacks. In addition to the added costs, time and uncertainties noted by ALS, there is always a chance that the delinquent homeowner will file an answer to the association's complaint and decide to contest the lawsuit (a situation which occurs roughly 20 percent of the time according to Fiore). Though the delinquent homeowner has

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Industry Leaders "Weigh-In" on
Which Foreclosure Process
Tops the Other.



little chance of ultimately prevailing in the lawsuit, requiring the association to engage in a protracted and potentially costly legal dispute would not serve the association's goal of securing a quick and efficient resolution to the matter.

What then are the primary advantages of judicial foreclosure? According to Fiore, "the biggest advantage of a judicial foreclosure action is that the association is able to obtain a money judgment and an order for foreclosure of its lien in the same proceeding. The Board can elect to foreclosure, or to enforce its money judgment (e.g., via a wage garnishment or bank levy) to collect the amounts owed. This differs from non-judicial foreclosure, where the association can only seek to foreclose its lien against the property."

The ability for the association to elect its remedy—to proceed with the judicial foreclosure sale or collect on the association's money judgment—provides the association with flexibility in the event that,

for example, the association is unable to collect on its money judgment. In that situation, the association would still be able to enforce its judgment through foreclosing on the property; however, doing so would require thousands of dollars in attorney's fees, as well as sheriff's fees to conduct the judicial foreclosure sale (approximately \$3,000 total according to Fiore). That amount is in addition to attorney's fees and costs incurred by the association to first obtain the judgment (typically \$2,000 according to Fiore). When totaled, those fees and costs are roughly twice what ALS claims to be the average total amount of fees and costs that would be incurred throughout the entire non-judicial foreclosure process. There are procedures available to the association for recovering its fees and costs incurred in enforcing its judgment. However, the ability to secure such recovery is of course impacted by economic factors such as the

delinquent homeowner's employment and financial status.

Those economic factors may help an association determine which method of foreclosure is more beneficial in any given delinquency. If the association has information to believe that it will be able to collect on its money judgment and that the delinquent homeowner will thereafter keep his or her account current, a money judgment is of great benefit to the association by resolving the delinquency and by recovering the delinquent amounts owed to the association. If, however,

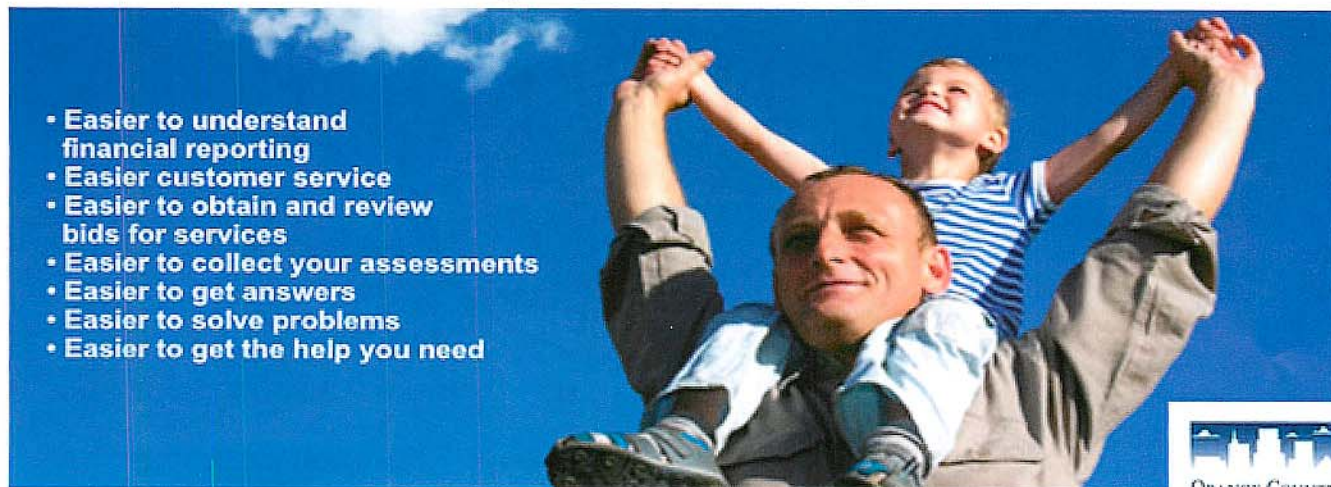
"...the collection professionals used by an association will have a far greater impact on the association's success than simply the foreclosure process itself."

the association is unable to collect on its money judgment, the association will be



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forced to incur more expense in foreclosing on the property judicially as compared to non-judicially—expense which it may not be able to recover. Additionally, if the homeowner fails to keep his or her account current after a judgment is obtained and collected, the association may be required to commence another judicial foreclosure action (another lawsuit) to obtain a second money judgment or to instead seek the judicial foreclosure sale of the property. In those situations, the association may have been better served by first foreclosing non-judicially and by expediting the process of getting a new, assessment-paying owner into the property.

But what if the property has no equity (is “upside-down”), there are no third-party purchasers of the property at the non-judicial foreclosure sale, and, as a result, the association takes title to the property? This situation currently occurs in roughly 50 percent of non-judicial foreclosure sales, according to ALS. Additionally, assuming that the delinquent homeowner will or has already defaulted on the property’s mortgage, why should the association take title to the property only to have the senior mortgage lender foreclose and extinguish the association’s ownership interest? These questions are what underlie Fiore’s belief that non-judicial foreclosure “is generally only effective when the property has equity. If it is upside-down, the delinquent homeowner may be happy to let the association take it off his hands without having to pay.”

According to ALS, “an association should not assume that a bank or servicer will foreclose against an owner who has defaulted on his or her mortgage obligation.” ALS has seen over the last four years “that banks are not foreclosing on defaulted mortgages, although in a position to do so.” The period between when the association takes title to the property and when a senior mortgage lender forecloses on a property may be several months or even years. That period may provide the association with sufficient time to recover the delinquent

amounts owed through selling the property (typically through a short-sale with the lender’s approval), or to rent out the property on a month-to-month basis.¹ It would not be financially beneficial for the association to have the prior owner remain in the property during that period and continue to fail to pay assessments. Thus, according to ALS, “there is no reason that an association should not conduct a non-judicial foreclosure in the event of a mortgage default unless, of course, the bank actually forecloses.”

Additionally, the association’s non-judicial foreclosure action may induce the senior mortgage lender to foreclose. In doing so, the lender would take title to the property and would be required to pay assessments to the association from the date of the lender’s foreclosure until the property is sold to a third party. The association thus benefits from having re-established the stream of assessment revenue from that property, but has waived its right to recover the delinquent amounts owed by the foreclosed homeowner. However, in situations where a delinquent homeowner is highly in-

¹ There are legal issues associated with the renting of foreclosed properties that are encumbered by senior mortgages (e.g., “rent skimming” laws). Associations wishing to do so should consult with their legal counsel.

debted, has no employment or financial means, and has no ability to keep the property and to pay assessments, the association is likely better served by forcing a transfer of ownership in the property as soon as possible.

The golden question then becomes: “Which foreclosure process is better?” After reviewing the thoughtful and detailed information provided by these two industry-leading firms, in addition to the wealth of information which has been authored in the past, the clear answer is that there is no clear answer. What is increasingly clear is how the collection professionals used by an association will have a far greater impact on the association’s success than simply the foreclosure process itself. It is paramount for an association to use the services of competent professionals who understand the complexities of assessment collection and who can work with the association in executing a collection strategy that benefits the association over the long term, regardless of whatever foreclosure process may be used. ⚙

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