by Dean Lennon, Esq.

Lien Cuisine

Defining Foreclosures and Sheriff's Sales

Common fee collections are vastly different in Massachusetts and New Hampshire. The most significant difference is that in Massachusetts, associations are afforded a priority lien ahead of the first mortgage, and that the lien can be foreclosed upon by the association. A recent amendment to the condominium statute in New Hampshire created a limited six-month priority lien applicable to mortgages given after Jan. 1, 2011, but a New Hampshire association cannot foreclose on its lien; it is only guaranteed that the priority lien will ultimately be paid.

Given the priority lien and ability to foreclose, a Massachusetts association that does not receive payment from a delinquent owner can retain counsel to obtain a judgment in court and obtain an Order of Sale authorizing foreclosure. Because a priority lien is, by definition, a lien that is ahead of the first mortgage, the first mortgage is effectively wiped out by the association's foreclosure sale. Likewise, all other subordinate liens, such as second mortgages or attachments, are also wiped out by the sale. Thus, the buyer at the foreclosure sale owns the property free and clear of any and all liens, except any lien for unpaid property taxes.

Collecting Outstanding Debt

By way of example, let's assume the association is owed $15,000 in unpaid monthly condominium fees, legal fees and costs (including foreclosure related costs). There is a first mortgage for $150,000. The association conducts a foreclosure sale and the high bid is $80,000. The association's attorney will apply the first $15,000 of the sale proceeds to the association's priority lien (late fees, interest and special assessments are not included). The remaining $65,000 of sale proceeds would be disbursed to the mortgagee. The mortgagee would take a loss of $85,000, since the bank originally loaned $150,000, of which only $65,000 was received from the sale.

Given that a sheriff's sale is subject to the first mortgage, it only makes sense to conduct such a sale if there is substantial equity in the property.

Conversely, in New Hampshire the law does not set forth foreclosure as a remedy to associations to recoup unpaid fees. Said another way, while the association may obtain a limited priority lien over a first mortgage given after Jan. 1, 2011, the association cannot foreclose on that lien, as in Massachusetts. The association must file suit against the owner and obtain a judgment for the unpaid fees. Upon receiving a judgment and obtaining an execution, the association can then conduct a sheriff's sale.

Since the execution is a lien on the unit that is subordinate to the first mortgage, when the association conducts a sheriff's sale, the sale is subject to the first mortgage. The phrase "subject to" means that the high bidder owns the property with the first mortgage still existing on title and encumbering the unit. As a result, the high bidder must pay off the first mortgage or the bank could foreclose on its lien and wipe out the high bidder's interest in the property.

Sheriff's sales in New Hampshire are also subject to the former owner's one-year right of redemption. The former owner can pay off the total debt to the association within one year of the sheriff's sale and take back the property from the high bidder.

Given that a sheriff's sale is subject to the first mortgage, it typically only makes sense to conduct such a sale if there is substantial equity in the property. For example, let's again look at a unit worth $150,000. The owner owes $5,000 to the association and has only a $75,000 home equity line on a property. In this example, an investor could purchase the property at a sheriff's sale for, say $8,000, pay off the mortgage and still enjoy $67,000 in equity.

Underwater Solution

The above scenario is quite atypical in today's market, however. Today, a large number of units are underwater. The first mortgage likely exceeds total fair market value of the home before one even considers the association's lien or any other creditor liens on record. When a unit is underwater, a sheriff's sale is still an option for an association eager to remove the problem owner from the unit with an eye on getting a paying owner into the unit sooner than later.

For underwater units, the only viable option is for the association to buy the property at the sale. The association would take ownership by purchasing the property at the sale, in exchange for the total debt owed. No money exchanges hands at the sale. If the association is owed $5,000 by the owner, that debt would simply be wiped out by the sale and the association would become owner, subject to the mortgage and the one-year right of redemption. The unit's account would start at a zero balance from the date of the sale.

Once the sheriff's deed is recorded, the association must then evict the now former owner and then rent out the unit to recoup the former owner's debt. There are certainly increased legal expenses for the sale and eviction, but the association should weigh those costs against the ability to rent the unit, as well as the fact that a non-paying owner is out of the unit.

Even though the sale is subject to the first mortgage, the association is not obligated to make mortgage payments. At some point the bank will foreclose on its lien and take the property back from the association. Should the bank foreclose soon after the sheriff's sale, the association's efforts to recoup money through renting will have been all for naught. However, the association's aggressive collections may expedite the bank's foreclosure, which benefits the association, since the non-paying owner is gone and the bank will begin paying fees.

A priority lien, coupled with the statutory ability to foreclose that lien, is an effective means of collection in Massachusetts. The priority lien foreclosure is a trump card for associations to collect fees and provides leverage to the collection process. A New Hampshire sheriff's sale, while less effective than a foreclosure sale, still has some benefits and should be considered by associations struggling with delinquent owners. CM

Dean Lennon, Esq. is an associate with the law firm of Marcus, Errico, Emmer & Brooks, P.C. He also serves on the CAI-NE program advisory council.