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# Muddying the Waterfall: How Ambiguous Liability Statutes Distort Creditor Priority in Condominium Foreclosures

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## I. INTRODUCTION

Intentionally or not, every state's law regarding lien priority and post-foreclosure liability allocates risk between mortgage lenders and privately governed "common interest communities" (CICs), such as condominium associations.<sup>1</sup> Mortgage lenders minimize their risk of not collecting a loan by securing the debt obligation with a lien on collateral, thereby allowing the lender dual recourse to the borrower and to the property.<sup>2</sup> CIC associations, by their very nature, are vulnerable to community members not paying their

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1. The Restatement (Third) of Property defines "common-interest community" as a "development or neighborhood in which individually owned lots or units are burdened by a servitude . . . that cannot be avoided by nonuse or withdrawal." *RESTATEMENT (THIRD) OF PROP.: SERVITUDES* § 6.2(1) (2000). Sometimes, statutes may use the term "common interest development" (CID) to refer to a CIC. *See, e.g., CAL. CIV. CODE* § 1351 (West 2013), *repealed by CAL. CIV. CODE* § 4100 (West 2014). CICs include condominiums and homeowner associations, *RESTATEMENT (THIRD) OF PROP.: SERVITUDES* § 6.2 cmt. a, c (2000), also known as planned-unit developments (PUDs). *See BLACK'S LAW DICTIONARY* 1268 (9th ed. 2009). While structured differently, cooperative-ownership developments are often included within the rubric of a CIC. *See RESTATEMENT (THIRD) OF PROP.: SERVITUDES* § 6.2 cmt. a-b.

2. *See, e.g., Bierwirth v. BAC Home Loans Servicing*, No. 03-11-00644-CV, 2012 WL 3793190, at \*3 (Tex. Ct. App. Aug. 30, 2012) ("[A] lien creditor may pursue foreclosure of a lien against real property under the deed of trust independent of any personal action against the borrower for collection on the note.").

assessments.<sup>3</sup> Like mortgage lenders, these associations may seek collection of unpaid amounts either personally from the non-paying owner or through foreclosure of a lien on real property that secures the obligation.<sup>4</sup> When mortgages exist on property within a CIC, they may compete against the CIC's interests for primacy in the lien hierarchy.

Modernly, states typically delineate the respective rights of mortgagees and CIC associations according to lien-priority statutes.<sup>5</sup> Older condominium-enabling statutes, however, do not address CIC lien priority directly and speak only to personal liability for subsequent property owners.<sup>6</sup> These older and more ambiguous statutes do not indicate how state law intended to—or should—balance the competing interests of mortgage lenders and community associations. Today, these vague statutes present important and politically charged issues that merit legislative consideration and clarification. Furthermore, as the Arkansas Supreme Court's decision in *First State Bank v. Metro District Condominium Property Owners' Association* illustrates, a plain-meaning construction of such an unclarified statute can produce an outcome that is wrong as a matter of law and unwise as a matter of policy.<sup>7</sup>

This article examines the problems of vague statutory provisions regarding assessment obligations and their effect on lien priority. It advocates for judicial interpretations that focus on the purposes and intent of these provisions while upholding basic lien-priority law, and it urges legislative clarification of the existing language.

Part I distinguishes “debt” from “security” and the law regarding lien priority from that of mortgage foreclosures in

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3. See WAYNE S. HYATT, CONDOMINIUM AND HOMEOWNER ASSOCIATION PRACTICE: COMMUNITY ASSOCIATION LAW 121 (3d ed. 2000) (“Assessments are generally the community's primary funding source. When one member of the community chooses not to pay the assessments, everyone in the community pays the price through increased assessments, decreased services, and declining community appearance and quality of living.”).

4. See *id.* at 120-21.

5. See *infra* Sections II.B, III.A.

6. See, e.g., ARK. CODE ANN. § 18-13-116(d) (Repl. 2003) (Arkansas Horizontal Property Act); NEB. REV. STAT. ANN. § 76-819 (West 2013) (Nebraska Condominium Property Act); N.J. STAT. ANN. § 46:8A-22 (West 2013) (New Jersey Horizontal Property Act).

7. See 2014 Ark. 48, \_\_\_ S.W.3d \_\_\_.

general. It also gives a brief overview of the CIC ownership form and some inadequacies in CIC law uncovered by the recent surge of foreclosures. Part II examines how various state-condominium and CIC enabling statutes treat the twin issues of liability and lien priority, and it considers possible meanings for certain ambiguous statutory language. Part II also discusses the Arkansas Supreme Court's decision in *First State Bank*, which misinterprets and misapplies ambiguous statutory language. Next, Part III illuminates the origins and intent underlying Arkansas's statute at issue in *First State Bank*, arguing that the court should have interpreted the statute to uphold the lien-hierarchy waterfall. This article frames this important issue for careful legislative consideration, advocating for statutory clarification over whether or not buyers at foreclosure sales assume personal liability for prior unpaid assessments on property.

## II. THE CONTEXT

Secured lending is a pillar of capitalism and a significant way to build wealth and increase consumption. But borrowers, lenders, and even courts sometimes misunderstand the distinction between “debt” and “security,” not only mischaracterizing collateral as an obligation itself, but also with respect to the legal interrelationship of creditors regarding the same collateral. Creditors holding security in the same collateral are legally ordered in a hierarchy, generally based on when a creditor perfects its lien.<sup>8</sup> If a senior lienholder forecloses a debtor's equity of redemption and sells the collateral to recoup a debt, any excess proceeds from the sale will go to junior lienholders in a “waterfall” of payments according to the hierarchical order.<sup>9</sup> It is axiomatic under the law of lien priority that junior liens—to the extent they are not repaid by senior-lien-foreclosure proceeds—are wiped out by such foreclosure, with any junior-debt deficiency becoming unsecured.<sup>10</sup>

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8. See *infra* Part II.A.3.

9. See *infra* Part II.A.4.

10. See *infra* Part II.A.4.

Statutes may modify the common-law first-in-time baseline of lien priority, creating a super-priority status for certain secured interests.<sup>11</sup> Multiple policy justifications have caused states to provide super-priority for mechanics' liens; purchase-money security interests; and, in some states for limited amounts, homeowner-association assessment liens.<sup>12</sup> In the context of real-property liens, states' approaches to priority mechanisms are far from uniform, and some legislative mandates are clearer than others.<sup>13</sup> And poorly written statutory provisions lead to judicial confusion over the effects of senior-lien foreclosures.

Section A of this Part discusses the difference between, and the relationship of, liability and liens. Furthermore, it explains the lien-priority system and analyzes how foreclosure affects liens. Section B discusses the CIC ownership structure, focusing on assessment liens and the statutes and policies governing association-lien priority.

## A. Secured Obligations and Priority

### 1. *The Debt and the Lien*

Knowing the difference between a debt and a lien is necessary to understand the law of finance.<sup>14</sup> Debt is the obligation to repay,<sup>15</sup> and it is typically represented by a promissory note.<sup>16</sup> A debtor's obligation to pay is distinct from the collateral given to secure the debt.<sup>17</sup> Unless a specific statute or a contract provides otherwise, all debt is unsecured. In secured lending, a debtor pledges property as collateral to secure the debt in a separate act, indicated by a mortgage or security agreement.<sup>18</sup> The pledge of collateral

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11. See *infra* Part II.A.2.

12. See *infra* Part II.A.2.

13. See *infra* Part III.

14. A "lien" is "[a] legal right or interest that a creditor has in another's property, lasting usu[ally] until a debt or duty that it secures is satisfied." BLACK'S LAW DICTIONARY 1006 (9th ed. 2009). A "debt" is "[l]iability on a claim; a specific sum of money due by agreement or otherwise." *Id.* at 462.

15. See *id.*

16. See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 1.1 cmt. (1997).

17. See *id.*

18. See *id.*

gives the creditor a security interest in the property—a lien securing the payment obligation.<sup>19</sup>

A lien can be created by contract,<sup>20</sup> by statute,<sup>21</sup> and by judgment.<sup>22</sup> If a voluntary or statutory lien secures the creditor's right to repayment, then the value of particular property will back up the repayment.<sup>23</sup> Conversely, unsecured creditors have no security interest in a debtor's assets.<sup>24</sup> Unsecured creditors rely exclusively on a debtor's credit—his willingness and ability to repay—rather than on the value of any particular assets.<sup>25</sup> An unsecured creditor can only obtain lien rights to collect from a debtor's property through the judicial process and state collections law.<sup>26</sup>

When a debtor pledges real property as the collateral securing payment of a loan, the lien on the real property is called a mortgage.<sup>27</sup> A mortgage is security for an obligation;

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19. See 1 GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 5.27, at 529 (5th ed. 2007) (“[T]he mortgagee of real property has two things: the obligation owed by the mortgagor, and the interest in the realty securing that obligation.”).

20. 53 C.J.S. *Liens* § 11 (2005) (known as “consensual liens”).

21. 53 C.J.S. *Judgments* § 13 (2005). Many states have statutes that grant liens to landlords, mechanics, artisans, tax authorities, attorneys, and CICs. See, e.g., 56 C.J.S. *Mechanics' Liens* § 1 (2007); 7A C.J.S. *Attorney & Client* § 444 (2004); 52A C.J.S. *Landlord & Tenant* § 1212 (2003); 85 C.J.S. *Taxation* § 2065 (2001).

22. 50 C.J.S. *Judgments* § 760 (2009). However, “[a] judgment lien is entirely dependent for its existence on the statutory provision that created it.” *Id.* Unsecured creditors can obtain a judicial lien by reducing the debt to a liquidated amount through judgment and then using the applicable state collection process to obtain and execute a writ. See 50 C.J.S. *Judgments* §§ 760-61.

23. See 53 C.J.S. *Liens* §§ 2, 11, 13 (2005). Because a lien neither provides title to property nor a right to possession, the secured creditor relies on both the debtor's credit and the value of the collateral should that credit fail. See 53 C.J.S. *Liens* § 2.

24. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 24-2, at 841 (5th ed. 2000). This security interest in the collateral—in addition to the contract right to payment from the debtor—is advantageous to creditors in bankruptcy, where proceedings guarantee repayment to a secured lender up to the value of the collateral, even if unsecured lenders only receive a small percentage of their debt. See 79 C.J.S. *Secured Transactions* § 7 (2006).

25. See WHITE & SUMMERS, *supra* note 24.

26. See 53 C.J.S. *Liens* § 15 (2005). Once a creditor obtains a judicial lien, a sheriff will execute a writ and then seize and sell a debtor's property; the proceeds from such a sale will apply to the debt. See 55 AM. JUR. 2D *Mortgages* § 778 (1996).

27. See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 1.1 cmt. (1997) (“The function of a mortgage is to employ an interest in real estate as security for the performance of some obligation.”). The law of the state in which the property is located governs liens on real property. 53 C.J.S. *Liens* § 2. A state's version of Article 9 of the Uniform Commercial Code (UCC), which all 50 states have adopted, governs

therefore, an obligation must exist in order for a mortgage to have any effect.<sup>28</sup> The note and mortgage perform different functions and provide different rights and remedies. The note represents the borrower's personal obligation to the creditor.<sup>29</sup> The mortgage, on the other hand, gives the creditor a remedy for the borrower's failure to satisfy the obligation by granting the creditor a security interest in the real property.<sup>30</sup> Under the note, recovery is against the borrower for the money owed; under the mortgage, recovery is against the collateral's value.<sup>31</sup> Without the note, the mortgage has no effect; even without the mortgage, however, the note still indicates a debt obligation—albeit an unsecured one.<sup>32</sup>

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liens in personal property. JAMES BROOK, *PROBLEMS & CASES ON SECURED TRANSACTIONS* 18 (2d ed. 2012).

28. "While no personal liability is necessary to a valid mortgage, it is essential that the mortgage secure some obligation." RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 1.1 reporters' note (citing *Drummond v. Callejo (In re Janis)*, 151 B.R. 936 (Bankr. D. Ariz. 1992); *Cnty. of Keith v. Fuller*, 452 N.W.2d 25, 30 (Neb. 1990)). Recently, cases have increased where borrowers defend against enforcement of a mortgage obligation by demanding that a lender first prove the existence of the secured obligation. See, e.g., *Jerde v. JPMorgan Chase Bank*, 502 F. App'x 616, 617 (8th Cir. 2013); *Jackson v. Mortg. Elec. Registration Sys., Inc.*, 770 N.W.2d 487, 500-01 (Minn. 2009); *Bierwirth v. BAC Home Loans Servicing*, No. 03-11-00644-CV, 2012 WL 3793190, at \*3-5 (Tex. Ct. App. Aug. 30, 2012). Although enforcement requires an obligation to the lender, a party may be able to enforce the mortgage without having physical possession of the note evidencing that obligation. See, e.g., *Jerde*, 502 F. App'x at 617; *Jackson*, 770 N.W.2d at 500-01; *Bierwirth*, 2012 WL 3793190, at 3-5. Initially, some argued successfully that Article 3 of the UCC precludes someone who does not possess a note from enforcing a mortgage unless the non-possessor is acting as an agent of the note-holder (the "show me the note" defense), but courts and scholars have since determined that a non-possessor may enforce a mortgage as long as she can adequately prove her rights to collect on the debt that the mortgage secures. NELSON & WHITMAN, *supra* note 19, at 530 ("For a transfer to be complete both the obligation and the security interest must pass to the same person."). Effective securitization of mortgages requires transferring and "pooling" the promissory notes, along with the associated mortgages, usually to a trustee or custodian who retains the legal right to enforce both. *Id.* at 531.

29. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 1.1 cmt.

30. 59 C.J.S. *Mortgages* § 2 (1998); RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 1.1 cmt.

31. See, e.g., *Bierwirth*, 2012 WL 3793190, at \*3 ("[A] lien creditor may pursue foreclosure of a lien against real property under the deed of trust independent of any personal action against the borrower for collection on the note.").

32. See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 1.1 cmt.

## 2. Lien Foreclosure

Because a secured creditor has a security interest in the collateral, it can seek payment of a secured obligation from the property itself. This is accomplished through foreclosure: the sale of the collateral and application of the proceeds of that sale to the unpaid debt.<sup>33</sup> Mortgage-foreclosure sales—based on state law, contract requirements, and a creditor’s choice of remedies—happen in two ways: judicial foreclosure and non-judicial foreclosure. All states permit judicial foreclosure, which is a court proceeding followed by a judicially ordered and conducted public sale.<sup>34</sup> Judicial foreclosure is expensive and time consuming.<sup>35</sup> In an increasing number of states, parties can contract out of the judicial-foreclosure process and opt for a privately conducted public-auction sale of property.<sup>36</sup> Where available, this non-judicial foreclosure requires strict compliance with enumerated statutory procedures, such as notice and timing, but it occurs without direct involvement or oversight by the court.<sup>37</sup>

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33. See BLACK’S LAW DICTIONARY 719 (9th ed. 2009). When the collateral is personal property, the UCC provides that with the debtor’s consent, in lieu of a sale of the collateral, the creditor may take title to the collateral in full or partial satisfaction of the debt. U.C.C. § 9-620 (2001). With respect to real property, however, “strict foreclosure” is generally unavailable under modern mortgage-finance laws. 59A C.J.S. *Mortgages* § 694 (1998). Nonetheless, a creditor can still bid on real property at a public foreclosure, and a debtor can consent to deeding the property to the creditor in order to satisfy the debt (a so-called “deed in lieu of foreclosure”). See BLACK’S LAW DICTIONARY 476 (9th ed. 2009) (defining a “deed in lieu of foreclosure” as “[a] deed by which a borrower conveys fee-simple title to a lender in satisfaction of a mortgage debt and as a substitute for foreclosure”).

34. BLACK’S LAW DICTIONARY 719 (9th ed. 2009).

35. *Id.* After the mortgage crisis of 2008, the high volume of defaulted mortgages created a huge backlog in judicial foreclosures in many states. See Christopher Mayer et al., *The Rise in Mortgage Defaults*, 23 J. ECON. PERSPECTIVES 27, 27 (2009). This increase also exacerbated the delays between mortgage default and the foreclosure sale. See *id.* (noting that anecdotal evidence suggests that less than half of foreclosures are completed). In some states, foreclosure sales were not conducted until more than a year after initiation of the foreclosure proceeding. Lisa Prevost, *Paying for Foreclosure Delays*, N.Y. TIMES, Jan. 5, 2014, at RE5.

36. See NELSON & WHITMAN, *supra* note 19, § 7.19, at 845-46. Non-judicial foreclosure is also called “power-of-sale foreclosure.” BLACK’S LAW DICTIONARY 719 (9th ed. 2009). Typically, a trustee who holds title to the property pledged as collateral conducts the sale. NELSON & WHITMAN, *supra* note 19, § 7.10, at 845-46.

37. NELSON & WHITMAN, *supra* note 19, § 7.19, at 848-49. Deviation from the statutory requirements can void the foreclosure sale. *Id.* § 7.20, at 850.



If a creditor is over-secured, the proceeds from the foreclosure sale will be sufficient to repay the debt in full, leaving excess “equity” value that will be distributed to the debtor.<sup>38</sup> If a creditor is under-secured, however, the foreclosure proceeds will be insufficient to pay the entire debt.<sup>39</sup> In this case, unless applicable statutory or contract terms provide otherwise, the unpaid debt will remain a valid obligation, but it will be unsecured.<sup>40</sup>

### 3. *The Law of Lien Priority*

When property encumbered by a lien is sold in satisfaction of a debt, the proceeds of that sale must be used to pay off that debt.<sup>41</sup> If multiple creditors have lien rights in the same collateral, payment will be made according to a hierarchy based on lien priority.<sup>42</sup> A debtor must repay all senior obligations in full before paying an obligation that is junior to the foreclosing lienholder’s claim.<sup>43</sup> Because the prior “bucket” of obligations must overflow (generating excess proceeds) before any proceeds trickle down to a junior obligation, the financial industry uses the phrase “payment waterfall” to describe this hierarchical application of proceeds<sup>44</sup>—with money flowing from higher buckets (senior obligations) to lower buckets (junior obligations) until the proceeds are exhausted.<sup>45</sup>

Liens are created by pledging a security interest in collateral, as documented in the security agreement or

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38. 59A C.J.S. *Mortgages* § 967 (1998).

39. *See id.* § 933.

40. *See id.* § 932. Some states have anti-deficiency statutes prohibiting a mortgage lender from seeking payment of the under-secured portion of the debt. *Id.* § 933. Additionally, some mortgage financing is made on a nonrecourse basis, meaning that recovery from the collateral property effectively discharges any post-foreclosure unpaid debt. NELSON & WHITMAN, *supra* note 19, § 2.1, at 20 (noting that nonrecourse clauses eliminate a mortgagor’s personal liability for the debt). Nonrecourse financing is more common in commercial real-estate transactions. *See id.*

41. 59A C.J.S. *Mortgages* § 966.

42. *Id.* § 961.

43. *Id.*

44. Steven L. Schwarcz, *Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown*, 93 MINN. L. REV. 373, 378 (2008).

45. *See id.*

mortgage.<sup>46</sup> But in order to perfect a security interest, one must give public notice of the lien.<sup>47</sup> For mortgages, this means recording them in the applicable local land records.<sup>48</sup> Creation of the lien gives a creditor the right to the property as against the debtor, but perfection makes that right safe from competing creditors' claims and gives the perfected creditor a right to the property as against the world.<sup>49</sup>

Lien perfection establishes a creditor's place in the queue of claims against given collateral; and unless modified by statute, the chronological order of perfection establishes priority.<sup>50</sup> Some statutes change the general rule, creating a super-priority for certain liens.<sup>51</sup> Priority is the dispositive issue for determining the order in which proceeds from a

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46. *See id.*

47. WHITE & SUMMERS, *supra* note 24, § 22-4, at 758 (citing "filing" and "possession" as ways to "put a diligent searcher on notice of the secured party's claim").

48. For a security interest in personal property, perfection is governed by UCC Article 9 and typically involves filing a financing statement in the appropriate place, as determined by the type of collateral. *See* U.C.C. § 9-310(a) (2012); WHITE & SUMMERS, *supra* note 24, § 22-4, at 757-58. Under UCC Article 9, creditors can, or must, perfect some types of collateral through possession or control. *See* U.C.C. § 9-313(a) (2012) ("[A] secured party may perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral."); U.C.C. § 9-314(a) (2012) (providing that a security interest in investment property and electronic chattel paper "may be perfected by control" and that, with narrow exceptions, creditors must perfect by control security interests in letter-of-credit rights and deposit accounts).

49. WHITE & SUMMERS, *supra* note 24, § 22-4, at 757.

50. The Restatement describes this process as follows:

Generally, the priority of mortgages and other interests in real estate is determined by the chronological order of their creation. However, this principle is subject to a multitude of limitations. Foremost of these are the recording acts, which in every state allow qualifying subsequent takers of real estate interests to prevail over those holding prior unrecorded interests. The chronological priority rule is also limited by subordination agreements, bankruptcy, mechanics' lien legislation, and principles governing mortgages providing for future advances, as well as other legislation and common-law concepts.

RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.1 cmt. a (1997). Purchase-money liens generally take precedence over any other claim or lien attaching to the property. *See* 59 C.J.S. *Mortgages* § 215 (1998). Statutory liens will have the priority assigned by the statute or, absent a statute, by "the well-known principle of first in time, first in right." 53 C.J.S. *Liens* § 27 (2005). Judicial liens are often "perfected" through attachment or levy pursuant to a writ. *See* 50 C.J.S. *Judgments* § 818 (2009).

51. For example, a purchase-money security interest typically enjoys a "super-priority" interest. *See* 59 C.J.S. *Mortgages* § 215.

foreclosure sale are applied to claims in the waterfall and for determining when and how to discharge liens.<sup>52</sup>

#### 4. The Payment Waterfall

In a foreclosure sale, the proceeds first satisfy the foreclosing creditor, with any remaining funds applying to junior security interests in order of priority.<sup>53</sup> The underlying principle for this distribution scheme is that “the surplus represents the remnant of the equity of redemption and security wiped out by the foreclosure.”<sup>54</sup> Thus, foreclosure will necessarily wipe out the debtor’s equity in the property and any liens that are junior to the foreclosing lien, regardless of whether the debtor repaid them in part or in full.<sup>55</sup> As an example, if senior lender A, owed \$100,000, forecloses on its lien and the sale generates \$120,000, lender A will receive \$100,000, and the remaining \$20,000 will pay any junior liens in order of priority. If two junior lienors, B and C, each claim \$30,000, then the first of these junior lienors (B) will receive a payment of \$20,000 and the second (C) will receive nothing. Both of the junior liens will be extinguished, regardless of whether any foreclosure proceeds satisfy them.<sup>56</sup> The surplus from A’s foreclosure is

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52. *See id.* § 204.

53. 59A C.J.S. *Mortgages* § 968 (1998).

54. NELSON & WHITMAN *supra* note 19, § 7.31, at 920.

55. *See, e.g.,* Reilly v. Firestone Tire and Rubber Co., 764 F.2d 167, 172 (3d Cir. 1985) (noting that senior-lien foreclosure extinguished junior lease); United States v. Roberts, 788 F. Supp. 555, 557 (S.D. Fla. 1991) (concluding that foreclosure of prior mortgage extinguished easement); First Interstate Bank v. Tanktech, Inc., 864 P.2d 116, 119 (Colo. 1993) (concluding that the foreclosure of a senior security interest terminates any junior liens); W. Fertilizer & Cordage Co. v. City of Alliance, 504 N.W.2d 808, 815 (Neb. 1993) (noting that the foreclosure of senior mortgage extinguished a junior lien); Hembree v. Mid-Am. Fed. Sav. & Loan Ass’n, 580 N.E.2d 1103, 1108 (Ohio Ct. App. 1989) (noting that a foreclosure will “cut off the rights in the property of all parties to the action,” including “the mortgagor, the [foreclosing] mortgagee, subsequent holders of title, junior lienholders, and all other claimants whose claims or interests in the property attached subsequent to the mortgage”).

56. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.1 (1997) (“A valid foreclosure of a mortgage terminates all interests in the foreclosed real estate that are junior to the mortgage being foreclosed and whose holders are properly joined or notified under applicable law. Foreclosure does not terminate interests in the foreclosed real estate that are senior to the mortgage being foreclosed.”).

the monetization of the liens that previously attached to the real estate.<sup>57</sup>

Although junior liens will necessarily vanish in a foreclosure, extinguishing a lien does not extinguish the associated debt.<sup>58</sup> In the example above, after A's foreclosure is complete, B will continue to have an unsecured claim against the debtor for \$10,000 (the unpaid portion of the debt to B), and C will have an unsecured claim of \$30,000.<sup>59</sup> These debts are personal obligations of the debtor, and contract law governs their collectability.<sup>60</sup> But because B and C's debts are no longer secured, they will no longer have any claim on the debtor's assets that were sold in A's foreclosure.<sup>61</sup>

Treatment of lenders who are senior to a foreclosing lienor differs from the junior-lienor hypothetical above. The waterfall of payments and lien discharge flows down, not up.<sup>62</sup> So in the aforementioned example, if B, rather than A, foreclosed on his lien, then the proceeds from B's foreclosure would first pay off the debt owed to B and then pay off the debt owed to C, with any excess going to the debtor. Neither B nor C, nor the debtor, would have any remaining interest in the property. But A, as a holder of a lien senior in priority to B's foreclosed lien, would continue to hold a lien on the

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57. See *Hanley v. Pearson*, 61 P.3d 29, 31 (Ariz. Ct. App. 2003) (“[S]urplus from a trustee sale is applied to those liens that are extinguished by the sale in the order of their priority.” (citing RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.4 (1997))).

58. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.5 cmt. c (1997) (“Enforceability of the obligation and of the mortgage are governed by different bodies of law; the obligation’s enforcement is governed by the Uniform Commercial Code and by contract law, while mortgage enforcement is governed by a specialized body of property law.”).

59. These creditors will have the unsecured claims unless either obligation is expressly nonrecourse, either through contractual provision or because of anti-deficiency legislation.

60. See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.5 cmt. c. Note that such unsecured obligations will be wiped out in a borrower’s bankruptcy.

61. See NELSON & WHITMAN *supra* note 19, § 7.14, at 819 (“Ultimately the purpose is to place the foreclosure sale purchaser in the position of the mortgagor when the foreclosed mortgage was executed. Thus, the proper object of a foreclosure action is to sell the property given as security by the mortgagor and in doing so cut off the rights of redemption in that property of the mortgagor and everyone claiming under him or her.” (footnote omitted)).

62. *Id.* § 7.2, at 769.

property—fully securing the unpaid debt obligation to A.<sup>63</sup> Accordingly, the purchaser at B's foreclosure sale would take title subject to A's continuing lien.<sup>64</sup> Unless A opts to join in the foreclosure action, A's lien is not discharged, nor is A entitled to any proceeds from B's foreclosure sale.<sup>65</sup> After the foreclosure sale, A could seek payment either from the debtor or from the property, even though the debtor is no longer the property's owner.<sup>66</sup>

The difference between a senior and junior lienor at foreclosure turns on whether the lien is monetized and extinguished, or whether it remains attached to the property after the foreclosure sale. The only reason that a lien would persist after foreclosure would be that it has priority over the foreclosed lien.<sup>67</sup> "It is a fundamental principle of mortgage law that a valid judicial foreclosure of a senior mortgage terminates not only the owner's title and equitable

63. See *id.* § 1.1, at 6 ("[T]he foreclosure of a junior mortgage normally will not affect the status of a senior mortgage on the property.").

64. See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.1 cmt. a (1997) ("It is equally axiomatic that the title deriving from a foreclosure sale, whether judicial or by power of sale, will be subject to all mortgages and other interests that are senior to the mortgage being foreclosed. Therefore, in calculating an appropriate foreclosure bid a prospective purchaser should subtract any senior liens from the fair market value of the real estate." (citation omitted)).

65. See, e.g., *R-Ranch Mkts. #2, Inc. v. Old Stone Bank*, 21 Cal. Rptr. 2d 21, 23 (Ct. App. 1993) (holding that the foreclosure of junior deed of trust did not extinguish prior senior lease); *Sumitomo Bank v. Davis*, 6 Cal. Rptr. 2d 381, 385 (Ct. App. 1992) (holding that foreclosure of junior lien does not affect senior liens); *Heritage Fed. Credit Union v. Giampa*, 622 N.E.2d 48, 49-50 (Ill. App. Ct. 1993) (holding that foreclosure of a junior mortgage does not cut off senior mortgage).

66. See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.4 cmt. c (1997) ("Unlike their junior lien counterparts, [senior lienor's] liens are unaffected by foreclosure and remain on the foreclosed real estate. [Senior lienors] remain free to foreclose on the real estate, and thus there is no justification for transferring any part of their liens to the junior foreclosure surplus.").

67. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.1. Foreclosure law requires that all junior interests be joined in the foreclosure proceeding of a senior lienholder because the foreclosure extinguishes all such junior liens. See *id.* Moreover:

A purchaser of property at an execution sale does not take subject to liens junior to the one under which the execution sale was made . . . . A sheriff's sale of real property divests all junior liens on that property. A sale under a senior judgment cancels the lien of a junior judgment, which is thereafter transferred to the surplus proceeds of the sale. If there is no surplus, the junior judgment creditor must save the debt by redeeming from the sale.

33 C.J.S. *Executions* § 472 (footnote omitted).

redemption rights but also all other junior interests whose holders were made parties defendant.”<sup>68</sup>

### B. CIC Assessments: Liens and Liability

In a CIC, all properties are subject to real covenants that require every homeowner to share funding of community costs and to be a member of the governing association.<sup>69</sup> Property ownership through CICs and private-community governance is increasingly common.<sup>70</sup> Approximately 63.4 million people in the United States (20% of the country’s population) currently live in one of 323,600 privately governed CICs.<sup>71</sup> CIC neighborhoods exist in both urban and suburban developments throughout the country; indeed, CICs so dominate new housing that finding a new home outside of a CIC is virtually impossible in some geographic

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68. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.1 cmt. a (“A power of sale (nonjudicial) foreclosure that complies with applicable statutory notice and related requirements accomplishes the same result. Thus, a purchaser at a foreclosure sale not only acquires the previous owner’s interests in the real estate, but a title free and clear of all other properly joined interests that were junior to the foreclosed lien.”).

69. See HYATT, *supra* note 3, at 7-8. A board of directors, elected by the unit owners, governs the association. *Id.* at 80-81. Every property owner within a CIC is also a mandatory member of the association. *Id.* at 8. A recorded declaration of covenants grants the association the power and authority to govern, to assess owners for upkeep, and to enforce rules regarding use and appearance of individual properties. See *id.* at 32.

70. See JOEL GARREAU, *EDGE CITY: LIFE ON THE NEW FRONTIER* 189 (1991) (“If you want a new home, it is increasingly difficult to get one that doesn’t come with a homeowners’ association . . . .” (internal quotation marks omitted)).

71. FOUND. FOR CMTY. ASS’N RESEARCH, *STATISTICAL REVIEW 2012: FOR U.S. HOMEOWNERS ASSOCIATIONS, CONDOMINIUM COMMUNITIES, AND HOUSING COOPERATIVES* (2012), available at <http://www.cairf.org/foundationstatsbrochure.pdf>. Data indicates that the number of CIC residents increased from 2.1 million in 1970 to 63.4 million in 2012. *Id.* This figure represents nearly 20% of the U.S. population, which the U.S. Census Bureau estimated to be 313.8 million in 2012. *Population Quick Facts*, U.S. CENSUS BUREAU, <http://quickfacts.census.gov/qfd/states/00000.html> (last updated Mar. 27, 2014). The number of communities adopting a private-governance model continues to grow. Andrea J. Boyack, *Community Collateral Damage: A Question of Priorities*, 43 *LOY. U. CHI. L.J.* 53, 58 (2011). But the proliferation of the CIC form is not uniformly heralded as a positive development. See David E. Grassmick, *Minding the Neighbor’s Business: Just How Far Can Condominium Owners’ Associations Go in Deciding Who Can Move into the Building*, 2002 *U. ILL. L. REV.* 185, 189 & n.34 (“In a sort of Gresham’s Law of property [under which bad money drives out good money], the condominium or owners’ association-governed community is crowding other types of housing from the market.” (footnote omitted)).

areas.<sup>72</sup> Municipal governments promote the CIC structure as a way to avoid funding community improvements and infrastructure.<sup>73</sup> Moreover, some homebuyers prefer CICs as a way to provide shared amenities such as open space, golf courses, and swimming pools.<sup>74</sup> Additionally, condominium ownership allows apartment dwellers to own their own home in fee simple.<sup>75</sup>

### 1. *Financial Entanglement and Assessment Non-Payment*

CIC ownership permits individual ownership of a parcel of land or a unit in a building together with co-ownership and/or joint right to use common areas.<sup>76</sup> In a CIC, servitudes bind all unit owners to share the costs of maintaining common areas; a neighborhood association assesses the upkeep costs and otherwise governs and

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72. See Paula A. Franzese & Steven Siegel, *Trust and Community: The Common Interest Community as Metaphor and Paradox*, 72 MO. L. REV. 1111, 1117 (2007); see also FOUND. FOR CMTY. ASS'N RESEARCH, *supra* note 71 (reporting that approximately 38% of the country's CIC communities are in just four states—Florida, California, Texas, and Illinois); Michelle Conlin & Tamara Lush, *Neighbor vs. Neighbor as Homeowner Fights Get Ugly*, YAHOO! FIN. (July 7, 2011, 4:24 PM), <http://finance.yahoo.com/news/Neighbor-vs-neighbor-as-apf-344592220.html> (“More than 80 percent of newly constructed homes in the U.S. are in association communities.”). In such local markets, buyers of new homes have little or no choice but to buy into a CIC. See Franzese & Siegel, *supra* at 1113 (“[A]t present, there exists no meaningful consumer choice amongst CIC organizational structures.”).

73. See FOUND. FOR CMTY. ASS'N RESEARCH, *supra* note 71 (noting that municipal governments generally require a CIC to “assume many responsibilities that traditionally belonged to local and state government”).

74. See Rachel Furman, Note, *Collecting Unpaid Assessments: The Homeowner Dilemma When Foreclosure Is No Longer a Viable Option*, 19 J.L. & POL'Y 751, 756 (2011).

75. See Donna S. Bennett, *Condominium Homeownership in the United States: A Selected Annotated Bibliography of Legal Sources*, 10 LAW LIBR. J. 249, 255 (2011); see 31 C.J.S. *Estates* § 234 (2008) (“As condominium units or apartments are considered to be real property, an ownership interest therein is an interest in real property.”). By 1970, all fifty states had enacted condominium-enabling legislation permitting fee-simple ownership of apartment units. Bennett, *supra* at 256-57. Since passing throughout the United States, “[t]he concept has electrified the housing profession.” *Id.* at 256 (internal quotation marks omitted).

76. James H. Jefferies IV, Note, *North Carolina Adopts the Uniform Condominium Act*, 66 N.C. L. REV. 199, 199-200 (1987).

maintains the CIC.<sup>77</sup> A lien on the unit owner's property secures his obligation to pay CIC assessments.<sup>78</sup>

Owners in a CIC are financially interconnected with their neighbors, even though they may not anticipate or understand this relationship.<sup>79</sup> When one owner fails to pay assessed upkeep charges, the deficiency, if left uncollected, will eventually cost the other owners additional fees or negatively impact promised community upkeep.<sup>80</sup> Sam Chandan, chief economist at the real-estate research firm Reis, explained how the benefit of community contributions to shared amenities always comes at a cost of economic entanglement:

What motivated people to go into the condo market in a way that led to overbuilding was the expectation that it would be easier than owning a home on a maintenance basis . . . . The downside is that your fate is tied to 50 or 100 other people who may stop making their condo payments.<sup>81</sup>

The more non-paying owners and the larger the unpaid debt, the greater the financial impact on those members of the community that do pay.<sup>82</sup> In 2010, for example, in over 60% of Florida's condominiums, half of the owners were at least two months behind on their assessments.<sup>83</sup> One California CIC demanded that owners pay a six-figure

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77. Boyack, *supra* note 71, at 72-73. Most associations' governing documents provide explicitly for assessment funding of the association. HYATT, *supra* note 3, at 108 ("Generally, covenants in the declaration provide authority for the association to collect assessments from each owner."). Even in the rare case where covenants do not authorize assessments explicitly, courts generally find an association's power to assess implicit in the structure of a CIC. See, e.g., *Meadow Run & Mountain Lane Park Ass'n v. Berkel*, 598 A.2d 1024, 1027 (Pa. Super. Ct. 1991) (finding that an association's power to assess maintenance costs on property owners is inherent in its duty to maintain a neighborhood's common areas and amenities); *Fogarty v. Hemlock Farms Cmty. Ass'n*, 685 A.2d 241, 244 (Pa. Commw. Ct. 1996) (holding that the association could assess property owners the proportionate costs of the association absent language in the deed to the contrary).

78. See *infra* Section II.B.2.

79. Boyack, *supra* note 71, at 60-61, 76-77.

80. See *id.* at 61 ("Increased assessments, triggered by chronic non-payments, essentially result in forced inter-neighbor loans.").

81. Christine Haughney, *Collateral Foreclosure Damage*, N.Y. TIMES, May 15, 2008, at C1 (internal quotation marks omitted).

82. See Boyack, *supra* note 71, at 60-62.

83. Rachel Lee Coleman, *Desperate Condos Thrown a Lifeline*, MIAMI HERALD, Mar. 7, 2010, at 1A.



special assessment to cover the association's budgetary shortfall caused by non-paying members.<sup>84</sup>

When robbed of assessment payments, an association will necessarily increase assessments, decrease services, and/or allow the community's appearance and quality of living to decline.<sup>85</sup> Furthermore, decreasing services can mean much more than closing a golf course or swimming pool. For example, in condominiums, an association may fund casualty insurance on the building, and non-payment could leave the CIC structure uninsured.<sup>86</sup> And in some CICs, an association's budgetary failure may eliminate association-paid utilities, shut down elevators, or leave roofs unrepaired.<sup>87</sup> Requiring that paying owners foot the bill for their non-paying neighbors is "wrong, inefficient, and destabilizing."<sup>88</sup>

## 2. CIC Assessments and Liens

Property owners in a CIC are bound to pay the community assessments,<sup>89</sup> and those covenants are specifically enforceable obligations that run with the land and bind its successive owners.<sup>90</sup> Under this system, owners are personally liable to pay assessments, and a lien

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84. Carol Lloyd, *Condominium Homeowners Face Rising Condo Fees and Special Assessments*, SFGate.com (Aug. 3, 2007, 4:00 AM), <http://www.sfgate.com/entertainment/article/Condominium-homeowners-face-rising-condo-fees-and-2549603.php>.

85. HYATT, *supra* note 3, at 121 ("Assessments are generally the community's primary funding source. When one member of the community chooses not to pay the assessments, everyone in the community pays the price through increased assessments, decreased services, and declining community appearance and quality of living.").

86. See Boyack, *supra* note 71, at 62.

87. See *id.* at 77-80 (describing multiple ill-effects from widespread assessment non-payment).

88. *Id.* at 61-62; see also JOHN RAWLS, *A THEORY OF JUSTICE* 112 (5th ed. 1973) (advocating that beneficiaries of a cooperative venture should bear the costs of that venture on a pro rata basis); H. L. A. Hart, *Are There Any Natural Rights?* 64 *PHILOSOPHICAL REV.* 175, 185-86 (1955) (explaining that the unfair enjoyment of benefits by parties not bearing associated costs is inequitable).

89. See RESTATEMENT (THIRD) OF PROP.: SERVITUDES §§ 6.4, 6.7, 6.16 (2000) (concerning the powers of CIC associations).

90. See Andrea J. Boyack, *Freedom of Contract and the Endangered Right to Transfer*, J.L. & POL'Y (forthcoming 2014).

encumbers property to secure this obligation.<sup>91</sup> The association can seek payment from the owner personally.<sup>92</sup> The association also has the power to foreclose on its lien, sell the property, and apply the sale proceeds to unpaid assessments.<sup>93</sup>

Although courts thought initially that assessment obligations could not be real covenants running with the land,<sup>94</sup> no doubt exists today that the obligation to fund community upkeep can be a servitude binding all present and future owners of property.<sup>95</sup> This does not necessarily mean, however, that future owners of the property become liable for the prior owner's unpaid assessments.<sup>96</sup> Nevertheless, because a property lien secures assessment obligations, even if a purchaser has no personal obligation to pay amounts overdue at the time of purchase, a lien securing the association's right to the overdue amount would still encumber the purchased property.<sup>97</sup> A purchaser of CIC

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91. Trevor G. Pinkerton, Comment, *Escaping the Death Spiral of Dues and Debt: Bankruptcy and Condominium Association Debtors*, 26 EMORY BANKR. DEV. J. 125, 136 (2009).

92. For a discussion of the collection efforts that CIC associations can employ, see Boyack, *supra* note 71, at 87-93.

93. HYATT, *supra* note 3, at 119. In some jurisdictions, a CIC association's foreclosure power is limited; common limitations include requiring judicial (as opposed to non-judicial) foreclosure of an association's lien. Boyack, *supra* note 71, at 90 ("Judicial foreclosure is the exclusive method of foreclosure in over one-third of the states . . .").

94. Prior to *Neponsit Property Owners' Association v. Emigrant Industrial Savings Bank*, courts characterized covenants to pay money as personal—by definition not "touching and concerning" the real property—and did not permit them to run with the land. 15 N.E.2d 793, 796-97 (N.Y. 1938). The *Neponsit* court held that assessments made to maintain real property had a sufficient nexus with real property to "touch and concern" the land and, therefore, operate as a servitude. *Id.* at 798. This decision spurred growth of such covenants across the country. Paul Boudreaux, *Homes, Rights, and Private Communities*, 20 U. FLA. J.L. & PUB. POL'Y 479, 486 (2009). Enforcing payment obligations as servitudes on real property is now routine. See, e.g., *Regency Homes Ass'n v. Egermayer*, 498 N.W.2d 783, 792-93 (Neb. 1993) (holding that a covenant to pay dues to a community association to maintain neighborhood amenities is a real covenant that runs with the land).

95. HYATT, *supra* note 3, at 117 ("Case law is generally well settled that, if properly drafted, an affirmative covenant to pay assessments to the association runs with the land and is binding on all successors in title.").

96. See *infra* notes 112-16 and accompanying text.

97. HYATT, *supra* note 3, at 107 ("There is normally both *in personam* and *in rem* liability with respect to unpaid assessments, and the community association typically has the right to pursue either or both theories of liability until the debt is

property, therefore, regardless of whether he or she is personally liable for previously unpaid assessments, takes title subject to any lien securing this obligation<sup>98</sup> unless the lien is specifically extinguished, for example, through foreclosure of a senior lien.<sup>99</sup>

Legislation imposing joint and several liability on buyers and sellers for unpaid CIC assessments creates symmetry in market sales where a buyer takes the property subject to the association lien.<sup>100</sup> When buyers take the property subject to the lien, holding them personally liable for the amount secured is sensible. In practical terms, if a lien on one's home secures a debt, a homeowner has every incentive to repay the debt even if he is not personally liable for it. Although an association cannot collect against an owner who bears no personal liability, the association can still foreclose the lien and collect from the property.<sup>101</sup> A buyer would be well advised to pay the arrearages to the association in either case.

When a buyer takes title through foreclosure of a lien that is senior to the association lien, however, a crucial difference exists. Foreclosure extinguishes the junior association lien, allowing the buyer to take title free and clear of the lien.<sup>102</sup> In such a case, imposing personal liability on the buyer creates, rather than cures, a liability-lien asymmetry. If a buyer is liable for preexisting assessment arrearages at the time of the foreclosure, an association could seek payment of the overdue amount from that buyer in a personal-debt-collection action, but no lien securing that amount would exist for the association to foreclose.<sup>103</sup>

The very existence of an association assessment lien reflects the policy of empowering associations to collect unpaid dues.<sup>104</sup> The priority rules for CIC assessment liens relative to first-mortgage liens, however, must delicately

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satisfied.”). State law governs the ability of an association to foreclose on an assessment lien, including requirements for perfecting that lien. *Id.* at 120-21.

98. *See id.*

99. *See Boyack, supra* note 71, at 75.

100. *See infra* Part III.A.2.

101. *See supra* notes 91-92 and accompanying text.

102. *See Boyack, supra* note 71, at 75.

103. *See infra* Part III.A.1.c (describing Florida's approach).

104. *See Pinkerton, supra* note 91.

balance two policies: (1) allocating costs equitably for jointly used property; and (2) encouraging home-mortgage finance.<sup>105</sup> A state's lien-priority legislation typically reflects its approach to balancing these policies.<sup>106</sup> Although states employ various approaches for priority and perfection of association liens, every state generally considers association liens to be junior in priority to a first-mortgage lien on individual units.<sup>107</sup> Nonetheless, some states have legislatively created a limited super-priority for a capped amount of unpaid assessments.<sup>108</sup>

To the extent that an assessment lien is junior in priority to a first mortgage on a unit in the community, foreclosure by the first-mortgage lender extinguishes the association's assessment lien.<sup>109</sup> The non-paying obligor, who no longer owns the property, remains personally liable for unpaid assessments even after the lien securing that obligation extinguishes.<sup>110</sup> Although extinguishing the lien does not eliminate the prior owner's debt,<sup>111</sup> it raises the question of whether the new owner will also be personally liable for unpaid amounts.

Generally, whether or not a subsequent purchaser will share the prior owner's personal liability for overdue assessments turns on the CIC's governing documents<sup>112</sup> or,

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105. See, e.g., *Bd. of Dirs. v. Wachovia Bank*, 581 S.E.2d 201, 202 (Va. 2003) (“[T]he realities of the marketplace require that such lenders be encouraged to provide the desired financing for individual condominium units by granting priority to the lien of their first mortgages or first deeds of trust.”).

106. See *Boyack supra* note 71, at 75 (discussing various statutory approaches). Earlier iterations of condominium-enabling legislation did not address lien priority for CICs. See *infra* note 126 and accompanying text. Instead, these statutes attempted to protect the association against non-payment of assessments by holding buyers of CIC property jointly and severally liable with their seller for all unpaid assessment amounts. See *infra* Section III.A.

107. See *Boyack, supra* note 71, at 93-97 (discussing various jurisdictional approaches to lien priority).

108. See, e.g., FLA. STAT. ANN. § 718.116(1)(a)–(b) (West 2014).

109. See, e.g., *Highland Lakes Country Club & Cmty. Ass'n v. Franzino*, 892 A.2d 646, 654 (N.J. 2006) (holding that foreclosure of the senior, first-priority-mortgage lien discharged the lien for unpaid assessments).

110. See, e.g., *id.* at 654 n.5.

111. See, e.g., *id.* at 654 (“The property was no longer encumbered by [the association's junior] lien. That said, although that lien became unenforceable, the underlying debt that gave rise to that lien was not affected.”).

112. See, e.g., *Coral Lakes Cmty. Ass'n v. Busey Bank*, 30 So. 3d 579, 583-84 (Fla. Dist. Ct. App. 2010) (treating the language of the CIC's declaration as dispositive

in some cases, on an applicable statute.<sup>113</sup> Some CIC's governing documents specifically hold a purchaser of property personally liable for all assessment arrearages.<sup>114</sup> A statute may also impose personal liability for prior unpaid assessments on a buyer who purchases the property outside of or in foreclosure.<sup>115</sup> Alternately, some statutes specifically protect all buyers from such personal liability.<sup>116</sup>

### III. STATUTORY APPROACHES TO CIC ASSESSMENTS IN THE FORECLOSURE CONTEXT

Foreclosures of condominium units raise issues of debt survival, security validity, and the priority of creditors, including first-mortgage lenders and CIC associations. As noted earlier, most states provide that a first-mortgage lien

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in determining whether an obligation to pay unpaid assessments survived foreclosure of a senior mortgage lien).

113. See *infra* Part III.A.

114. See, e.g., *Highland Lakes*, 892 A.2d at 655 (holding a subsequent purchaser personally liable for unpaid assessments based on contract interpretation of the association's terms, and notwithstanding the extinguishment of the association's lien in foreclosure).

115. See *infra* Part III.A.1.

116. For example, a California law provides that no buyer of property will be "liable for a breach of the covenant before he acquired the estate." CAL. CIV. CODE § 1466 (West 2014). California courts have confirmed the applicability of this statute to CIC assessment obligations, noting that the buyer in a foreclosure "should not be liable for the debts of its predecessors in interest" and describing this result as mandated by "fairness." *Mountain Home Props. v. Pine Mountain Lake Ass'n*, 185 Cal. Rptr. 623, 629 (Ct. App. 1982). Like California, New Jersey offers a similar protection:

If a mortgagee of a first mortgage of record or other purchaser of a unit obtains title to such unit as a result of foreclosure of the first mortgage, such acquirer of title, his successors and assigns shall not be liable for the share of common expenses or other assessments by the association pertaining to such unit or chargeable to the former unit owner which became due prior to acquisition of title as a result of the foreclosure. Any remaining unpaid share of common expenses and other assessments, except assessments derived from late fees or fines, shall be deemed to be common expenses collectible from all of the remaining unit owners including such acquirer, his successors and assigns.

N.J. STAT. ANN. § 46:8B-21(e) (West 2013); see also *Bedminster Hills Hous. Corp. v. Timberbrooke at Bedminster Condo. Ass'n*, Nos. C-12057-06, F-1396-02, 2008 WL 631299, at \*3 (N.J. Super. Ct. App. Div. Mar. 11, 2008) (applying the statute). New Jersey courts have not applied this statute retroactively. See *Chase Manhattan Mortg. Corp. v. Spina*, 737 A.2d 704, 710 (N.J. Super. Ct. Ch. Div. 1998), *aff'd sub nom.*, *Chase Manhattan Mortg. Corp. v. Heritage Square Ass'n*, 737 A.2d 682 (N.J. Super. Ct. App. Div. 1999).

on a unit is completely superior in priority to association liens.<sup>117</sup> Some states require an association to file a notice of delinquent assessment—which occurs after one perfects the first-mortgage lien—as a prerequisite step to perfecting an association lien.<sup>118</sup> In other states, an association’s lien perfects at the time of the CIC’s formation; thus, recording the CIC declaration is the act of perfection.<sup>119</sup> Recordation of the CIC declaration occurs when the CIC is formed, and this happens before individual units are created, sold, or mortgaged, but even in these states, association priority is subordinate to first mortgage liens. Such states’ statutes specifically provide that first-mortgage liens on individual units in a common-interest community take priority over the association lien, even though the association lien relates back to the date of the CIC declaration.<sup>120</sup> Most states’ statutes are very clear that first-mortgage liens enjoy priority over assessment liens,<sup>121</sup> and in the few states where statutes are less clear or do not address this point at all, courts have uniformly acknowledged the superior priority of first mortgagees<sup>122</sup>—consistent with the desire to promote the availability of mortgage capital.<sup>123</sup>

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117. Boyack, *supra* note 71, at 93-98.

118. *E.g.*, CAL. CIV. CODE § 5675(a) (West 2014) (requiring an association to file a notice before its lien is perfected).

119. *E.g.*, FLA. STAT. ANN § 718.116(5)(a) (West 2014); TEX. PROP. CODE ANN. § 82.113(c) (West 2013).

120. *See, e.g.*, COLO. REV. STAT. ANN. § 38-33.3-316 (West 2014) (granting priority over an association lien to “[a] security interest on the unit which has priority over all other security interests on the unit and which was recorded before the date on which the assessment sought to be enforced became delinquent”); VA. CODE ANN. § 55-79.84(A) (West 2013).

121. *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-1256(B)(2) (West 2013); N.C. GEN. STAT. ANN. § 47F-3-116(j) (West 2013).

122. *See, e.g.*, Holly Lake Ass’n v. Fed. Nat’l Mortg. Ass’n, 660 So. 2d 266, 269 (Fla. 1995) (holding that for an assessment “to have priority over an intervening recorded mortgage, the declaration must contain specific language indicating that the lien relates back to the date of the filing of the declaration or that it otherwise takes priority over intervening mortgages”); Tally Arms Condo. Ass’n v. Breland, 854 So. 2d 28, 30 (Miss. Ct. App. 2003) (holding CIC’s assessments that were unfiled and subsequent to the original deed of the trust were senior in priority); First Fed. Sav. & Loan Ass’n of Charleston v. Bailey, 450 S.E.2d 77, 81 (S.C. Ct. App. 1994) (“[T]he assessments . . . were . . . subsequent to [the] mortgage lien and, thus, must necessarily be subordinate to the mortgage lien”).

123. *E.g.*, Bd. of Dirs. v. Wachovia Bank, 581 S.E.2d 201, 202 (Va. 2003) (“[T]he realities of the marketplace require that such lenders be encouraged to provide the

### A. Statutory Regimes

Over the past several decades, every state has adopted legislation enabling condominiums and, in many cases, addressing issues arising in a CIC context. Some such statutes are called “Horizontal Property Acts.”<sup>124</sup>

These acts vary widely in how they address buyers’ liability and association-lien priority. Some statutes, while mandating that a buyer of a CIC unit share liability with his seller for unpaid assessments,<sup>125</sup> say nothing about the survivability of any accompanying liens on the unit.<sup>126</sup> In contrast, several states’ joint-and-several-liability statutes specifically exclude all or some purchasers at foreclosure sales from such liability, while others do not reference foreclosure sales explicitly.<sup>127</sup> The statutory divide among states is traceable largely to the historical development of their condominium regimes. Generally, states that enacted condominium acts relatively early—prior to model acts—are those that are ambiguous with respect to whether a purchaser is liable for a seller’s past-due assessments.<sup>128</sup>

#### 1. *Origins of Horizontal-Property Legislation*

Current horizontal-property legislation has developed from four foundational condominium-ownership statutes: (a) the Puerto Rican Horizontal Property Act; (b) the

desired financing for individual condominium units by granting priority to the lien of their first mortgages or first deeds of trust”).

124. 15B AM. JUR. 2D *Condominiums* § 1 (2011) (internal quotation marks omitted).

125. See, e.g., ARK. CODE ANN. § 18-13-116(d) (Repl. 2003). This statute, part of the Arkansas Horizontal Property Act, maintains typical language establishing buyer liability for previously assessed amounts, providing that a buyer of property is “jointly and severally liable with the seller” for amounts owing at the time of conveyance. ARK. CODE ANN. § 18-13-116(d).

126. See, e.g., ARK. CODE ANN. § 18-13-116(d). If a statute is silent on lien priority, the priority scheme follows the common law “first in time, first in right” rule, which means that any buyer in a market sale would take subject to the lien, but any buyer in a foreclosure of a senior lien would take free and clear of the association lien. See Boyack, *supra* note 71, at 93.

127. Three types of joint-and-several-liability statutes exist: (1) some states’ statutes exclude all foreclosure sales from provisions regarding purchasers’ joint liability; (2) other statutes apply a joint-liability provision only to “voluntary” purchases; and (3) statutes may specifically exclude mortgagees who take title at the foreclosure of their lien. See *infra* Part III.A.2.

128. See UNIF. CONDO. ACT prefatory note (1980).

Federal Housing Administration's (FHA) Model Statute for the Creation of Apartment Ownership; (c) the Uniform Condominium Act (UCA); and (d) the Uniform Common Interest Ownership Act (UCIOA).

a. The Puerto Rican Horizontal Property Act

Condominiums are a relatively recent addition to the modes of property ownership in the United States. Indeed, condominium-ownership statutes first took hold in Cuba (in 1951) and Puerto Rico (in 1958) before becoming popular in the states.<sup>129</sup> The Puerto Rican Horizontal Property Act was itself based upon the Cuban law of 1951.<sup>130</sup> As to association dues, the 1958 Puerto Rican Act obligated all co-owners of condominium apartments to contribute pro rata to the expenses associated with the common elements of the property. Furthermore, it specifically prioritized this obligation over all other encumbrances, except for past-due taxes, insurance premiums, and recorded mortgages.<sup>131</sup> The

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129. ROBERT G. NATELSON, *LAW OF PROPERTY OWNERS ASSOCIATIONS* 29 & n.35 (1989).

130. *Id.*

131. The relevant provisions of the original 1958 Puerto Rican Act read as follows:

Section 39.—The co-owners of the apartments are bound to contribute pro rata toward the expenses of administration and of maintenance and repair of the general common elements, and, in the proper case, of the limited common elements, of the building, and toward any other expense lawfully agreed upon.

No co-owner may exempt himself from contributing toward such expenses by waiver of the use or enjoyment of the common elements or by abandonment of the apartment belonging to him.

Section 40.—The credit against a co-owner for his share in the expenses to which the preceding section refers shall have preference over any other credits of whatever nature but the following:

- (a) Credits in favor of the Commonwealth for the taxes of the last three annual assessments past-due and unpaid on the apartment.
- (b) For two years of premium on the insurance of the apartment, or of the whole building, as the case may be, and, in the case of mutual insurance, for the last two dividends distributed.
- (c) Mortgage credits recorded in the Registry of Property.



Act went on to make the buyer of a condominium unit liable for his seller's assessments.<sup>132</sup> Accordingly, under the Puerto Rican regime, one could not convey a condominium unit without the accompanying liability for any past-due assessments.<sup>133</sup> The Act, however, did not specifically address foreclosure sales or the priority of a condominium association's lien.

When states began adopting horizontal-property acts in the early 1960s, they adopted the Puerto Rican regime.<sup>134</sup> The Horizontal Property Acts in Arkansas,<sup>136</sup>

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Act of June 25, 1958, No. 104, §§ 39-40, 1958 P.R. LAWS 253-54 (codified as amended at P.R. LAWS ANN. tit. 31, §§ 1293c-1293d (West 2011)).

132. The Act states:

The acquirer of an apartment shall be jointly and severally liable with the conveyer for the amounts owing by the latter [for pro rata common element contributions] . . . up to the time of the conveyance, without prejudice to the acquirer's right to recover from the other party the amounts paid by him as such joint debtor.

Act of June 25, 1958, No. 104, § 41, 1958 P.R. LAWS 254 (codified as amended at P.R. LAWS ANN. tit. 31, § 1293e (West 2011)).

133. Act of June 25, 1958, No. 104, §§ 39-41, 1958 P.R. LAWS 253-54 (codified as amended at P.R. LAWS ANN. tit. 31, §§ 1293c-1293e).

134. "[T]he Puerto Rican Horizontal Property Act . . . was the basis upon which many American state legislatures built" their Horizontal Property Acts. NATELSON, *supra* note 129.

136. ARK. CODE ANN. §§ 18-13-101 to -120. Section 116 of the Arkansas Horizontal Property Act provides, in part:

(c) Upon the sale or conveyance of an apartment, all unpaid assessments against a co-owner for his or her pro rata share in the expenses to which subsection (a) of this section refers shall first be paid out of the sales price or by the acquirer in preference over any other assessments or charges of whatever nature except the following:

- (1) Assessments, liens, and charges for taxes past due and unpaid on the apartment; and
- (2) Payments due under mortgage instruments of encumbrance duly recorded.

(d) The purchaser of an apartment shall be jointly and severally liable with the seller for the amounts owing by the latter under subsection (a) of this section up to the time of the conveyance, without prejudice to the purchaser's right to recover from the other party the amounts paid by him or her as the joint debtor.

ARK. CODE ANN. § 18-13-116(c)-(d).

Nebraska,<sup>137</sup> and New Jersey<sup>138</sup> closely track the Puerto Rican statute.<sup>139</sup> Statutes in these states thus reflect the first-generation joint-and-several-liability approach taken from

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137. Nebraska Condominium Property Act, NEB. REV. STAT. ANN. §§ 76-801 to -823 (West 2013) (enacted originally in 1963). Section 818 of the Act provides:

Upon the sale or conveyance of an apartment, all unpaid assessments against a co-owner for his pro rata share in the expenses to which section 76-817 refers shall first be paid out of the sales price or by the acquirer in preference over any other assessments or charges of whatever nature except the following:

- (1) Assessments, liens, and charges for taxes past due and unpaid on the apartment; and
- (2) Payments due under duly recorded mortgage and lien instruments.

NEB. REV. STAT. ANN. § 76-818. Section 819 of the Act provides:

The purchaser of an apartment shall be jointly and severally liable with the seller for the amounts owing by the latter under section 76-817 up to the time of the conveyance, without prejudice to the purchaser's right to recover from the other party the amounts paid by him or her as such joint debtor. Co-owners shall not be individually liable for damages arising from the use of common elements. Any tort liability arising from the use of common elements shall be a common expense and shall be borne by all co-owners in proportion to the basic values referred to in sections 76-806 and 76-809.

NEB. REV. STAT. ANN. § 76-819.

138. N.J. STAT. ANN. §§ 46:8A-1 to -28. Section 46:8A-21 of the New Jersey Horizontal Property Act provides:

Upon the sale or conveyance of an apartment, all unpaid assessments against a co-owner for his pro rata share in the expenses to which section 18 refers shall first be paid out of the sales price or by the acquirer in preference over any other assessments or charges of whatever nature except the following:

- (a) Assessments, liens, and charges for taxes past due and unpaid on the apartment; and
- (b) Payments due under mortgage instruments of encumbrance duly recorded.

N.J. STAT. ANN. § 46:8A-21. Section 46:8A-22 of the Act provides:

The purchaser of an apartment shall be jointly and severally liable with the seller for the amounts owing by the latter under section 18 of this Title up to the time of the conveyance, without prejudice to the purchaser's right to recover from the other party the amounts paid by him as such joint debtor. The council of co-owners shall provide for the issuance and issue to any purchaser, upon his request, a statement of such amounts due by the seller and the purchaser's liability under this section shall be limited to the amount as set forth in said statement.

N.J. STAT. ANN. § 46:8A-22 (footnote omitted).

139. See *supra* notes 131-33 and accompanying text.

the original Puerto Rican Act. While these statutes provide that “[t]he purchaser of an apartment shall be jointly and severally liable with the seller for the amounts owing by the latter” for CIC assessments, like the original Puerto Rican statute, the question of liability to the purchase in an involuntary transaction<sup>143</sup>—such as when a lender purchases the property with a credit bid at a foreclosure sale—is not specifically addressed. The question of priority of an association lien is dealt with separately, and these statutes acknowledge that CIC assessment liens are lower in priority than tax and mortgage debts, even though unpaid CIC assessments take priority over other assessments or charges on the property.<sup>144</sup>

#### b. The FHA Model Statute for the Creation of Apartment Ownership

The United States Congress held hearings in 1960 on proposed amendments to the National Housing Act, which included an amendment allowing the Federal Housing Administration (FHA) to insure mortgages secured by condominium units.<sup>145</sup> At the hearings, Puerto Rican businessmen and the Resident Commissioner of Puerto Rico testified about condominium laws benefiting the Latin American community.<sup>146</sup> Congress passed the amendment; and in 1962, the FHA issued the Model Statute for the Creation of Apartment Ownership, which mostly tracked the Puerto Rican law but refined and clarified sections on assessment liability to address the issue of purchaser liability following foreclosure sales.<sup>147</sup> The FHA Model Act states

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143. See ARK. CODE ANN. §§ 18-13-101 to -120 (Repl. 2003) (Arkansas Horizontal Property Act); NEB. REV. STAT. ANN. §§ 76-801 to -823 (West 2013) (Nebraska Condominium Property Act); N.J. STAT. ANN. §§ 46:8A-1 to -28 (West 2013) (New Jersey Horizontal Property Act). Although New Jersey has enacted a new statute, it does not apply retroactively; therefore, the original New Jersey Horizontal Property Act remains applicable to many condominium regimes in that state. See *supra* note 116.

144. See, e.g., ARK. CODE ANN. § 18-13-116(c).

145. NATELSON, *supra* note 129, at 30.

146. *Id.*

147. *Id.*; see also FHA MODEL STATUTE FOR THE CREATION OF APARTMENT OWNERSHIP (1962), reprinted in JAMES H. BACKMAN & DAVID A. THOMAS, A PRACTICAL GUIDE TO DISPUTES BETWEEN ADJOINING LANDOWNERS—EASEMENTS § 15.10[1] (2013) [hereinafter FHA MODEL STATUTE].

specifically that any purchaser, whether the mortgagee or otherwise, of the first mortgage at a foreclosure sale will *not* be liable for the share of the CIC's common expenses or assessments chargeable to the foreclosed apartment that became due prior to the foreclosure sale.<sup>148</sup>

Additionally, the statute holds the buyer and seller jointly and severally liable for assessments only in "voluntary conveyances," a term which is meant to exclude foreclosure sales: "In a *voluntary* conveyance the grantee of an apartment shall be jointly and severally liable with the grantor for all unpaid assessments against the latter for his share of the common expenses up to the time of the grant or conveyance . . . ."<sup>149</sup> The second generation of condominium acts, which many states passed in the mid-1960s and 1970s, tracked the FHA Model Act and its progeny.<sup>150</sup>

Creating joint and several liability for purchasers outside of foreclosure bolstered the surviving lien and created a lien-liability symmetry. After a market sale, the association would have recourse both to the property through the surviving lien *and* to the new title-holder personally.<sup>151</sup> Furthermore, imposing personal liability on the title-holder in this context added very little cost because the buyer would have to pay the past-due assessment amount in any case in order to have clear title and release the association's lien.<sup>152</sup>

### c. The Uniform Condominium Act

In 1977, the National Conference of Commissioners on Uniform State Laws (NCCUSL) promulgated the Uniform Condominium Act (UCA).<sup>153</sup> Instead of focusing on the transfer of debt from a seller to a purchaser, the UCA strengthens associations' ability to obtain assessments in a different way.<sup>154</sup> Like previous statutory models, the UCA

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148. FHA MODEL STATUTE, *supra* note 147.

149. *Id.* at 15-43 (emphasis added).

150. *See* UNIF. CONDO. ACT prefatory note (1980).

151. *See* FHA MODEL STATUTE, *supra* note 147, at 15-42 to -43 ("Suit to recover a money judgment for unpaid common expenses shall be maintainable without foreclosing or waiving the lien securing the same.").

152. *See id.* at 15-43.

153. UNIF. CONDO. ACT prefatory note.

154. UNIF. CONDO. ACT § 3-116 (1980).

prioritizes liens for CIC assessments over all other liens securing the property except for those arising prior to the condominium declaration, taxes, and other government assessments, and the first-priority mortgagee.<sup>155</sup> But the UCA also innovated a lien super-priority, providing that a limited portion of an association's assessment lien—up to six months' of assessments—would enjoy a position above a first-mortgage lien.<sup>156</sup> The official comment to the UCA highlighted this dramatic shift in priority schemes and predicted how lenders might protect themselves against lingering CIC liens:

A significant departure from existing practice, the 6 months' priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of mortgage lenders. As a practical matter, mortgage lenders will most likely pay the 6 months' assessments demanded by the association rather than having the association foreclose on the unit. If the

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155. See UNIF. CONDO. ACT § 3-116(a)–(b). This sections provides:

(a) The association has a lien on a unit for any assessment levied against that unit or fines imposed against its unit owner from the time the assessment or fine becomes due. The association's lien may be foreclosed in like manner as a mortgage on real estate [or a power of sale under (insert appropriate state statute)] [but the association shall give reasonable notice of its action to all lienholders of the unit whose interest would be affected]. Unless the declaration otherwise provides, fees, charges, late charges, fines, and interest charged pursuant to Section 3-102(a)(10), (11) and (12) are enforceable as assessments under this section. If an assessment is payable in installments, the full amount of the assessment is a lien from the time the first installment thereof becomes due.

(b) A lien under this section is prior to all other liens and encumbrances on a unit except (i) liens and encumbrances recorded before the recordation of the declaration, (ii) a first mortgage or deed of trust on the unit recorded before the date on which the assessment sought to be enforced became delinquent, and (iii) liens for real estate taxes and other governmental assessments or charges against the unit.

UNIF. CONDO. ACT § 3-116(a)–(b).

156. UNIF. CONDO. ACT § 3-116(b) (“The lien is also prior to the mortgages and deeds of trust described in clause (ii) above to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien.”).

mortgage lender wishes, an escrow for assessments can be required.<sup>157</sup>

Accordingly, lenders concerned about their liens becoming subordinate to CIC assessment liens could escrow an amount equal to six months of those assessments along with property taxes and insurance.<sup>158</sup>

#### d. The Uniform Common Interest Ownership Act

In 1982, only five years after the release of the UCA, the NCCUSL developed the first Uniform Common Interest Ownership Act (UCIOA).<sup>159</sup> Drafters of the UCIOA desired enhanced protection of association-assessment obligations but specifically rejected the idea of granting association liens unlimited priority, reasoning that this would discourage CIC development.<sup>160</sup> Accordingly, the Joint Editorial Board for Uniform Real Property Acts stated:

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157. UNIF. CONDO. ACT § 3-116 cmt. 2. Fannie Mae and Freddie Mac use mortgage forms that anticipate escrow accounts for CIC assessments. Boyack, *supra* note 71, at 122.

158. The campaign to enact state versions of the Uniform Common Interest Ownership Act (UCIOA) touted the ability of lenders to escrow super-priority assessment amounts. See James L. Winokur, *Meaner Lienor Community Associations: The "Super-Priority" Lien and Related Reforms Under the Uniform Common Interest Community Act*, 27 WAKE FOREST L. REV. 353, 391-92 (1992) (noting that although drafters of the super-priority lien anticipated escrow accounts for assessments, few lenders actually collect assessment escrows). According to the preliminary notes to the 1994 UCIOA, twenty-one states had adopted the UCA in some form, making it the most prevalent uniform condominium statutory regime. UNIF. COMMON INTEREST OWNERSHIP ACT prefatory note (amended 2008), 7(II) U.L.A. 3 (Supp. 2013). This article focuses solely on the distinctions in CIC assessment liability for purchasers and lien priority, so its classifications do not necessarily trace the adoption of various uniform acts.

159. UNIF. COMMON INTEREST OWNERSHIP ACT prefatory note (amended 2008), 7(II) U.L.A. 3-4. In 1977, the NCCUSL began drafting the UCA (governing condominiums); and subsequently, the Conference prepared two other uniform laws—the Uniform Planned Community Act (governing homeowners' associations) and the Model Real Estate Cooperative Act (governing cooperatives). *Id.* at 4. The Conference then combined these three acts, resulting in the UCIOA. *Id.* at 7. Five states have adopted the 1982 UCA: Alaska, Colorado, Minnesota, Nevada, and West Virginia. UNIF. COMMON INTEREST OWNERSHIP ACT (amended 2008), 7(II) U.L.A. 1 (citing ALASKA STAT. ANN. §§ 34.08.010–.995 (West 2013); COLO. REV. STAT. ANN. §§ 38-33.3-101 to -401 (West 2014); MINN. STAT. ANN. §§ 515B.1-101 to -118 (West 2013); NEV. REV. STAT. ANN. § 116 (West 2013); W. VA. ANN. §§ 36B-1-101 to -4-120 (West 2014)).

160. See UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 cmt. 1 (amended 2008), 7(II) U.L.A. 124 (explaining that “the 6 months’ priority for the assessment lien strikes an equitable balance between the need to enforce collection of unpaid

Traditional first mortgage lenders might be reluctant to lend from a subordinate lien position if there was no “cap” on the potential burden of an association’s assessment lien. In addition, some federally- or state-regulated lenders face regulatory restrictions on the amount of mortgage lending they can undertake involving security other than first lien security.<sup>161</sup>

Instead of unlimited priority, the UCIOA incorporated the UCA policy compromise—the association’s lien would enjoy a limited super-priority in a capped amount equal to assessments charged “during the six months immediately preceding institution of an action to enforce the lien.”<sup>162</sup> The remainder of an owner’s obligation to the association would be junior in priority to a first-mortgage lien on the unit.<sup>163</sup>

The NCCUSL revised the UCIOA in 1994, but the basic CIC super-priority structure remained largely unchanged.<sup>164</sup> The 1994 version of UCIOA provided for the extinguishment of CIC liens that had not been foreclosed upon after three years of non-enforcement.<sup>165</sup> Finally, in 2008, the NCCUSL amended the UCIOA again,<sup>166</sup> this time adding attorneys’ fees and associated costs incurred in foreclosing the CIC lien to the amount accorded super-priority.<sup>167</sup>

assessments and the obvious necessity for protecting the priority of the security interests of lenders”).

161. JOINT EDITORIAL BD. FOR UNIF. REAL PROP. ACTS, THE SIX-MONTH “LIMITED PRIORITY LIEN” FOR ASSOCIATION FEES UNDER THE UNIFORM COMMON INTEREST OWNERSHIP ACT (2013) [hereinafter JEB REPORT]. The concern over priority-underwriting requirements of lenders and, specifically, of secondary-mortgage-market purchasers remains a driving force behind the law of association-lien priority. *See infra* Section IV.D.2.

162. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(b) (amended 2008), 7(II) U.L.A. 122 (2009).

163. Boyack, *supra* note 71, at 98-99.

164. Indeed, only Connecticut and Vermont adopted the 1994 UCIOA. UNIF. COMMON INTEREST OWNERSHIP ACT (amended 2008), 7(I)(B) U.L.A. 439 (2009).

165. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(f) (amended 2008), 7(I)(B) U.L.A. 569 (2009) (“A lien for unpaid assessments is extinguished unless proceedings to enforce the lien are instituted within three years after the full amount of the assessments becomes due.”).

166. Connecticut, Delaware, and Vermont have adopted the 2008 UCIOA. UNIF. COMMON INTEREST OWNERSHIP ACT (2008), 7(I)(B) U.L.A. 223 (2009), 119 (Supp. 2013).

167. Specifically, the 2008 Act states:

This historical development indicates that current condominium statutes differ over whether they address CICs' protection in foreclosure by referring to survival of assessment debt (typically as joint and several liability of the purchaser and seller); whether they give the CIC assessment lien priority over all or some other debts; and whether they combine debt survivability and lien priority.

## 2. "Joint and Several Liability" for CIC Assessments

States following the archetypal joint-and-several-liability approach fall into three broad categories based on how they treat CIC assessment debts during foreclosure: (a) statutes specifically providing that a buyer (whether a first-priority lender or otherwise) at a foreclosure sale takes the property free of any CIC assessment debts of the previous owner;<sup>168</sup> (b) statutes holding foreclosure purchasers, other than first-priority lenders, jointly and severally liable for the previous owner's past-due CIC assessments;<sup>169</sup> and (c) the Florida statute, which holds foreclosure purchasers jointly and severally liable for the previous owner's past-due assessments, but limits any lender's liability to the amount of the CIC's super-priority lien.<sup>170</sup> There are three states with statutes that hold purchasers of condominium units jointly and severally liable with their sellers for past-due CIC assessments but do not address specifically what this means

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A lien under this section is also prior to all security interests described in subsection (b)(2) to the extent of . . . [the] *reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien.*

UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(c) (2008), 7(1)(B) U.L.A. 374-75 (2009) (emphasis added).

168. See *infra* n.176 and accompanying text.

169. See, e.g., HAW. REV. STAT. § 421J-10.5 (West 2013); 765 ILL. COMP. STAT. ANN. 605/9(g)(3)-(4) (West 2014).

170. See FLA. STAT. ANN. § 718.116 (West 2014). All of the aforementioned statutes give the CIC the ability to assess condominium owners for their share of community costs and generally allow for the placement of a lien on the condominium unit for any unpaid assessments. This section focuses solely on the issue of liability for unpaid assessments, lien priority, and the effect of foreclosure on that liability. Statutes included together in this review may vary widely in many other respects, including the procedural requirements to maintain priority or initiate foreclosure proceedings.



in the context of foreclosure sales.<sup>171</sup> These are discussed in subsection (d).

a. Statutes Allowing Foreclosure-Sale Buyers to Take Title Free of the Previous Owner's Association Debt

States within the first category of joint-and-several-liability statutes clearly resolve the question of whether past-due assessments survive a foreclosure sale.<sup>172</sup> The states based their statutes primarily on the FHA Model Act of 1962, although no state's law follows the Model Act exactly.<sup>173</sup> Again, the FHA Model Act notes specifically that any acquirer at a foreclosure sale of the first mortgage, whether the mortgagee or otherwise, will not be liable for the foreclosed unit's share of CIC expenses or assessments that became due prior to the foreclosure sale.<sup>174</sup> The Model Act imposed joint and several liability on the buyer and seller for assessments only in voluntary conveyances, which, on its terms, excludes foreclosure sales.<sup>175</sup>

Presently, nine states' condominium regimes protect against liability for past-due assessments for all purchasers at a foreclosure sale of the first mortgage.<sup>176</sup> For example, the South Carolina statute, originally enacted in 1962, specifically guards a mortgagee or other purchaser at a foreclosure sale:

Where the *mortgagee of any mortgage of record or other purchaser* of an apartment obtains title at the foreclosure sale of such a mortgage, such acquirer of title, his successors and assigns, shall not be liable for the share of the common expenses or assessments by the co-owners chargeable to such apartment accruing after the date of recording such mortgage but prior to the

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171. See ARK. CODE ANN. § 18-13-116(d) (Repl. 2003); NEB. REV. STAT. ANN. § 76-819 (West 2013); N.J. STAT. ANN. § 46:8A-22 (West 2013).

172. See sources cited *infra* note 176.

173. See *supra* Part III.A.1.b.

174. FHA MODEL STATUTE, *supra* note 147, at 15-43.

175. *Id.*

176. IND. CODE ANN. § 32-35-6-3(e) (West 2013); IOWA CODE ANN. § 499B.18 (West 2013); KAN. STAT. ANN. § 58-3123(b) (West 2013); MICH. COMP. LAWS ANN. § 559.158 (West 2014); MONT. CODE ANN. § 70-23-607(1) (West 2013); N.C. GEN. STAT. ANN. § 47C-3-116(j) (West 2013); OKLA. STAT. ANN. tit. 60, § 524(d) (West 2013); OR. REV. STAT. ANN. § 100.475(2) (West 2013); S.C. CODE ANN. § 27-31-210(b) (West 2013); WASH. REV. CODE ANN. § 64.32.200 (West 2013).

acquisition of title to such apartment by such acquirer. Such unpaid share of common expenses or assessments shall be deemed to be common expenses collectible from all of the apartment owners, including such acquirer, his successors and assigns.<sup>177</sup>

Further, like the FHA Model Act, the South Carolina Code excludes foreclosure-sale purchasers from joint and several liability: “The purchaser of an apartment (*other than a purchaser at a foreclosure sale . . .*) shall be jointly and severally liable with the seller for the amounts owing by the latter [for past-due assessments] . . . .”<sup>178</sup> These provisions clearly state that if the first security holder forecloses on the unit, then neither that mortgagee nor any other foreclosure purchaser will be liable for unpaid common expenses.<sup>179</sup>

#### b. Statutes Making Foreclosure Purchasers—Except for First-Priority Lenders—Jointly and Severally Liable for CIC Assessment Debts

In contrast, the second category of statutes distinguishes between a mortgagee and other purchasers at a judicial foreclosure, excluding only the mortgagee from post-foreclosure liability. This is the approach followed in Illinois and Hawaii. The Illinois Condominium Property Act, for example, states:

The purchaser of a condominium unit at a judicial foreclosure sale, *other than a mortgagee*, who takes possession of a condominium unit pursuant to a court order or a purchaser who acquires title from a mortgagee shall have the duty to pay the proportionate share, if any, of the common expenses for the unit which would have become due in the absence of any assessment acceleration during the 6 months immediately preceding institution of an action to enforce the collection of assessments, and which remain

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177. S.C. CODE ANN. § 27-31-210(b) (emphasis added).

178. S.C. CODE ANN. § 27-31-220 (West 2013) (emphasis added).

179. However, because uncollected assessments are collected by a special assessment imposed on the community as a whole, any owner of a unit in a CIC will bear some shared burden of the unpaid amounts.

unpaid by the owner during whose possession the assessments accrued.<sup>180</sup>

Accordingly, a foreclosing mortgagee in Illinois is not liable for past-due assessments, but any other purchaser is responsible for up to six months of unpaid CIC assessments.

Hawaii's statute gives an association recourse for up to six months of unpaid assessments by imposing liability for six months of assessment arrearages on a foreclosure purchaser, but it does not create a corresponding super-priority lien.<sup>181</sup> A non-lender foreclosure purchaser, therefore, is personally liable for assessment arrearages, but this obligation is unsecured. Hawaii exempts the mortgagee who purchases at foreclosure from liability for overdue assessments;<sup>182</sup> but interestingly, it provides that a subsequent purchaser—who later acquires title from the mortgagee—will become liable for six months of unpaid assessments.<sup>183</sup> In apparent disregard for the practical implications of such a combination,<sup>184</sup> the statute essentially creates a “springing” obligation that occurs upon a post-foreclosure transfer but skips any lender who acquires title at foreclosure.<sup>185</sup>

### c. Florida

Florida stands alone in the third category of joint-and-several-liability approaches, imposing joint and several liability on any foreclosure purchaser for past-due assessments of the previous owner but limiting such liability in the case of a first-priority lender to the amount of the CIC

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180. 765 ILL. COMP. STAT. ANN. 605/9(g)(4) (West 2014) (emphasis added).

181. HAW. REV. STAT. § 421J-10.5(a)–(h) (West 2013). This statute states that the priority of liens for unpaid association assessments shall “be as provided in the association documents or, if no priority is provided in the association documents, by the recordation date of the liens.” HAW. REV. STAT. § 421J-10.5(a).

182. See HAW. REV. STAT. § 514A-90(b) (West 2013).

183. HAW. REV. STAT. § 514A-90(g)(2)–(h). The statute provides that the CIC board may “specially assess the amount of the unpaid . . . assessments . . . against a person who, in a judicial or nonjudicial power of sale foreclosure, purchases a delinquent apartment.” HAW. REV. STAT. § 514A-90(g).

184. Although this approach endeavors to prevent the priority lender from being out of pocket for the CIC assessments, any reasonably informed purchaser would simply reduce the price it is willing to pay to the lender for the unit, thereby requiring the lender to cover the past-due amounts indirectly.

185. See HAW. REV. STAT. § 514A-90(g).

super-priority lien.<sup>186</sup> Florida is the only state that imposes assessment liability on a lender who acquires title at foreclosure sale, although it caps the amount of liability imposed on such lender. When a lender recovers property at a foreclosure sale in Florida, it faces personal liability in an amount equal to the lesser of twelve months of assessments or 1% of the original mortgage debt.<sup>187</sup> According to a plain-language reading of the Florida statute, non-lender-foreclosure purchasers will be liable for the entire amount of unpaid assessments.<sup>188</sup>

#### d. The First-Generation, Puerto Rican Regime

Finally, three states—Arkansas, Nebraska, and New Jersey—still retain first-generation statutes, which, like the original Puerto Rican Act, do not overtly address the possibility of joint and several liability in a foreclosure sale.<sup>189</sup> These statutes address purchases and sales of condominium units and provide that the buyer will be liable for the sellers' past-due assessments.<sup>190</sup> However, they are unclear on whether this provision reaches involuntary sales. The horizontal property acts in Arkansas, Nebraska, and New

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186. FLA. STAT. ANN. § 718.116(1) (West 2014). Florida limits the liability of a buyer who acquires the property by foreclosure to:

the lesser of . . . [t]he unit's unpaid common expenses and regular periodic assessments which accrued or came due during the 12 months immediately preceding the acquisition of title and for which payment in full has not been received by the association; or . . . [o]ne percent of the original mortgage debt.

FLA. STAT. ANN. § 718.116(1)(b)(1).

187. FLA. STAT. ANN. § 718.116(1)(b)(1).

188. However, the related caselaw is muddled, and some courts have noted that any post-foreclosure liability for unpaid assessments must be limited to correspond with the surviving lien (capped at the lesser of twelve months of arrearages or 1% of the mortgage loan). *See, e.g.*, Final Judgment at 1, U.S. Bank Nat'l Ass'n v. Pine Rush Villas Condo. Ass'n, No. 13-004710-CI, 2013 WL 6991983, at \*1 (Fla. Cir. Ct. 2013). Seemingly, this interpretation strives to read into the statute some symmetry between the lien-priority provisions and the liability term.

189. *Compare* ARK. CODE ANN. § 18-13-116(d) (Repl. 2003) (imposing joint and several liability "up to the time of conveyance"), NEB. REV. STAT. ANN. § 76-819 (West 2013) (same), *and* N.J. STAT. ANN. § 46:8A-22 (West 2013), *with* Act of June 25, 1958, § 41, 1958 PR. LAWS 254 (codified as amended at P.R. LAWS ANN. tit. 31, § 1293(e) (West 2011)) (same).

190. ARK. CODE ANN. § 18-13-116(d); NEB. REV. STAT. ANN. § 76-819; N.J. STAT. ANN. § 46:8A-22.

Jersey “muddy” the debt, security, and priority “waters” with seemingly conflicting provisions over the status of CIC assessments on the property subject to foreclosure. The statutory provisions in question address the disposition of proceeds at a sale of a unit subject to the horizontal-property regime,<sup>191</sup> but whether the “sale” addressed by the statutes contemplates a foreclosure sale is unclear.

All three first-generation statutes acknowledge that CIC assessment liens are lower in priority than taxes and mortgage debts.<sup>192</sup> For example, subsection 18-13-116(c) of the Arkansas Code reads:

Upon the sale or conveyance of an apartment, all unpaid assessments against a co-owner for his or her pro rata share in the expenses . . . shall first be paid out of the sales price or by the acquirer in preference over any other assessments or charges of whatever nature except the following:

- (1) Assessments, liens, and charges for taxes past due and unpaid on the apartment; and
- (2) Payments due under mortgage instruments of encumbrance duly recorded.<sup>193</sup>

Accordingly, the statute prioritizes unpaid CIC assessments over some other assessments or charges on the property, but it elects to have CIC assessments be lower in priority to taxes and mortgage liens. Arkansas’s statute represents the typical treatment of assessment-lien priority in jurisdictions that have specifically chosen not to grant any super-priority to association liens.<sup>194</sup>

The Arkansas, Nebraska, and New Jersey statutes do provide that a purchaser of a CIC unit will be jointly and severally liable with the seller of the property for prioritized past-due assessments.<sup>195</sup> For example, subsection 18-13-116(d) of the Arkansas Code provides: “The purchaser of

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191. See ARK. CODE ANN. § 18-13-116(c); NEB. REV. STAT. ANN. § 76-818; N.J. STAT. ANN. § 46:8A-21.

192. See ARK. CODE ANN. § 18-13-116(c); NEB. REV. STAT. ANN. § 76-818; N.J. STAT. ANN. § 46:8A-21.

193. ARK. CODE ANN. § 18-13-116(c) (emphasis added).

194. See, e.g., NEB. REV. STAT. ANN. § 76-818; N.J. STAT. ANN. § 46:8A-21.

195. ARK. CODE ANN. § 18-13-116(d); NEB. REV. STAT. ANN. § 76-819; N.J. STAT. ANN. § 46:8A-22.

an apartment shall be jointly and severally liable with the seller for the amounts owing by the latter [for CIC assessments].”<sup>196</sup> The plain language of the statute suggests that the joint obligation is personal (in personam),<sup>197</sup> and it does not mention a “lien” or an obligation that runs with the land (in rem).<sup>198</sup> In a typical sale, lack of personal obligation means little to a buyer who acquires a home with an assessment lien intact. Whether or not the in personam obligation persists, the in rem security interest runs with the land and continues to burden the property until someone repays the debt.<sup>199</sup> Whether or not personal obligation exists is key, however, in foreclosure purchases, since foreclosures extinguish all junior liens, including the lien securing the CIC assessment obligation. In statutes that fail to distinguish between the two types of sales,<sup>200</sup> therefore, it is possible to argue that a foreclosure buyer is personally obligated, and, further, an argument can be made that post-foreclosure liability for a purchaser implies post-foreclosure assessment lien survival.<sup>201</sup>

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196. ARK. CODE ANN. § 18-13-116(d).

197. BLACK’S LAW DICTIONARY 862 (9th ed. 2009) (defining “*in personam*” as “involving or determining the personal rights and obligations of the parties” or as “a legal action brought against a person rather than property”). *Black’s Law Dictionary* further provides:

An action is said to be *in personam* when its object is to determine the rights and interests of the parties themselves in the subject-matter of the action, however the action may arise, and the effect of a judgment in such an action is merely to bind the parties to it.

*Id.* (quoting R.H. GRAVESON, CONFLICT OF LAWS 98 (7th ed. 1974)) (internal quotation marks omitted).

198. BLACK’S LAW DICTIONARY 864 (9th ed. 2009) (defining “*in rem*” as “[i]nvolving or determining the status of a thing, and therefore the rights of persons generally with respect to that thing”). *Black’s Law Dictionary* further provides:

An action *in rem* is one in which the judgment of the court determines the title to property and the rights of the parties, not merely as between themselves, but also as against all persons at any time dealing with them or with the property upon which the court has adjudicated.

*Id.* (quoting R.H. GRAVESON, CONFLICT OF LAWS 98 (7th ed. 1974)) (internal quotation marks omitted).

199. Boyack, *supra* note 71, at 74.

200. See, e.g., ARK. CODE ANN. § 18-13-116(c)–(d).

201. As discussed below, however, this conclusion necessarily inflates the priority of the association lien. See *infra* Part IV.D.1.

### 3. Super-Priority for Assessment Liens

States embracing the modern approach to CIC assessment protection model their statutes after the UCIOA and provide security for a capped amount of assessment deficiency (typically six months of unpaid assessments) in the form of a separate, super-priority lien that survives foreclosure of the first-mortgage lien on a unit.<sup>202</sup> Under this model, an assessment lien—which is normally subordinate to a first-mortgage lien—has priority over the first-mortgage-priority lien upon foreclosure “to the extent . . . the common expense assessments based on the periodic budget adopted by the association . . . would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien.”<sup>203</sup> In this capped-priority arrangement, the priority position of the association lien is split: a super-priority position garners up to six months of unpaid assessments while the remainder of unpaid amounts enjoy the typical priority position of the association lien—subordinate to the first-mortgage lien.<sup>204</sup> In states that utilize this limited-assessment super-priority lien, an association can seek reimbursement of the capped amount of arrearages even after foreclosure because a buyer at foreclosure takes title subject to the association’s lien (in the capped amount).<sup>205</sup>

Since the UCA and the UCIOA introduced the concept of a six-month priority for association liens, more than twenty jurisdictions have adopted a capped super-priority approach to association liens.<sup>206</sup> Some states have accomplished this approach by adopting either the UCA or

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202. See Boyack *supra* note 71, at 98-103; see also JEB REPORT, *supra* note 161, at 2-3.

203. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(c) (2008), 7(I)(B) U.L.A. 374-75 (2009).

204. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 cmt. 2 (2008), 7(I)(B) U.L.A. 378.

205. However, when non-payment persists for longer than the time-limit cap (i.e., longer than six months), this solution is inadequate—leading some to call for increasing the size of the association’s super-priority lien. See, e.g., Boyack, *supra* note 71, at 112-15; JEB REPORT, *supra* note 161, at 1.

206. See JEB REPORT, *supra* note 161, at 2-3.

the UCIOA.<sup>207</sup> Other states have grafted the six-month priority concept onto their existing CIC legislation.<sup>208</sup>

Legislatures in some states have recently increased the size of associations' limited-lien priority beyond the traditional six months. Nevada's statute, for example, provides for a nine-month assessment amount for association-lien super-priority.<sup>209</sup> In 2013, Connecticut increased its super-priority amount to nine months.<sup>210</sup> In Florida, an association's super-priority lien provides up to twelve months of assessments.<sup>211</sup> In Maryland, however, the legislature slightly reduced the amount an association may claim under a super-priority lien to a mere four months of assessments.<sup>212</sup>

Three western states' statutes do not specifically address lien priority, liability of purchasers or past owners at

207. *Id.*; see, e.g., ALA. CODE § 35-8A-316(b) (West 2014); ALASKA STAT. ANN. § 34.08.470(b) (West 2013); COLO. REV. STAT. ANN. § 38-33.3-316(2) (West 2014); DEL. CODE ANN. tit. 25, § 81-316(b) (West 2014); MINN. STAT. ANN. § 515B.3-116(c) (West 2013); MO. ANN. STAT. § 448.3-116(2) (West 2014); 68 PA. CONST. STAT. ANN. §§ 3315(b), 4315(b), 5315(b) (West 2014); R.I. GEN. LAWS ANN. § 34-36.1-3.16(b) (West 2013); VT. STAT. ANN. tit. 27A, § 3-116(b) (West 2013); WASH. REV. CODE ANN. § 64.34.364(3) (West 2013); W. VA. CODE ANN. § 36B-3-116(b) (West 2013). Although Kentucky, Maine, Nebraska, New Mexico, North Carolina, Texas, and Virginia each adopted versions of the UCA, they did not enact the six-month limited priority for condominium association liens. See KY. REV. STAT. ANN. § 381.9193(1)–(2) (West 2013); ME. REV. STAT. tit. 33, § 1603-116(b) (West 2013); NEB. REV. STAT. ANN. § 76-874(a)–(b) (West 2013); N.M. STAT. ANN. § 47-7C-16(A)–(B) (West 2013); N.C. GEN. STAT. ANN. § 47C-3-116 (West 2013); TEX. PROP. CODE ANN. § 82.113(b) (West 2013); VA. CODE ANN. § 55-79.84(A) (West 2014).

208. See D.C. CODE § 42-1903.13(a)(2) (West 2013); 765 ILL. COMP. STAT. § 605/9(g)(4) (West 2014); MASS. GEN. LAWS ANN. ch. 183A, § 6(c) (West 2014); N.H. REV. STAT. ANN. § 356-B:46(I)(c) (West 2013); N.J. STAT. ANN. § 46:8B-21(b)(1) (West 2013); TENN. CODE ANN. § 66-27-415(b)(2)(A) (West 2013).

209. NEV. REV. STAT. ANN. § 116.3116(2)(c) (West 2013). However, Nevada's statute also states that the amount secured by the lien will be reduced to six months if required by a federal regulatory mortgage-underwriting mandate. NEV. REV. STAT. ANN. § 116.3116(2)(c). Fannie Mae recently reiterated its mandate that no assessment in excess of six months would enjoy a super-priority over its first-mortgage lien. Fannie Mae, *Selling Guide Announcement SEL-2014-02: Priority of Common Expense Assessments 1* (Jan. 14, 2014) [hereinafter Fannie Mae, *Selling Guide Announcement*], [available at https://www.fanniemae.com/content/announcement/sel1402.pdf](https://www.fanniemae.com/content/announcement/sel1402.pdf).

210. CONN. GEN. STAT. ANN. § 47-258(b) (West 2014).

211. FLA. STAT. ANN. §§ 718.116(1)(b)(1), 720.3085(2)(c) (West 2014) (limiting priority for associations' assessment liens to the lesser of twelve months of assessments or 1% of the original mortgage debt).

212. See MD. CODE ANN., REAL PROP. § 11B-117(c)(3)(i) (West 2014).



foreclosure, or special circumstances in the condominium context.<sup>213</sup> Although these states allow condominium associations to levy assessments against unit owners for common expenses, they do not mention how to address these charges if the unit changes ownership or if a priority lien attaches to the property due to non-payment.<sup>214</sup> This approach gives the judiciary the responsibility to decide the issue. Where statutes are silent, courts will determine who will be left holding the bag of unpaid assessments in a CIC foreclosure.

**B. The Perfect-Priority Storm in Arkansas: *First State Bank v. Metro District Condominiums Property Owners' Association***

This article focuses on statutes that are ambiguous with respect to whether a purchaser of a CIC becomes jointly and severally liable under the statutes covering transfers of title in first-mortgage foreclosures. These ambiguous statutes impose joint liability on the purchaser but do not specifically address the effects of foreclosure actions.<sup>215</sup> The statutes only discuss purchaser liability in a "sale," failing to clarify whether such "sale" includes foreclosure actions or simply voluntary conveyances.<sup>216</sup> Only three states retain this ambiguity,<sup>217</sup> which arose under CIC legislation enacted in the 1960s before other states began adopting the uniform acts.<sup>218</sup> As discussed, these statutes rely primarily on the original Puerto Rican Horizontal Property Act,<sup>219</sup> which

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213. These "sparse guidance" states include North Dakota, South Dakota, and Wyoming. See N.D. CENT. CODE ANN. § 47-04.1-11 (West 2013); S.D. CODIFIED LAWS § 43-15A-1 to -30 (West 2013); WYO. STAT. ANN. § 34-20-104 (West 2013).

214. See N.D. CENT. CODE ANN. § 47-04.1-11; S.D. CODIFIED LAWS § 43-15A-1 to -30; WYO. STAT. ANN. § 34-20-104.

215. See *supra* notes 189-90 and accompanying text.

216. See *supra* notes 189-90 and accompanying text.

217. The three states are Arkansas, Nebraska, and New Jersey. See *supra* notes 189-90 and accompanying text.

218. Other states have replaced earlier-enacted statutes with more modern language, for example, using language modeled on the UCIOA. See William K. Kerr, *Condominium—Statutory Interpretation*, 38 ST. JOHN'S L. REV. 1, 5-6 (1963) (discussing states' widespread adoption of condominium laws in the early 1960s).

219. See *supra* Part III.A.1.a.

never specifically discussed the treatment of assessment liens during a foreclosure proceeding.<sup>220</sup>

Given the apparent ambiguity within the three statutes tracking the Puerto Rican Act, courts in those states must decide whether a purchaser at a foreclosure sale is jointly and severally liable with the seller for the seller's past-due assessments. If these courts decide this question in the affirmative, they must then determine whether such liability extends to a foreclosure purchaser who is also the foreclosing first-priority purchase-money lender. If a court determines that a lender acquiring property at the foreclosure of its first mortgage lien becomes jointly and severally liable for unpaid assessments, a court must further clarify to what extent imposing past debt on the lender-acquirer implies that the association's lien remains attached to the property to secure that debt.

Recently, Arkansas courts have encountered these precise questions and have, suprisingly, construed the statute to mean both: (1) that the foreclosure purchaser (including the mortgagee) becomes personally obligated for all assessment arrearages; and (2) that the association's lien survives the foreclosure sale, securing the purchaser's obligation to pay all overdue assessments.<sup>221</sup>

In *First State Bank v. Metro District Condominiums Property Owners' Association*, the Arkansas Supreme Court affirmed a Northwest Arkansas trial court's ruling that an association's assessment lien and obligation survived the foreclosure sale of a condominium unit.<sup>222</sup> The following discussion sets forth a detailed description of the facts and reasoning of the trial court's determination of the case.

In December 2008, First State Bank lent \$275,000 to Nock-Broyles Land Development, LLC (Nock-Broyles), for the purpose of purchasing Unit 270 of the Metro District Condominiums in Fayetteville, Arkansas (the Unit).<sup>223</sup> The Unit was subject to a horizontal-property regime in the Metro District Condominiums' master deed, which was filed

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220. See *supra* Part III.A.1.a.

221. See *First State Bank v. Metro Dist. Condos. Prop. Owners' Ass'n*, 2014 Ark. 48, at 8, \_\_\_ S.W.3d \_\_\_, \_\_\_.

222. *Id.* at 1, \_\_\_ S.W.3d at \_\_\_.

223. *Id.* at 1-2, \_\_\_ S.W.3d at \_\_\_.

in 2005.<sup>224</sup> A promissory note evidenced the loan, which was also secured by a mortgage on the Unit and an assignment of rents and leases.<sup>225</sup> The bank subsequently consented to convey the unit to 270 Metro, LLC (270 Metro), and the mortgage remained as collateral for the note (then owed by both Nock-Broyles and 270 Metro) and continued as a first-priority lien on the Unit.<sup>226</sup>

In August 2011, First State Bank sued Nock-Broyles and 270 Metro to enforce the promissory note and to foreclose upon the mortgage.<sup>227</sup> First State Bank subsequently added Metro District Condominiums Property Owners' Association (Metro POA) to extinguish Metro POA's interest in the Unit.<sup>228</sup> Junior lienholders are "necessary parties" in a foreclosure suit, and failure to name junior lienholders either renders the entire foreclosure ineffective or inflates the priority of the junior lien.<sup>229</sup> If a junior lienholder is named, foreclosure of the senior lien extinguishes the security interest.<sup>230</sup> Metro POA was the only defendant to answer the complaint<sup>231</sup> and sought past-due assessments, which had accrued at \$233.33 per month since November 2011.<sup>232</sup>

In February 2013, the trial court entered default judgment and a decree of foreclosure against both Nock-Broyles and 270 Metro.<sup>233</sup> The court ordered the circuit clerk to sell the Unit at a foreclosure sale.<sup>234</sup> First State Bank

224. *Id.* at 3, \_\_\_ S.W.3d at \_\_\_.

225. *Id.* at 1-2, \_\_\_ S.W.3d at \_\_\_.

226. *First State Bank*, 2014 Ark. 48, at 1-2, \_\_\_ S.W.3d at \_\_\_.

227. *Id.* at 2 n.1, \_\_\_ S.W.3d at \_\_\_.

228. *Id.* at 2-3, \_\_\_ S.W.3d at \_\_\_.

229. *See* 55 AM. JUR. 2D *Mortgages* §§ 651-52, at 288-89 (1996).

230. *See supra* Part II.A.4.

231. *First State Bank*, 2014 Ark. 48, at 3, \_\_\_ S.W.3d at \_\_\_.

232. Amended Default Judgment and Decree of Foreclosure ¶ 26, *First State Bank v. Nock-Broyles Land Dev., LLC*, Case No. CIV 2011-2386-4 (Ark. Cir. Ct. Feb. 6, 2013) [hereinafter Amended Default Judgment].

233. *First State Bank*, 2014 Ark. 48, at 4, \_\_\_ S.W.3d at \_\_\_. The default judgment was in the amount of \$247,289.13, plus certain interest and costs. *Id.*

234. *Id.* In Arkansas, the circuit court can appoint a circuit clerk to act as the commissioner of the court in a foreclosure sale. *See* ARK. CODE ANN. § 16-66-116(a) (Repl. 2005) (authorizing a commissioner to convey property when appointed by a court); ARK. CODE ANN. § 21-6-412(c) (Supp. 2013) (setting the fee a circuit clerk can collect when appointed by a court as commissioner in a judicial sale).

purchased the Unit at the foreclosure sale with a credit bid<sup>235</sup> of \$148,000.<sup>236</sup> Before the court issued the final judgment and decree, First State Bank sought summary judgment, claiming that the foreclosure would extinguish any interest of Metro POA arising from its assessments.<sup>237</sup> The trial court purported to agree that First State Bank's mortgage lien was superior to any CIC assessment, but it inconsistently refused to extinguish either the assessment obligation or Metro POA's junior lien.<sup>238</sup> Instead, the court held that the liability for past-due assessments ran to future owners, including a buyer at foreclosure, and based on this reasoning, the court also held that Metro POA's lien survived the foreclosure.<sup>239</sup> The trial court's Amended Judgment and Decree of Foreclosure stated:

Over the objection of the Plaintiff, the Court finds and hereby orders that Metro POA's interest in the subject real property for assessments upon said property that remain unpaid as of the date of the foreclosure shall survive the foreclosure and shall further be the liability of whoever purchases said property at the foreclosure sale. Specifically, . . . the Court hereby finds and orders that the purchaser of said property shall be liable for assessments of \$233.33 per month for the time period of November 2011 to the date of foreclosure.<sup>240</sup>

Furthermore, the court provided:

Upon the foreclosure sale of the subject real property and the confirmation of such sale by the Court, any and all rights, title, claims, claims, [sic] mortgages, liens, interest, encumbrances, equity and estate of or asserted

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235. Most foreclosure statutes require a purchaser at a foreclosure sale to pay in cash or a cash equivalent. See 2 BAXTER DUNAWAY, THE LAW OF DISTRESS REAL ESTATE FORECLOSURE WORKOUTS PROCEDURES § 16:41 (2013). But when the bidder is the foreclosing lender, that lender has the ability to "credit bid" up to the amount of the mortgage debt, plus allowable expenses. *Id.* If the lender were not permitted to credit bid and, instead, were required to bid and pay in cash, the foreclosing lender would essentially be paying itself the same cash. *Id.* However, the foreclosing lender must typically pay in cash any excess over the mortgage debt (plus expenses). *Id.*

236. *First State Bank*, 2014 Ark. 48, at 4, \_\_\_ S.W.3d at \_\_\_.

237. *Id.* at 3, \_\_\_ S.W.3d at \_\_\_.

238. *Id.* at 4, \_\_\_ S.W.3d at \_\_\_.

239. *Id.*

240. Amended Default Judgment, *supra* note 232, ¶ 28.

or claimed by any party, including Defendants Nock-Broyles and 270 Metro, LLC, in, against, and/or to the subject real property shall be foreclosed and forever barred and extinguished, *except for the interest of Metro POA . . .*<sup>241</sup>

The trial court thus interpreted subsection 18-13-116(d) of the Arkansas Code as: (1) imposing joint and several liability for past-due CIC assessments on any purchaser at a foreclosure sale, including a mortgage lender acquiring title through a credit bid; and (2) requiring the survival of the real-property lien that secures the CIC assessment obligations.<sup>242</sup> Under this interpretation, when a mortgage lender purchases property at foreclosure of its lien—which is often the result of foreclosure and was the case with First State Bank here—the lender will take the property with the CIC lien for past-due assessments still attached. Failure to extinguish the CIC lien effectively elevates that lien’s priority, making the CIC lien a complete super-priority, one that completely primes the first mortgage.

The transcript of the summary-judgment hearing indicates that, in interpreting the vague statutory language, the trial judge misconstrued lien-priority law and missed the practical effect of allowing a CIC’s assessment to survive the first-mortgage foreclosure sale. At the hearing, Judge G. Chadd Mason stated the following:

I have looked at the statute. I think this is pretty clear. I think the Bank has the authority, based on the mortgage, to foreclose on the property. I think that any assessments owed at the time of that go with the property to whoever buys in the foreclosure. It would be no different than if the property was leased and under those obligations as a result of that lease to a tenant. Whoever is the unfortunate person who comes in and buys this property is going to buy it subject to whatever assessments are owed on the property that have accrued. When the Bank gets the property, their interest has priority. Their interest will be paid first. Once that [is] taken care of, next in line would be the

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241. *Id.* ¶ 29 (emphasis added). This emphasized language suggests that Metro POA’s interest against the real property (its lien) is not extinguished by the senior mortgage lien’s foreclosure.

242. *See First State Bank*, 2014 Ark. 48, at 4, \_\_\_ S.W.3d at \_\_\_.

POA. The statute is clear that a downstream purchaser is jointly and severally liable. It even means, the case or statute, that the downstream buyers could seek compensation from the original owner. They may have a cause of action to seek indemnification or contributions from the original owner. That is what I believe is in the law.<sup>243</sup>

In responding to First State Bank's argument against allowing Metro POA's assessments to survive the foreclosure sale, Judge Mason asked: "How is it affecting the bank? You're getting the property."<sup>244</sup> Later, Judge Mason explained:

In my view, the Bank's lien has priority. You are going to get the property. You're going to foreclose on it. You're going to have a foreclosure sale. If you receive any proceeds above and beyond your interest, the POA is going to be taken care of. If you do not end up with the property, in my view, this is a contingent liability that's out there. That's just part of how the property is valued. I don't think that necessarily prejudices the bank.<sup>245</sup>

The Arkansas Supreme Court accepted certification of First State Bank's appeal because the issue involved a matter of first impression over the Arkansas Horizontal Property Act.<sup>246</sup> In a relatively brief opinion, the Arkansas Supreme Court affirmed the circuit court's decision, permitting both the Bank's adjudged liability for assessment arrearages and the lien securing the obligation to continue after foreclosure.<sup>247</sup> By upholding the survivability of the CIC lien, however, the Arkansas Supreme Court's holding effectively created an unlimited super-priority for Metro POA's lien and imposed unlimited liability for the previous owner's

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243. First State Bank's Abstract, Appellant's Brief, and Addendum at ab. 3-4, *First State Bank v. Nock-Broyles Land Dev., LLC*, No. CV 13-00349 (Ark. Ct. App. 2013) (citations omitted). Note that under lien-priority and lease law, a tenant would only have continuing rights after foreclosure of a mortgage if that lease was entered into prior to funding of the mortgage loan. If a lease is first in time, then it has priority over the mortgage. But if the lease is later in time, then foreclosure of the mortgage lien will extinguish the lease, absent agreement by the parties to the contrary.

244. *Id.* at ab. 8-9.

245. *Id.* (citation omitted).

246. *First State Bank*, 2014 Ark. 48, at 1, \_\_\_ S.W.3d at \_\_\_.

247. *Id.* at 1, 4, \_\_\_ S.W.3d at \_\_\_, \_\_\_.

assessment liabilities on the first-mortgage holder.<sup>248</sup> This holding goes well beyond the jurisprudence with respect to CIC lien priority and CIC purchaser liability in any other state.

The court also based its decision on the out-of-context, plain language of subsection 18-13-116(a)(1) of the Arkansas Horizontal Property Act.<sup>249</sup> The court found: “[T]here is nothing in the plain language of [the joint-and-several liability provision of the Arkansas Code (i.e., section 18-13-116(d))] that supports First State’s assertion that subsection (d) does not apply to a mortgage foreclosure sale.”<sup>250</sup> The court refused to “read words into subsection (d) that simply are not there” and, thus, would not overturn the circuit court’s “refus[al] to extinguish Metro POA’s interest.”<sup>251</sup> Although the Arkansas Supreme Court’s decision speaks to the issue of liability, it left unchanged the holding below—that the lien effectively remains intact beyond foreclosure.

#### IV. CLARIFYING THE WATERFALL

The seemingly straightforward ruling in *First State Bank* masks a radical departure from the law of lien priority and post-foreclosure liability with respect to CIC assessment liens. By ignoring the larger context of the statute—both from its drafting and how it applies to various actors—the court has problematically allowed a CIC’s “interest in the real property related to unpaid assessments” to survive first-mortgage foreclosure proceedings while also upholding the first-mortgage lien’s priority.<sup>252</sup> Moreover, by imposing unlimited personal liability for unpaid assessments on any and all purchasers at foreclosure, the *First State Bank* decision rendered Arkansas the first and only state to determine that a first-mortgage lender could face uncapped assessment liability through taking title to property in a

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248. See *id.* at 4, \_\_\_ S.W.3d at \_\_\_ (affirming the circuit court’s finding “that Metro POA’s interest from the unpaid monthly assessments would survive the foreclosure and would become the liability of whoever purchased the property at the foreclosure sale”).

249. *Id.* at 6, \_\_\_ S.W.3d at \_\_\_.

250. *Id.* at 8, \_\_\_ S.W.3d at \_\_\_.

251. *First State Bank*, 2014 Ark. 48, at 8, \_\_\_ S.W.3d at \_\_\_.

252. *Id.* at 3, \_\_\_ S.W.3d at \_\_\_.

foreclosure credit bid.<sup>253</sup> Thus, although the Arkansas Supreme Court's decision reads like a conservative, plain-language approach to statutory interpretation, it is both an extreme, unprecedented extension of lender liability and essentially a judicial imposition of an unlimited super-priority lien position for association assessment obligations.

Furthermore, the Arkansas Supreme Court's interpretation of the language in Arkansas's early-generation horizontal-property statute conflicts with precedent in other jurisdictions that appraised language of similar statutes. This Part explains how the Arkansas Supreme Court's lack of contextual clarity and confusion of the debt and lien issues led to an incorrect and problematic result. The latent ambiguity in the statute, highlighted by the decision in *First State Bank*, shows why legislative action clarifying such statutes is essential.

#### A. Puerto Rican Jurisprudence

Because the early-generation statutes are based largely on the 1958 Puerto Rican Act,<sup>254</sup> in-depth analysis of that Act may reveal the intended effect of Arkansas's Horizontal Property Act's provision on assessment liens in foreclosure proceedings.

As noted earlier, the original Puerto Rican Act did not explicitly address foreclosure sales.<sup>255</sup> Despite the lack of any statutory discussion of foreclosure sales, Puerto Rican caselaw indicates that the Puerto Rican Act's joint-and-several-liability language was not intended to apply in the context of first-mortgage foreclosures. The Puerto Rican Supreme Court had the chance to interpret the Act in 1977 when it heard *Association of Co-owners v. Naveira*.<sup>256</sup> In *Naveira*, a condominium association sued a purchaser at a foreclosure sale for \$2,777.70, the amount of common expenses owed by the pre-foreclosure owner.<sup>257</sup> "The apartment was auctioned to satisfy a judgment . . . for

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253. Other jurisdictions cap the priority of an assessment lien at a specified time, such as four months, six months, or nine months. *See supra* Part III.A.3.

254. NATELSON, *supra* note 129, at 29.

255. *See supra* Part III.A.1.a.

256. 6 P.R. Offic. Trans. 119 (1977).

257. *Id.* at 122.



\$17,526.93 principal, \$2,000.00 for attorney's fees, and other credits, rendered in favor of [the mortgagee]."<sup>258</sup> The defendant's \$24,000 bid was the highest of seven made at the auction.<sup>259</sup> The trial court cancelled all junior liens, including the lien securing the association's debt of \$248.00.<sup>260</sup>

The defendant sought summary judgment on the grounds that "he was a purchaser in good faith at a public auction who" should benefit from the senior-mortgage lien's priority over the maintenance fees of the condominium.<sup>261</sup> After hailing the development of apartment-building ownership pursuant to the horizontal-property regime as "by far the best contribution to the improvement of housing facilities for families of all economic levels in Puerto Rico," the court emphasized the importance of CIC units contributing to the common expenses (i.e., maintenance fees) for ensuring peaceful coexistence between unit owners and the preservation of the building.<sup>262</sup>

However, the court also identified the public interest in protecting sources of mortgage credit needed for the development of horizontal-property communities, as evidenced by the legislative provisions establishing a credit preference for taxes, insurance premiums, and duly recorded first mortgages.<sup>263</sup> The court noted that by providing joint liability for apartment acquirers, the legislature attempted to ensure that no co-owner could shirk responsibility for common expenses via waiver or abandonment.<sup>264</sup> But the court distinguished between a voluntary acquisition of property and an "involuntary" acquisition by a lender in foreclosure.<sup>265</sup> Balancing the different policies in each sort of acquisition was the critical issue in *Naveira*.<sup>266</sup>

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258. *Id.*

259. *Id.* at 123.

260. *Id.* This lien arose from a condominium association's successful action for collection of money against the pre-foreclosure owner. *Naveira*, 6 P.R. Offic. Trans. at 123.

261. *Id.*

262. *Id.* at 123-24.

263. *Id.* at 125-26 (quoting P.R. LAWS ANN. tit. 31, § 1293d (West 2011)).

264. *Id.* at 127 (quoting P.R. LAWS ANN. tit. 31, § 1293e (West 2011)).

265. *See Naveira*, 6 P.R. Offic. Trans. at 127-28.

266. *See id.* at 130-31 (explaining the reasoning for the distinction between a voluntary and involuntary acquirer).

The original text of the Puerto Rican Act did not distinguish between voluntary and involuntary transfers; thus, a plain-language reading of the 1958 Act arguably meant that purchasers at foreclosure sales, like any other “acquirers,” should be subject to joint and several liability with the pre-foreclosure owner.<sup>267</sup> But before the court decided *Naveira*, Puerto Rican lawmakers amended the 1958 Act to clarify the intended reach of the joint-liability provision.<sup>268</sup> The relevant amendment, in Act 157 of 1976, provides:

The obligation of the co-owner of an apartment for his proportionate share in the common expenses shall constitute a lien on said apartment. Therefore, the *voluntary* acquirer of an apartment shall be jointly liable with the conveyer for the amounts owing by the latter . . . up to the time of the conveyance, without prejudice to the acquirer’s right to recover from the other party the amounts paid by him as such joint debtor.<sup>269</sup>

Because the 1976 amendment was enacted after promulgation of the FHA Model Act,<sup>270</sup> and since the amendment’s language did not specifically *exclude* foreclosure buyers (unlike the FHA model), the *Naveira* court found that the “all-embracing wording” indicated the legislature’s intent to apply the joint-liability provision to foreclosure sales.<sup>271</sup> While the Puerto Rican amendment

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267. See Act of June 25, 1958, No. 104, § 41, 1958 P.R. Laws 254 (codified as amended at P.R. LAWS ANN. tit. 31, § 1293e (West 2011)) (providing that “the acquirer” is jointly and severally liable without further distinction).

268. See *Naveira*, 6 P.R. Offic. Trans. at 129 (explaining that the legislature amended the relevant provision in 1976).

269. Act of June 4, 1976, No. 157, § 41, 1976 P.R. Laws 482 (codified as amended at P.R. LAWS ANN. tit. 31, § 1293e (West 2011)) (emphasis added); see also *Naveira*, 6 P.R. Offic. Trans. at 129 (quoting the 1976 amendment).

270. See *supra* Part III.A.1.

271. *Naveira*, 6 P.R. Offic. Trans. at 129. The court found:

The legislative intent to strengthen the joint liability between the co-owner debtor and the acquirer of the apartment for common expenses unpaid up to the time of the conveyance and which is extensive to successful bidders, is inferred from the all-embracing wording of [the provision] even in its original text of 1958 where the lawmaker discarded the exemption provided for the acquirer in an involuntary sale pursuant to the F.H.A. Model Statute, § 23(b).

clearly extended assessment liability to any “voluntary” acquirers—including a “conventional purchaser, a donee, a permutant or a bidder who obtains the award at the auction”<sup>272</sup>—the amendment exempted involuntary acquirers, such as those who acquired apartments by exercising a preferred credit for taxes, insurance premiums, and exercising rights to security under recorded mortgages.<sup>273</sup>

The court explained the policy behind the distinction between voluntary and involuntary purchasers as follows:

The well-founded reason for this distinction between *voluntary* and *involuntary* acquirer lies on the different interests of one and the other. The voluntary purchaser is a person who, fully aware of the liens and encumbrances of the apartment, acquires it because it is a good deal. The involuntary acquirer is originally a creditor whose main interest is not to become the owner of the apartment but to protect his credit which has been generally constituted before the accrual of the debt for common expenses of the condominium. The voluntary acquirer has the opportunity and the means to learn about the debt for the common expenses of the condominium; he also has the decision-making power to assume responsibility for them as a lien over the property he acquires. For the involuntary acquirer, the creditor is one of the three cases set up by art. 40, [i.e., those with preferred credits for taxes, insurance premiums, and recorded mortgages] said debt is not an element or object of contract and his credit should not be reduced upon the debtor’s failure to comply with an obligation alien to those of said acquirer. In no case would it be just to collect said debt from the State, or from the Municipality foreclosing for the collection of taxes; from the insurer who makes a judicial claim of the two-year premium, or from the mortgagor seeking the recovery of the principal and the interests agreed upon. Any of these would be an incidental acquirer who would become owner only if the apartment is placed in public

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*Id.* at 129-30. The court added that the FHA Model “is followed by some states in the U.S. and due to the frequent financing of dwellings by said agency, it is a well-known regulation in Puerto Rico.” *Id.* at 130.

272. *Id.* (emphasis added).

273. *Id.*

auction, and no bidder attends it, and the executor has to take the property as total or partial payment of his credit for the sake of protecting such credit.<sup>274</sup>

The *Naveira* court found the statute did not exempt the purchaser at the foreclosure sale “from solidarity with the debtor co-owner because [the purchaser was] not a creditor executing one of the preferred credits.”<sup>275</sup> Instead, *Naveira* (the purchaser) had “participated voluntarily at a public auction where he had to surpass two other bidders to get the auction . . . .”<sup>276</sup> Accordingly, the court found that *Naveira* voluntarily subjected himself to the joint-liability rule because “[h]is decision to buy was a willful act done for his own convenience in the business area.”<sup>277</sup> The joint-and-several-liability language, however, implicitly would *not* apply to a lender acquiring at foreclosure of its own lien.<sup>278</sup>

For ascertaining the legislative intent of the original Puerto Rican joint-and-several-liability provision—the one replicated in Arkansas, Nebraska, and New Jersey—the most important discussion in the *Naveira* case is in the footnotes.<sup>279</sup> Footnote two addresses the deleterious impact of interpreting the statute to impose past-due condominium assessments on foreclosing lenders:

Article 40<sup>280</sup> is clear as to the mortgage credit for it acknowledges its priority only over six annual

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274. *Naveira*, 6 P.R. Offic. Trans. at 130-31 (footnote omitted). The court noted that the legislature had clarified the lasting effect of the assessment liability. *Id.* at 131-32 (“Act No. 157 of June 4, 1976 introduced a fundamental amendment to art. 41 upon ordering that ‘the obligation of the co-owner of an apartment for his proportionate share in the common expenses shall constitute a lien on said apartment.’ This provision is tantamount to declaring that a co-owner’s liability for common expenses always follows the title to his apartment even with regard to expenses accrued prior to its purchase.” (quoting Act of June 4, 1976, No. 157, § 41, 1976 P.R. Laws 482 (codified as amended at P.R. LAWS ANN. tit. 31, § 1293e (West 2011)))).

275. *Id.* at 132.

276. *Id.* at 127.

277. *Id.* at 127-28.

278. This approach is similar to the approach taken in Illinois and Hawaii, where non-lender foreclosure buyers become personally liable for past-due assessments, but lenders who acquire by credit bid do not. *See supra* notes 180-85 and accompanying text.

279. *See Naveira*, 6 P.R. Offic. Trans. at 124-31 nn.1-6.

280. Article 40 of the 1958 Puerto Rican Horizontal Property Act provided:

assessments and two years premium on the insurance. This article is highly important to investors and to companies which finance condominiums for it guarantees that their money shall not be diminished by the mortgage debtor's unpaid maintenance fees. Otherwise, a new element would be introduced in the financing of property and the obtention of credit by the purchaser of an apartment would be burdensome. It is evident that in Puerto Rico most apartments are purchased through credit facilities secured by mortgage; therefore, anything which may restrict or make more expensive this mortgage market will reduce the purchaser's capacity to acquire a dwelling. We are thus able to understand the reason why the lawmaker preferred the mortgage over the liability for maintenance fees accrued after the prior lien and whose amount is unpredictable at the time of constituting the mortgage credit.<sup>281</sup>

Even more critically, footnote four explains that the addition of the term "voluntary" to the joint-and-several-liability provision in 1976 was not a substantive modification but, rather, a mere clarification.<sup>282</sup> Naveira argued that if the preference did not favor him as a bidder, it would not benefit other creditors; but the court noted that this argument opposed the public policy of the Horizontal Property Act and the "careful balance" between the interests of

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[T]he credit against a co-owner for his share in the expenses to which the preceding section refers shall have preference over any other credits of whatever nature but the following:

- (a) Credits in favor of the Commonwealth for the taxes of the last three annual assessments past-due and unpaid on the apartment.
- (b) For two years of premium on the insurance of the apartment, or of the whole building, as the case may be, and, in the case of mutual insurance, for the last two dividends distributed.
- (c) Mortgage credits recorded in the Registry of Property.

Act of June 25, 1958, No. 104, § 40, 1958 P.R. Laws 253-54 (codified as amended at P.R. LAWS ANN. tit. 31, § 1293d (West 2011)).

281. *Naveira*, 6 P.R. Offic. Trans. at 125 n.2 (footnote added).

282. *Id.* at 128 n.4 (noting that the addition of the word "voluntary" was a "grammatical" correction).

condominium management and creditors.<sup>283</sup> Accordingly, the court found that the established joint-and-several-liability doctrine was never intended to apply to a mortgagee acquiring title in a foreclosure proceeding.<sup>284</sup>

Unlike the Puerto Rican Act, which was modified in 1976 to exclude “involuntary” transactions (particularly foreclosure purchases by purchase-money lenders),<sup>285</sup> the ambiguous state statutes that followed the original 1958 Puerto Rican Act remain in their un-amended, unclarified form.<sup>286</sup> One can only speculate over why these states have not changed their Acts in light of the Puerto Rican amendment. On one hand, the *Naveira* court’s insistence that the amendment was merely a clarification—addressing a “grammatical deficiency”<sup>287</sup>—suggests that the amendment may have been unnecessary. Because the court believed the intended scope of the originally phrased provision was apparent (or at least ascertainable), the term “voluntary” did not impact the statutory meaning in a strict technical sense. Perhaps, relying on *Naveira*, the legislature and courts in Arkansas, Nebraska, and New Jersey have simply viewed such an amendment as unnecessary and obvious, and statutory interpretation in these cases should yield the same result as *Naveira*—namely, that in foreclosure, non-lender acquirers become liable for unpaid assessments, but that lender acquirers do not.

On the other hand, the failure of Arkansas, Nebraska, and New Jersey to amend their statutes could indicate a deliberate decision by those states to reject *Naveira*’s limitation, suggesting that, in such states, the statute should impose liability on all purchases, whether voluntary, involuntary, via market sale, or via foreclosure. This interpretation would provide abundant protection to condominium associations—beyond that provided in any other jurisdiction—and perhaps impose a heavy burden on

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283. *Id.*

284. *Id.* at 127-30.

285. See Act of June 4, 1976, No. 157, § 41, 1976 P.R. Laws 461, 482 (codified as amended at P.R. LAWS ANN. tit. 31, § 1293e (West 2011)) (“[T]he voluntary acquirer of an apartment shall be jointly and severally liable with the conveyor for the amounts owing by the latter . . .”).

286. See *supra* Part III.A.2.d.

287. *Naveira*, 6 P.R. Offic. Trans. at 128 n.4.

lenders. But maybe that was an intentional policy choice. In fact, the plain text of the statutes, as the Arkansas Supreme Court noted, incorporates no exclusion from the term “sale” and, therefore, appears to encompass foreclosures and acquisitions by foreclosing lenders.<sup>288</sup> It is possible that state legislatures, strictly construing the language, have made a deliberate decision not to alter the statutes specifically in order to bolster efforts of condominium associations to collect fees, even at the expense of lenders who acquire property in a foreclosure sale.

Most likely, however, neither of these two scenarios represents why these three first-generation statutes remain in their original form. Instead, these legislatures probably never specifically considered the issue of amending their Horizontal Property Acts to address the question of post-foreclosure liability, possibly because they have yet to notice the ambiguity and corresponding need for clarification. The ambiguity in these statutes flew under the radar as no challenges to the statutory interpretation arose in an appellate court until the *First State Bank* decision.

### B. Foreclosures Are Different

In addition to ignoring the historical intentions of the statutory drafters, another significant shortfall of the Arkansas Supreme Court’s recent opinion in *First State Bank* is that it fails to acknowledge that foreclosure sales are fundamentally different from typical market sales. From a strict, plain-language perspective, the Arkansas Supreme Court correctly noted that the joint-and-several liability statute does not specifically reference and, therefore, does not specifically exempt foreclosure sales.<sup>289</sup> But the unique legal and financial aspects of foreclosure sales warrant different treatment under the statutory provisions governing transfers of condominium units.

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288. *First State Bank v. Metro Dist. Condos. Prop. Owners’ Ass’n*, 2014 Ark. 48, at 8, \_\_\_ S.W.3d \_\_\_, \_\_\_.

289. *Id.* (“There is nothing in the plain language of [the joint-and-several-liability] provision that supports First State’s assertion that [it] does not apply to a mortgage foreclosure sale.”).

A foreclosure sale is technically a purchase and a sale.<sup>290</sup> But this strict constructionist approach ignores not only the intent of the drafters of statutes like Arkansas's Horizontal Property Act—as explained by the Puerto Rican courts<sup>291</sup>—but also the mechanics and realities of the foreclosure-sale process in some states.

First, the seller of property at a foreclosure sale in certain states, including Arkansas, technically is not the owner who has accumulated the CIC assessment debt but, instead, is the county clerk.<sup>292</sup> The county clerk's role in transferring the property pursuant to judicial or statutory foreclosure would plainly not make the clerk liable for the assessments. The precise mechanics of foreclosure differ from state to state, and some states may deem the "seller" to be a court, a sheriff, a county clerk, or a trustee who holds legal title to the collateral property on behalf of a lender.<sup>293</sup> A foreclosure is not a sale based on an agreement entered into by an owner and a third party; rather, it is an administrative sale.<sup>294</sup> The usual continuity between seller and buyer does not exist because the seller is a different person and plays a different role from the seller in an ordinary market sale.<sup>295</sup> And even if a statute intended the term "seller" in a foreclosure to refer to the previous owner, the technical distinction between the two underscores the problems of ignoring context when interpreting the concept of property "sale" in such a statute.

Second, foreclosure sales are different because they are not protracted, negotiated market transactions where the seller and buyer bargain back and forth over conveyancing terms and price.<sup>296</sup> Rather, they are auctions of property,

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290. See BLACK'S LAW DICTIONARY 719 (9th ed. 2009).

291. See *Ass'n of Co-owners v. Naveira*, 6 P.R. Offic. Trans. 119, 129 (1977).

292. See *supra* note 234.

293. See 2 DUNAWAY, *supra* note 235, § 16:40.

294. See *id.* § 16:1.

295. See Craig H. Averch & Michael J. Collins, *Avoidance of Foreclosure Sales as Preferential Transfers: Another Serious Threat to Secured Creditors?*, 24 TEX. TECH L. REV. 985, 989-90 (1993) (explaining why secured creditors, instead of third parties, often take ownership of collateral in a foreclosure sale).

296. See James B. Hughes, Jr., *Taking Personal Responsibility: A Different View of Mortgage Anti-Deficiency and Redemption Statutes*, 39 ARIZ. L. REV. 117, 125 (1997) ("[T]he very nature of a foreclosure sale, as a forced sale which does not benefit from the normal interplay of arms' length negotiation, is not conducive to yielding



sold as-is, and the price achieved at the sale does not reflect typical market dynamics.<sup>297</sup> Although foreclosures transfer title, some view the term “foreclosure sale” as misleading.<sup>298</sup> For one thing, “[i]n many cases, a ‘sale’ does not take place at a ‘foreclosure sale.’ At many foreclosure sales the secured lender converts its lien on collateral to ownership of the collateral.”<sup>299</sup> In other words, in the common foreclosure, only the lender is participating in the auction through a credit bid,<sup>300</sup> thus excluding real-market dynamics, or even the need to pay any purchase price at all. Because foreclosure sales occur in rapid fashion and without the benefit of a purchase contract’s executory period, “third-party purchasers may not have a sufficient opportunity to perform the due diligence necessary to make an informed bid at a foreclosure sale.”<sup>301</sup> In some states, third-party purchasers at foreclosure must pay cash, rendering acquisition by a non-lender rare and difficult. Accordingly, non-lender purchasers “often wait to purchase the property *after* the secured lender forecloses its lien.”<sup>302</sup> In this relatively non-competitive bidding environment, it is no wonder that “[t]he amount of a secured

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‘fair market value’ when the property is sold through foreclosure’s auction process.” (footnote omitted)).

297. See *id.*; see also Jeffery M. Sharp, *Returning Confidence to Prepetition Foreclosure Sales Under the Bankruptcy Code: Scrutinizing Federal Policy and a Vague Statute*, 32 AM. BUS. L.J. 185, 236-37 (1994) (“Often, a traditional real estate sale involves a longer marketing period than that of a foreclosure sale. Price differences between foreclosure sales and traditional sales may be attributable to a number of factors, including differences in timing, owner’s cooperation, and realtor advertising and marketing.”).

298. Averch & Collins, *supra* note 295, at 989 (“The term ‘foreclosure sale’ is a misnomer.”).

299. *Id.*

300. See *supra* note 235 (explaining a “credit bid”).

301. Averch & Collins, *supra* note 295. Due diligence performed during the executory period, of course, includes examination not only of the physical state of the property but also of the legal title issues, including any recorded obligations, such as liens and covenants, and obligations accruing to owners of the property by virtue of statutes. See 14 RICHARD R. POWELL, *POWELL ON REAL PROPERTY* § 81.01(2) (Michael Allan Wolf ed., 2000). One has difficulty conceiving that a buyer at foreclosure would have equivalent opportunity to know and, therefore, to deliberately agree to be bound by such statutory provisions.

302. Averch & Collins, *supra* note 295, at 990.

lender's foreclosure sale bid may not have any relationship to the fair market value of the property."<sup>303</sup>

Moreover, one of the primary purposes of the foreclosure process is to clear title to property and free the property from the previous owner's liabilities and encumbrances.<sup>304</sup> To free up the foreclosed property, lienholders are paid in order of priority out of the proceeds of the foreclosure sale, and the purchaser at the foreclosure sale takes the property free and clear of any debts previously associated with the property.<sup>305</sup> In the foreclosure process, all liens junior to the foreclosed lien are extinguished by the sale.<sup>306</sup> Therefore, the purpose of a foreclosure transaction is relevant to this discussion, particularly as it distinguishes foreclosures from traditional voluntary-market sales.

Thus, any interpretation that treats foreclosures as identical to traditional market sales for purposes of assessment liens ignores the very nature and purposes of a foreclosure transaction. To the extent a statute is ambiguous in failing to separate "sales" by their type of title conveyance, courts should not presume to resolve that ambiguity in favor of treating two very different transactions similarly. Such an approach undercuts lender expectations and discourages buyers from purchasing at foreclosure. This approach is dangerous, particularly today, when states hope to stabilize volatile housing markets. Broad interpretations that impact foreclosures and discourage third-party bidders only inhibit a return to housing-market equilibrium.

### C. Balancing Mortgagee and Association Protections

Laws regarding lien priorities and post-foreclosure liability for debts arbitrate among the claims of various creditors with respect to the subject property.<sup>307</sup> When a homeowner does not pay his association assessments and

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303. *Id.* Furthermore, "[s]tatutory foreclosure procedures generally are not designed to attract buyers or to allow interested buyers to conduct the necessary due diligence. Many foreclosure sales do not even produce liquidation values." *Id.* (footnote omitted).

304. DUNAWAY, *supra* note 235, § 16:3.

305. *See supra* Part II.A.2.

306. DUNAWAY, *supra* note 235, § 16:8.

307. 59 C.J.S. *Mortgages* § 210 (1998).

fails to pay his mortgage, the interests of the CIC association and the mortgage lender conflict.<sup>308</sup> Therefore, the rules regarding the waterfall of foreclosure payments, continuing liability, and lien survivability determine the level of protection for each party. Some states have carefully and deliberately balanced the policies of protecting a mortgagee and promoting home lending with the policies of protecting an association and promoting community financial stability, often considering and either adopting or refusing to adopt capped super-priority CIC liens.<sup>309</sup> Other states, however, have struck this balance in a less overt way, perhaps without deliberation.<sup>310</sup> But the law determines to what extent lender interests outweigh the interests of a community association, whether or not states have acted intentionally.

Most modern statutes do not hold buyers liable for unpaid assessments as of the date of purchase, even though a lien for those assessments continues to burden the property after a market sale.<sup>311</sup> Rather than address the ability of an association to seek unpaid assessments from the new buyer personally, associations in these states rely on their continuing lien to obtain payment of arrearages.<sup>312</sup> However, after foreclosure of a first mortgage in most of these states, the association has no recourse to the property because the assessment lien is junior to the first mortgage.<sup>313</sup>

At least ten of the states that do provide for purchaser joint liability limit the application of joint liability to a non-foreclosure sale context, explicitly excepting foreclosures from the scope of "sales."<sup>314</sup> Of these states, interestingly, only Washington provides a limited-lien priority for

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308. *Id.*

309. *See supra* notes 105-06 and accompanying text.

310. *See supra* Part III.A.

311. *See supra* Part III.A.2.

312. An association could foreclose on a lien and apply the proceeds toward unpaid assessments. *See* 31 C.J.S. *Estates* § 270 (2008). Alternately, the original owner remains liable. *Id.*

313. Boyack, *supra* note 71, at 75.

314. *See* IND. CODE ANN. § 32-25-6-3(e) (West 2013); IOWA CODE ANN. § 499B.18 (West 2013); KAN. STAT. ANN. § 58-3123(b) (West 2013); MICH. COMP. LAWS ANN. § 559.158 (West 2014); MONT. CODE ANN. § 70-23-610 (West 2013); N.C. GEN. STAT. ANN. § 47C-3-116(j) (West 2013); OKLA. STAT. ANN. tit. 60, § 524(d) (West 2013); OR. REV. STAT. ANN. § 100.475(2) (West 2013); S.C. CODE ANN. § 27-31-210(b) (West 2013); WASH. REV. CODE ANN. § 64.32.200(3) (West 2013).

associations.<sup>315</sup> In Washington, no statutory liability exists for a foreclosure buyer with respect to unpaid assessments that were due prior to the purchase of the property; nonetheless, a six-month super-priority lien primes first mortgages in the state.<sup>316</sup> In the other nine states, however, a buyer in foreclosure avoids both personal liability and a surviving (or super-priority) CIC lien.<sup>317</sup>

More modern statutes typically balance lender and association interests through lien priority.<sup>318</sup> These jurisdictions have created a limited and capped super-priority-association lien for a certain amount of months' worth of unpaid assessments.<sup>319</sup> Although rampant foreclosure delays create some unfairness when the association's super-priority position is capped, no state has opted to grant CIC assessment liens complete super-priority.<sup>320</sup> At a mortgage foreclosure, the super-priority portion of the association lien will either be repaid or will remain intact, not extinguished by the sale. Generally, no personal liability applies to any foreclosure purchaser in these states.<sup>321</sup> This means that one cannot personally sue a

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315. See WASH. REV. CODE ANN. § 64.34.364(3) (West 2013).

316. WASH. REV. CODE ANN. § 64.34.364(3).

317. See IND. CODE ANN. § 32-25-6-3; IOWA CODE ANN. § 499B.18; KAN. STAT. ANN. § 58-3123; MICH. COMP. LAWS ANN. § 559.158; MONT. CODE ANN. § 70-23-610; N.C. GEN. STAT. ANN. § 47C-3-116; OKLA. STAT. ANN. tit. 60, § 524; OR. REV. STAT. ANN. § 100.475; S.C. CODE ANN. § 27-31-210.

318. See Boyack, *supra* note 71, at 98-101 (noting that, as of 2011, eight states had adopted the UCIOA model, which contains an “‘innovative’ solution to the problem of assessment nonpayment during mortgage default: the six-month ‘limited priority lien.’”).

319. *Id.*

320. See *id.* at 62, 99; JEB REPORT, *supra* note 161, at 6.

321. Seventeen jurisdictions allow for an association super-priority lien capped at a specified number of months' worth of assessment but are silent regarding personal liability for a purchaser at foreclosure. ALA. CODE § 35-8A-316 (West 2014); ALASKA STAT. ANN. § 34.08.470 (West 2013); COLO. REV. STAT. ANN. 38-33.3-316 (West 2014); CONN. GEN. STAT. ANN. § 47-258 (West 2014); DEL. CODE ANN. tit. 25, § 81-316 (West 2014); D.C. CODE § 42-1903.13 (West 2013); MD. CODE ANN., Real Prop. § 11B-117 (West 2014); MASS. GEN. LAWS ANN. ch. 183A, § 6 (West 2014); MINN. STAT. ANN. § 515B.3-116 (West 2013); MO. ANN. STAT. § 448.3-116 (West 2014); NEV. REV. STAT. ANN. § 116.3116 (West 2013); N.J. STAT ANN. § 46:8B-21 (West 2013); 68 PA. CONS. STAT. ANN. § 3515 (West 2014); R.I. GEN. LAWS ANN. § 34-36.1-3.16 (West 2013); TENN. CODE ANN. § 66-27-415 (West 2014); VT. STAT. ANN. tit. 27, § 3-116 (West 2013); W. VA. CODE ANN. § 36B-3-116 (West 2014). No personal liability appears to cover purchasers at foreclosure in these states. Washington, which has a six-month super-priority association lien, creates personal

foreclosure purchaser for payment of the assessment arrearages;<sup>322</sup> nevertheless, the association's super-priority lien effectively requires a purchaser to pay the capped amount of unpaid dues (either as part of the purchase price at foreclosure or thereafter) to obtain clear title.

Earlier-generation statutes achieved the balance of lender-protective and association-protective policies not by a limited super-priority lien but, instead, by holding a third-party buyer at foreclosure personally liable for unpaid association dues.<sup>323</sup> Creating post-foreclosure liability indirectly achieved a similar effect as priming the mortgage lien because the new purchaser bore the obligation to pay post-foreclosure arrearages (although that obligation was unsecured). However, with one exception, every state that provides for foreclosure-buyer liability specifically makes an exception for mortgagees purchasing at foreclosure on a credit bid.<sup>324</sup> That one exception is Florida. Although Florida imposes liability on a lender who purchases at foreclosure for some unpaid assessments, it caps a lender's liability exposure at the lesser of 1% of the mortgage loan or an amount equal to twelve months of regular assessments.<sup>325</sup>

In terms of lender liability for unpaid assessments, therefore, states have taken a very lender-protective approach. Lenders are either shielded completely from pre-

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liability for buyers in non-foreclosure sales but specifically precludes arrearage liability for all foreclosure purchasers. See WASH. REV. CODE ANN. §§ 64.32.200, 34.364 (West 2013).

322. See JEB REPORT, *supra* note 161, at 3-4.

323. See, e.g., P.R. LAWS ANN. tit. 31, § 1293e (West 2011).

324. See, e.g., HAW. REV. STAT. § 421J-10.5(b) (West 2013) (providing for joint and several liability for a foreclosure purchaser *other than* the mortgagee taking title by credit bid); 765 ILL. COMP. STAT. ANN. 605/9(g)(4) (West 2014) (same). Illinois also has an association lien with six-month super-priority. 765 ILL. COMP. STAT. ANN. 605/9(g)(4). Therefore, non-mortgagee buyers have a personal obligation for all unpaid assessments, but a lien only secures six months' worth of this obligation. Lenders who purchase at foreclosure in Illinois acquire a property interest that is encumbered by a six-month lien, but they have no personal liability for the debt. 765 ILL. COMP. STAT. ANN. 605/9(g)(4). *Naveira's* interpretation of the Puerto Rican Act accords with this approach. See *generally* Ass'n of Co-owners v. Naveira, 6 P.R. Offic. Trans. 119 (1977). In Hawaii, lenders who purchase at foreclosure are not liable for unpaid assessments, but third-party purchasers at foreclosure, or purchasers who buy from a lender who acquired title in foreclosure, are liable for six-months' worth of assessments. HAW. REV. STAT. § 421J-10.5(b). However, no super-priority lien exists, so this liability is unsecured. HAW. REV. STAT. § 421J-10.5(a).

325. FLA. STAT. ANN. § 718.116(1) (West 2014).

acquisition assessment obligation (the majority approach), or are burdened with a capped amount of obligation for unpaid assessments (the Florida approach). In other states, policy balancing between lender and association interests occurs through lien priority rather than liability.<sup>326</sup> Until the Arkansas decision in *First State Bank*, no state had determined that an association's interest should completely outweigh a lender's interest, whether determined by liability or lien priority. Nor had any court held that a lender who buys at foreclosure would be personally liable for an unlimited amount of assessment arrearages. The *First State Bank* court held the plain meaning of the statute mandated that lender purchasers at foreclosure incur unlimited liability for unpaid assessments,<sup>327</sup> and compared to the law regarding lender foreclosure acquirer liability in all other states, this result is extreme.<sup>328</sup> The decision in *First State Bank* provides that a mortgagee purchasing at foreclosure will bear unlimited liability for unpaid CIC assessments.<sup>329</sup> Even Florida—the far end of the spectrum with respect to protecting an association's interests—fails to extend *unlimited* personal liability to a mortgagee for assessment arrearages.<sup>330</sup> Arkansas's interpretation means that all buyers in foreclosure, including mortgagees making a credit bid, become personally liable for the entire amount of

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326. See *infra* Part IV.D (specifically discussing the lien-priority approach).

327. *First State Bank v. Metro Dist. Condos. Prop. Owners' Ass'n*, 2014 Ark. 48, at 8, \_\_\_ S.W.3d \_\_\_, \_\_\_.

328. This interpretation is unique among all states in its result. If, on one hand, the court had interpreted buyer liability to exclude foreclosure, then Arkansas's statute would in effect follow a more conservative approach typical of the ten other states that impose liability on non-foreclosure purchasers but do not apply such liability in foreclosure. See *supra* note 314 and accompanying text. If, on the other hand, the court had interpreted the language in the same way the Puerto Rican Supreme Court interpreted identical language in *Naveira*, then liability for foreclosure purchasers would attach only to a non-lender buyer. This result would be similar to the law in Hawaii and Illinois. See HAW. REV. STAT. § 421J-10.5; 765 ILL. COMP. STAT. ANN. 605/9. But if the courts in these states deemed the buyer liability inclusive of lenders buying at foreclosure—as the Arkansas court did—then the balance of protection would be even more extreme than it is in Florida because the liability exposure of the lender under the Arkansas interpretation is uncapped. See *First State Bank*, 2014 Ark. 48, at 8, \_\_\_ S.W.3d at \_\_\_.

329. *First State Bank*, 2014 Ark. 48, at 8, \_\_\_ S.W.3d at \_\_\_.

330. FLA. STAT. ANN. § 718.116(1).

unpaid assessments. Currently, no other state has elected this radical result.

#### D. The Liability-Lien Connection and Backdoor Super-Priority

The decision in *First State Bank* not only makes Arkansas the first state to impose on a foreclosing lender unlimited liability for unpaid association assessments, but it also expands liability by allowing the association to collect the amounts owed from the property through a foreclosure of its own.<sup>331</sup> Although the court nominally stated that the Bank's lien had priority, it failed to consider the implications of this stated priority, since it held that Metro POA's "interest in the real property" to secure the debt—namely its lien—survived the mortgage foreclosure.<sup>332</sup> Survivability of a junior lien is unheard of in foreclosure, and permitting the association lien to persist after foreclosure of the bank's lien is paramount to judicially granting the association lien unlimited super-priority over the first mortgage.

##### 1. Liability vs. Lien

As discussed in Part II, allowing a lien to survive foreclosure is paramount to finding that the lien primes the foreclosing lien. Survival of liability does not mandate survival of the lien because an obligation and security for that obligation are distinct concepts.<sup>333</sup> A 2006 New Jersey case, *Highland Lakes Country Club & Community Association v. Franzino*, considered the joint liability of a foreclosure buyer for unpaid assessments and post-foreclosure lien liability—the same issues faced in *First State Bank*—and accurately separated these two concepts.<sup>334</sup>

In *Highland Lakes*, the New Jersey Supreme Court considered the effect of a CIC's master deed and bylaws, which required any purchaser of property in the community to pay assessment arrearages to enjoy the benefits of association membership and mandated association

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331. See *First State Bank*, 2014 Ark. 48, at 5, \_\_\_ S.W.3d at \_\_\_.

332. *Id.* at 5, \_\_\_ S.W.3d at \_\_\_.

333. See *supra* Part II.A.

334. See 892 A.2d 646, 654-55 (N.J. 2006).

membership for all property owners.<sup>335</sup> The purchaser at a foreclosure sale of property within the CIC claimed that the foreclosure extinguished the Association's lien<sup>336</sup> and, therefore, he had no liability with respect to assessments left unpaid at the time of the foreclosure purchase.<sup>337</sup> The court disagreed, explaining that based on the association's governing documents, *unsecured* liability remains even after a junior lien is extinguished.<sup>338</sup> The court carefully explained that although a foreclosure sale extinguishes a junior lien—here, the lien for the predecessor's homeowner-association dues—the foreclosure purchaser still acquires the obligation to pay the debt based on the language of this association's governing documents.<sup>339</sup>

New Jersey's statute is effectively identical to Arkansas's in that purchasers in a CIC are “jointly and severally liable” with their seller.<sup>340</sup> But the court in *Highland Lakes* did not apply the statute to reach its conclusion. Instead, the court carefully based its decision on provisions in the particular CIC's governing documents that mandated purchaser liability for dues.<sup>341</sup> The court found that these covenants were an equitable servitude, “‘running with the land,’” and that this servitude had been created prior to the mortgage and, therefore, survived foreclosure.<sup>342</sup>

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335. *Id.* at 647-48.

336. New Jersey currently has a super-priority lien statute for association assessment obligations, N.J. STAT. ANN. § 46:8B-21 (West 2013), but it does not apply retroactively; and the mortgage in this case was funded before adoption of that law.

337. *Highland Lakes*, 892 A.2d at 648.

338. *Id.* at 655.

339. *See id.* at 656-58.

340. Compare ARK. CODE ANN. § 18-13-116(c)-(d) (Repl. 2003) (“The purchaser of an apartment shall be jointly and severally liable with the seller . . .”), with N.J. STAT. ANN. § 46:8A-22 (West 2013) (“The purchaser of an apartment shall be jointly and severally liable with the seller . . .”).

341. *See Highland Lakes*, 892 A.2d at 655-57. The Association argued that, “based on deed language requiring adherence to Bylaw requirements, arrears on membership charges that were accrued by predecessors in title may be enforced both as a contractual obligation undertaken by an acquiring property owner and as an equitable servitude on the property.” *Id.* at 648. The community's recorded Master Deed included two covenants in which the purchaser: (1) acknowledged that homeowners were required to be members in the Association; and (2) “affirm[ed] that membership ha[d] been applied for, and agree[d] to abide by the Association's requirements,” including, specifically, the Bylaws. *Id.* at 648 n.1.

342. *Id.* at 659. In so finding, the New Jersey Supreme Court reversed the appellate court's determination that the covenants did not provide sufficient notice of



Accordingly, the purchaser at a foreclosure sale (and any subsequent purchaser) assumed liability for the arrears accrued by his predecessors in title.<sup>343</sup>

The New Jersey Supreme Court affirmed the trial court's finding that although the purchase-money mortgage had priority over the Association's lien with respect to the proceeds of the sale, "the foreclosure action did not extinguish Highland's contractual right to collect the assessments of prior owners from the current owner of the property."<sup>344</sup> Personal liability of purchasers arose from the recorded covenants and bylaws, which created adequate notice for lenders and third-party purchasers alike.<sup>345</sup>

In *Highland Lakes*, the court held the foreclosure purchaser personally liable for unpaid assessments based exclusively on the Association's recorded governing documents.<sup>346</sup> The court deliberately explained, however, that these documents could not affect lien-priority law or the black-letter law of foreclosure, which maintains that foreclosure of a senior lien extinguishes junior liens.<sup>347</sup> In

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an obligation to pay dues, fees, and assessments owed by prior owners. *Id.* at 653-54 ("Subsequent bona fide purchasers of property encumbered with an equitable lien take 'subject to the rights of the equitable lienor,' provided there is notice of the lien." (quoting 51 AM. JUR. 2D *Liens* § 18 (2000))).

343. *Highland Lakes*, 892 A.2d at 659. In stressing that its decision lay in the language of the CIC's governing documents, the court held that "homeowners' associations are created in New Jersey by the filing of a declaration of covenants, conditions, and restrictions contained in deeds and association bylaws" and not merely by operation of statute. *Id.* at 653 (citing E. Richard Kennedy & Mark D. Imbriani, *The Rights of Tenants in Condominium and Homeowner Association Communities*, N.J. LAW., Jan./Feb. 1996, at 18, 18).

344. *Id.* at 652.

345. The court stated:

The covenants include restrictions and conditions that run with the land and bind all current and future property owners. The bylaws set forth the rules and regulations that govern an association's members. Because such documents are instruments affecting title to real estate, homeowners' associations may record their governing documents. Once recorded, the recordation can serve as notice to subsequent judgment creditors and purchasers. . . . [M]embership obligations requiring homeowners in a community to join an association and to pay a fair share toward community maintenance are enforceable as contractual obligations. Moreover, such recorded covenants also can create a lien on the property.

*Id.* at 653 (citations omitted).

346. *Id.* at 656-59.

347. *Highland Lakes*, 892 A.2d at 654.

holding that the Association's lien could not survive the mortgage-foreclosure sale, the court identified a key component of the foreclosure process—that foreclosure frees the property from all subordinate liens.<sup>348</sup> The court explained that “mortgage foreclosure actions are designed to bring together for one disposition creditors' claims to the property” and that, after foreclosure, “[t]he property . . . is freed of the lien, enabling the purchaser at foreclosure sale to take title unencumbered by the lien. Stated otherwise, the lien is discharged as to the property.”<sup>349</sup> Accordingly, the foreclosure judgment and associated sale extinguished any lien created when the owners went into arrears.<sup>350</sup>

The court rejected outright the possibility that any lien created by operation of covenants and bylaws could survive the foreclosure judgment.<sup>351</sup> But the court was also quick to acknowledge that the obligation of the individual debtor was still enforceable, albeit unsecured.<sup>352</sup> The *Highland Lakes* decision articulates the long-accepted rule that liability for an obligation does not preserve the security for that obligation.<sup>353</sup> The inverse is also true: “It has long been the law in New Jersey that extinguishment of a lien does not affect the validity of the underlying debt that gave rise to the lien.”<sup>354</sup>

In *Highland Lakes*, the New Jersey Supreme Court avoided the flawed reasoning of the Arkansas trial court in *First State Bank* that conflated debt with security, reasoning which the Arkansas Supreme Court implicitly accepted in its blanket affirmation of the lower decision. The *Highland Lakes* court recognized that the post-foreclosure survival of assessment obligation of an individual owner and joint liability of the new purchaser was a completely separate

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348. *Id.*

349. *Id.* (citation omitted).

350. *See id.*

351. *Id.* (“The Association’s position is contrary to foreclosure’s essential purpose of transferring a lien claim from the property to the monies generated by the foreclosure sale, thus clearing title to the property.”).

352. *Highland Lakes*, 892 A.2d at 654 n.5 (“Of course, the Association may pursue the [foreclosure purchasers] personally on the debt owed. However, foreclosure is a *quasi in rem* action and, therefore, after the lien is extinguished by operation of the foreclosure judgment, the property no longer secures the debt.”).

353. *Id.* at 654.

354. *Id.* at 655.

question from the issue of whether foreclosure extinguished the CIC's lien.<sup>356</sup> If a mortgagee who acquires title at foreclosure is liable for the debt, such liability is not necessarily secured. The mortgage foreclosure extinguishes any junior lien—including the assessment lien. This is necessarily true, regardless of whether post-foreclosure liability for assessment arrearages arise under the CIC's recorded documents (as was the case in *Highland Lakes*) or under applicable statute (as was the case in *First State Bank*).

## 2. Association Super-Priority: A Political Hot Button

If assessment liens are allowed to survive a foreclosure sale, the mortgage lien is in effect subordinated to the lien of the CIC.<sup>357</sup> In the most typical foreclosure scenario, the mortgagee is the lone bidder at the foreclosure sale of its secured property, bidding up to the amount of the mortgage debt.<sup>358</sup> If the mortgagee takes title to the foreclosed property with the CIC lien still attached, and the lender thereafter seeks to sell the foreclosed property, then any purchaser will reduce the amount of its offer by the amount of the CIC lien, thereby reducing the ultimate proceeds to the lender. The capped amount of lien priority in at least seventeen jurisdictions recognizes conflicting policy concerns with respect to associations' interests in payment of the arrearages and lenders' interests in minimizing their exposure.<sup>359</sup> To date, Arkansas has refused to adopt a limited super-priority lien for association-assessment arrearages. But holding that a foreclosure purchaser remains liable for these arrearages *and* that the association can foreclose on the property to recover that obligation if it remains unpaid is paramount to creating an *unlimited* super-priority lien for unpaid association assessment—going far beyond the UCIOA's limited-priority-lien approach that the Arkansas legislature has yet to adopt. Judicial creation of what is effectively an unlimited super-priority lien in a state

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356. *Id.* at 658.

357. 31 C.J.S. *Estates* § 270 (2008) (“Where so provided by statute or condominium documents, the assessments shall constitute a lien superior to all other encumbrances other than those specifically excepted.”).

358. *See supra* Part III.B.

359. *See supra* Part IV.C.

that lacks the legislative will to create even a limited super-priority lien is highly problematic.

At the end of the day, the amount the lender can recover from disposal of the property dictates the lender's priority and security.<sup>360</sup> If, after acquiring the property at the courthouse steps, the lender cannot sell the property to a third party free of the CIC's lien, the lender is essentially tasked with satisfying the CIC's assessment out of its security. This would be true even if the bank bears no personal liability for the obligation. But personal liability coupled with lien survivability accomplishes an indirect, or backdoor, super-priority for the CIC lien over the first-priority mortgagee's security interest. No state has granted association liens complete super-priority over first-mortgage liens.<sup>361</sup> And from a lender's perspective, applying complete super-priority over loans already disbursed would be problematic because it significantly changes the lender's expectation.

Lenders make loans based on their calculations of risk and return.<sup>362</sup> Paramount in that calculation is the priority position of their lien. Lenders are careful to ensure that they obtain the highest lien priority possible and, to the extent certain liens prime their own, that they build protections into the mortgage ensuring that the obligations secured by those liens remain funded—such as property-tax escrow accounts.<sup>363</sup> Although national-lender forms provide for a possible escrow of CIC assessments, lenders do not in practice require CICs to fund these amounts into escrow.<sup>364</sup> Thus, increasing association priority without notice to lenders leaves lenders with an empty bag to fund association arrearages. Furthermore, this also impairs the contract rights of lenders who have bargained to be subordinate to certain liens (taxes and previously recorded liens) but have relied on the statutory-lien priority in believing they would be senior to other liens (such as, in Arkansas, the association's lien).

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360. See ARK. CODE ANN. § 4-9-601(a)(3), (e)(1)–(3) (Supp. 2013).

361. See *supra* Part IV.C.

362. See Carl Circo, *Real Estate Project Valuation and Underwriting—A Primer*, 2010 ARK. L. NOTES 155, 161 (explaining how real-estate lenders assess a project's financial viability).

363. Boyack, *supra* note 71, at 122.

364. See *supra* notes 157-58 and accompanying text.

Even if applied only prospectively, mortgage lenders are wary of association-lien super-priority.<sup>365</sup> In several states, mortgage lenders have mounted aggressive objections to proposed legislation that would create a six-month super-priority lien for association assessments.<sup>366</sup> For example, in Ohio, lenders stridently opposed efforts to pass a six-month-priority lien law, killing the bills that would have achieved that in both 2010 and 2011.<sup>367</sup> The national and state lenders in Ohio argued that the bill would increase the costs of lending and the complexity of mortgages and would chill mortgage lending in the already slow housing-capital market.<sup>368</sup> Similar efforts to create a limited lien priority failed in Georgia in 2012.<sup>369</sup> Reports on the demise of that bill explained that “[t]here was substantial opposition from the banking lobby and Realtors.”<sup>370</sup>

The super-priority status of association liens is also problematic because of underwriting requirements for secondary-mortgage-market purchasers, in particular Fannie Mae and Freddie Mac.<sup>371</sup> Most mortgage lenders

365. See Boyack, *supra* note 71, at 122, 129.

366. See generally SPERLONGA, THE HIDDEN THREAT OF HOA LIENS: WHY DELINQUENT HOA ACCOUNTS ARE A THREAT TO INVESTOR ROI AND FIRST MORTGAGE LIEN POSITIONS (2013), available at <https://www.sperlongadata.com/docs/TheHiddenThreatOfHOALiens-1.28.2013.pdf> (highlighting lender concerns over super-priority statutes and encouraging action opposing such legislation).

367. Boyack, *supra* note 71, at 109-10.

368. See Ann Fisher, *Condo Associations Want Plan to Make Owners Pay*, COLUMBUS DISPATCH (July 5, 2009, 10:46 AM), [http://www.dispatch.com/content/stories/local/2009/07/05/condofees.ART\\_ART\\_07-05-09\\_B1\\_78ECMU6.html](http://www.dispatch.com/content/stories/local/2009/07/05/condofees.ART_ART_07-05-09_B1_78ECMU6.html).

369. JULIE MCGHEE HOWARD, LEGISLATIVE ACTION COMM., CMTY. ASS'NS INST.-GA. 2012 LEGISLATIVE UPDATE (2012). The effort to have a lien-priority law adopted has been ongoing in Georgia for years. A 2012 proposed bill

would have amended the Georgia Condominium Act and the Georgia Property Owners' Association Act to expressly provide that an association's assessment lien is superior to the lien of any mortgage in an amount equal to half of the common expense assessments that came due during the 12 months immediately preceding the date of the foreclosure, or six months of assessments for condominiums.

*Id.* The Georgia Legislative Action Committee is still proposing a new version of the bill. *Id.*

370. *Id.*

371. See, e.g., Fannie Mae, *Selling Guide Announcement*, *supra* note 209, at 1. Fannie Mae (formerly the Federal National Mortgage Association) and the Federal Home Loan Mortgage Corporation (Freddie Mac) were chartered by Congress and

today seek to sell the mortgages they originate, and Fannie Mae and Freddie Mac are the two largest buyers in the secondary-mortgage market, with a current combined market share of over 70%.<sup>372</sup> As an underwriting requirement, Fannie Mae specifically refuses to purchase loans for which a lender could be liable for more than six months of assessment charges, either through a lien priority or through personal liability,<sup>373</sup> a position recently reiterated in Fannie Mae's newly issued selling guidelines.<sup>374</sup> Freddie Mac had limited its liability exposure to six months of assessments, but in August 2013, it slightly modified its requirements to allow exposure for greater than six months in states that statutorily capped super-priority liens for association assessments at some greater amount (i.e., nine or twelve months).<sup>375</sup> This exception, however, would not apply to unlimited liability exposure created through "joint and several" language or from a court's holding that foreclosure-buyer joint liability extends the life of an association lien.

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are regulated by federal agencies and, since 2008, have been in conservatorship with the federal government. See Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae and Freddie Mac*, 60 AM. U. L. REV. 1489, 1499-1502, 1525 (2011) (providing an overview of the market role and enumerated purposes of Fannie Mae and Freddie Mac). Recently, Fannie Mae and Freddie Mac have repaid bailout funds and have posted record profits but remain in conservatorship perhaps because "the administration of Barack Obama seems in no hurry to release its suddenly lucrative wards." *Fannie Mae and Freddie Mac: Two Albatrosses Take Flight*, ECONOMIST (Nov. 23, 2013), <http://www.economist.com/news/finance-and-economics/21590588-americas-mortgage-giants-are-now-profitable-enough-fight-over-two-albatrosses>.

372. Jason Gold, *Still No Appetite for Risk: Here's Why Killing off Fannie Mae and Freddie Mac Is a Bad Idea*, ECON. INTELLIGENCE (Aug. 28, 2013), <http://www.usnews.com/opinion/blogs/economic-intelligence/2013/08/28/more-evidence-that-ending-fannie-mae-and-freddie-mac-is-a-mistake> (noting that Fannie Mae and Freddie Mac's market share plummeted to 40% during the housing boom pre-2007 and then grew to 77% in 2012 as private capital fled the market).

373. FANNIE MAE, SELLING GUIDE 575-76 (June 28, 2011), available at <https://www.fanniemae.com/content/guide/sel062811.pdf>.

374. Fannie Mae, *Selling Guide Announcement*, *supra* note 209, at 1. The selling guidelines provide a limited exception for those states that have passed a super-priority statutory lien in an amount exceeding six months—namely, Florida and Connecticut. *Id.* Because Nevada's statute has a carve-out for Fannie Mae and Freddie Mac requirements, the six-month limit would apply. *Id.*

375. Freddie Mac, Bulletin No. 2013-15, at 1, 7-8 (Aug. 15, 2013), available at <http://www.caionline.org/govt/news/Political%20HeadsUp%20Public%20Document%20Library/Bulletin%202013-15Freddie.pdf>.

Clearly, lender liability for unpaid association assessments is a political hot button.<sup>376</sup> If a state truly wants to grant an association a super-priority lien or impose assessment liability on a lender who acquires title in foreclosure (whether that liability is limited or unlimited), it should clearly adopt that goal through the legislative process rather than through backdoor judicial interpretations of “joint and several liability” language and/or misinterpretations of association-lien priority. Super-priority for CICs is a significant policy decision that states must enact transparently so that lenders, borrowers, and third-party purchasers can all predict and appropriately price the impact of CIC assessments on their lending and investment decisions.<sup>377</sup> As noted by the official comment to the 1977 UCA, mortgage lenders aware of priority for CIC assessment liens will likely require escrows for CIC dues as they typically do for insurance and taxes on the property.<sup>378</sup> Mortgage lenders could also simply reduce the amount that they are willing to lend on a property to account for the risk that they will have to recover on behalf of the CIC in foreclosure. Again, any of these results may be acceptable, but the potential liability must be clear so that lenders can arrange their investments with some degree of certainty.

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376. The Sperlonga White Paper suggests that the lending community very much wants to (and needs to) be part of the conversation as states determine how best to protect associations while ensuring that mortgage funds keep flowing to homebuyers. SPERLONGA, *supra* note 366, at 4 (“The mortgage industry is virtually defenseless against foreclosures by community associations for unpaid assessments. As Mortgage Banking Magazine mentioned in a 2012 article, HOA issues may be the biggest problem most mortgage bankers have never heard about.” (internal quotation marks omitted)).

377. Co-author Andrea Boyack argued in a previous paper that lenders should be partially, if not completely, liable for unpaid association assessments, but imposing such liability may be unfair if lenders are not given notice and the ability to structure and price a mortgage loan with that in mind. *See generally*, Boyack *supra* note 71.

378. UNIF. CONDO. ACT § 3-116 cmt. 2 (amended 2008), 7(II) U.L.A. 625 (2009) (“As a practical matter, mortgage lenders will most likely pay the 6 months’ assessments demanded by the association rather than having the association foreclose on the unit. If the mortgage lender wishes, an escrow for assessments can be required.”).

## V. CONCLUSION

The *First State Bank* decision illuminates a once latent ambiguity in the statutes of the three jurisdictions that have not amended the early-generation, joint-and-several-liability language for CIC buyers: Arkansas, Nebraska, and New Jersey. Legislatures in these three states should now recognize not only that an ambiguity exists but also that they must carefully consider the conflicting interests of associations and lenders in the security asset value of homes in CICs. This statutory ambiguity also highlights the broader—and not completely considered or resolved—question of how every state should best balance competing policies between associations and lenders. On the one hand, states may protect associations by permitting them to recover unpaid assessments even after a mortgage foreclosure is desirable because the costs of CIC financial instability and uncollected arrearages affect innocent parties—namely, the paying members of a CIC. On the other hand, states need to ensure that mortgage lending remains unimpaired, particularly in today’s still-recovering housing market. States should resolve ambiguity with respect to post-foreclosure liability and lien priority, but only after fully considering the costs imposed by the chosen resolution. This policy decision—requiring a delicate balance of community and mortgage-capital concerns—must be left to state legislatures. A court cannot impose this decision.

Until legislatures in Arkansas, Nebraska, and New Jersey provide statutory clarification, however, judges in these states must determine whether their laws imposing joint and several liability on sellers and purchasers of condominium units for assessments apply in the context of foreclosure sales and, if so, whether they apply to mortgagee purchases at foreclosure. Courts can best make this determination by analyzing the applicable statutes in context and considering the implications of their interpretations. On multiple levels, foreclosure sales are different than ordinary market transactions; therefore, courts should treat them differently. Moreover, strong evidence suggests that statutory “joint and several liability” language for condominium purchasers was never intended to cover



purchasers in foreclosure, at the very least when the lender itself is forced to take title.

The lesson from the *First State Bank* case is even broader than the CIC-lender conflict, however. The court's holding in this case illustrates how applying a "plain language" approach to interpret statutes in a vacuum ignores context and legislative purpose. Instead, courts in these jurisdictions should consider context, history, purported intent, and the approach of every other jurisdiction. Courts should exclude foreclosure sales from joint and several liability for purchasers of condominium units. But even if a court determines that foreclosure sales should constitute a "sale" for this purpose, that court should recognize the extreme position of applying the provision—without limit and without clear legislative intent—to mortgage lenders who take title in foreclosure with a credit bid.

Further, even if courts are willing to extend liability to foreclosure purchasers for accrued CIC assessments, that liability must be unsecured unless the state has statutorily mandated a super-priority for association liens. No state currently grants CIC liens full seniority over first-mortgage liens. The jurisdictions that have granted some super-priority to association liens have carefully capped the amount that the super-priority lien secures. As a matter of law, foreclosure of a senior lien must extinguish any junior lien.

The ramifications of allowing a CIC junior lien to persist beyond foreclosure are serious. Allowing a CIC assessment lien to survive the mortgage foreclosure distorts the relative priorities of the lender and CIC association. The lender will most often be the sole bidder at the foreclosure sale. Its recovery is then deferred until it resells the foreclosed property, and anyone buying from the lender will reduce the purchase price by the amount necessary to satisfy any outstanding liens on the property. In this sense, the CIC association recovers before the purchase-money lender and receives a super-priority. Super-priority for assessments, even if limited to a matter of months, is a politically charged issue. It cannot be created through judicial stealth in an unpredictable application of an ambiguous statutory provision.

Legislative action and judicial discretion on this matter is imperative. Even though the Arkansas Supreme Court likely viewed the decision as a straightforward reading of its condominium statute, the *First State Bank* opinion places Arkansas as a complete outlier—in the most extreme position of post-foreclosure protection of an association’s interest—by essentially providing CIC associations an unlimited secured position for their claim for unpaid assessments.

The judicial branch is not in the best position to determine any particular state’s approach to the survival and prioritization of CIC assessments. Legislators can more effectively evaluate whether the state’s interests can be better advanced by protecting the traditional first-priority position of mortgage lenders or by giving CIC associations at least a limited super-priority protection. The trend over the last several decades is to focus on the relative secured priority position of the lender and CIC’s liens rather than balancing policies through joint and several liability for past-due assessments. Within this lien-priority approach exists a wide range of options, and a legislature can carefully consider and choose the correct balance for its jurisdiction. This sort of deliberate selection also permits lenders to act strategically prior to funding loans, creating methods to cover their risks and costs according to predictable criteria.

Compelling arguments support adopting a regime that protects a community association’s ability to recover unpaid assessments, even post-foreclosure and even to the detriment of the purchase-money lender. Nonetheless, equally valid reasons also favor maintaining the traditional preference for the mortgage lender above all other creditors, particularly in an era of tight credit. Whichever direction a state sees fit to go, the legislature must deliberately enact the policy decision. Above all, secured lending requires predictability. Without a clear understanding of the relative priority of association liabilities, mortgage liabilities, and liens, lenders will refrain from lending to condominium purchasers.

*First State Bank* is a cautionary tale of how an “easy” statutory interpretation can threaten the foundations of mortgage lending, inject unpredictability into the system of

foreclosures and lien priorities, and create unintended consequences for associations and lenders alike. Ideally, both courts and legislators will recognize the risks in facially clear but latently ambiguous statutes and will consciously choose a desired outcome and carefully clarify the law.