Is It Time for Michigan to Adopt "Limited" Super-priority Assessment Liens?

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All condominiums are created by statute and, depending upon the jurisdiction, by the recording of a master deed or declaration of covenants. The primary (if not the exclusive) source of revenue for maintenance or administration of condominiums is the assessments paid by the co-owners of the condominium property. In this regard, every jurisdiction in the country has adopted laws that give the condominium's governing body a lien against any unit that fails to timely pay assessments.

When the condominium concept first began, it was virtually unheard of that real property would lose value over time. Because of this, the "priority" given to condominium assessment liens was not necessarily the hot topic of debate it has become today – regardless of whether the mortgage holder or the condominium association had seniority, these secured parties could generally rest assured that no matter which party initiated the foreclosure process, there was a reasonably-good chance that there would be sufficient equity in the property to cover both secured interests. This meant that the junior lien holder could safely protect its interest by paying off the senior lien and then proceed with its own foreclosure, knowing that it was likely to recover most or all of its money in the process.

The real estate "boom" of the 1990's and the subsequent "collapse" of the 2000's, however, significantly altered this safety net. For example, during the "boom" years, people often over-extended themselves, comforted by the knowledge that their investment would only appreciate and they would eventually "grow into" affording their new real estate purchases or renovations. This often resulted in creative finance methods, such as the issuance of multiple mortgages to help buyers qualify for purchases or finance renovations. Financing what was essentially 100% of the property's value left little breathing room for the growing number of parties that might have a secured interest. Similarly, as property values later started to decline, this left little or no (or even negative) equity to cover all of these secured interests. As a result, it is certainly not unusual today for real property to be worth less than what is owed on the primary mortgage, let alone what is owed on all secured obligations combined.

Particularly as it relates to condominium property, it is also not uncommon to see the mortgage lender delay foreclosure proceedings because:

- there is an administrative overload due to the large number of properties banks are being forced to carry, and
- unless a property is particularly desirable and likely to sell quickly, lenders do not wish to become "co-owners" of condominiums who are liable for the payment of assessments. As is the case here in Michigan, most jurisdictions provide that a person taking ownership of a condominium unit in foreclosure is not liable for the assessments that accrue prior to the foreclosure sale (or, if there is such liability, it is often "capped" at a relatively small amount, such as 6-months worth of assessments); but liability for assessments attaches once there is a foreclosure purchase (either by the lender or a third party).

Birth of the "limited" super-priority lien

Because assessments are the primary source of revenue for condominium associations, assessment liens have been given some measure of "super-priority" in most jurisdictions. In other words, even though assessments may be levied and/or the assessment lien may arise or be recorded after other interests in the property, the assessment lien will, in whole or in part, be superior to some prior-recorded interests. For example, many jurisdictions have priority rules similar to those here in Michigan; namely, even if a second mortgage is recorded before the assessments became due and/or the assessment lien is recorded, the second mortgage will nevertheless be junior to the assessment lien. By the same token, nearly every jurisdiction provides that government tax liens have the highest priority, regardless of when they arise or are recorded, since the public's interest in having all property owners contribute for public services outweighs any interest that private property owners and/or lenders might have in securing the debts owed by individual unit owners.

With regard to "first" or primary mortgages, many jurisdictions now also provide for "limited" super-priority assessment liens so that the other joint owners of the condominium, at least in part, will not have to "insure" the obligations of their neighbors by paying more than their proportionate share of the common obligations. In those jurisdictions where assessment liens have been granted "limited" super-priority over first mortgages, the state statutes will generally grant the condominium association's lien priority for a limited period of time (usually 6 months). In those instances, lenders or third parties who purchase condominium units in foreclosure are generally required to pay the assessments that accrued during the 6 months immediately preceding the foreclosure (or similar acquisition of title, such as surrender or deed in lieu of foreclosure).

Since 1976, "uniform" laws have been drafted to help facilitate condominium association efforts to collect past-due assessments (1). Currently, this statute is known as the Uniform Common Interest Ownership Act (UCIOA) (2). Almost half of the states (and the District of Columbia) have adopted the UCIOA's provisions with respect to assessment lien priority or have crafted something similar to achieve this result. Currently, the "limited" super-priority provision of the UCIOA, Section 3-116(c), reads as follows:

> A lien under this section is also prior to [a first mortgage lien] to the extent of both the common expense assessments based on the periodic budget adopted by the association . . . which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien and reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien.

Under this provision, the assessment lien is "split", creating two separate and distinct liens: one which consists of that portion of the arrearage that is deemed to be "superior" to the prior-recorded first mortgage, and one which is "junior" to such a mortgage. Thus, if the condominium association elects to foreclose its lien, the mortgage lender will be required to pay off 6-months worth of assessments, plus any costs and fees incurred in foreclosing the assessment lien, or else it risks having its mortgage wiped out when the "superior" portion of the assessment lien is foreclosed.

States granting assessment liens "limited" super-priority

Currently, 13 states have adopted the UCIOA's "limited" super-priority provision with respect to assessment liens (3). Another 9 states (and the District of Columbia) have not adopted the UCIOA, but have nevertheless crafted some form of "limited" super-priority language in an effort to achieve this same result (4). Seven states have adopted portions of the UCIOA, but specifically have not adopted its language granting "limited" super-priority to assessment liens (5). Finally, 21 states have not adopted any “limited” super-priority language in their statutes (although some measure of super-priority may be granted in many of these jurisdictions, such as priority over prior-recorded second mortgages (6)).

In total, 22 states and the District of Columbia have adopted language in their statutes which grant “limited” super-priority to assessment liens (or its equivalent), while in 28 states, there is no such “splitting” of the assessment lien.

Purpose of “limited” super-priority liens

The obvious intent of these “limited” super-priority statutes is to eliminate (or at least reduce) the amount of money that a condominium association will lose if one of its owners defaults on his or her obligation to contribute to the condominium’s proportionate expenses (or, more realistically, to reduce or eliminate the additional amounts that will need to be passed along to the other co-owners of the condominium to make up this deficit). These statutes were originally designed under the assumptions that:

1. co-owners who default on their assessment obligations are also likely to default on their mortgage obligations, and
2. it usually takes about 6 months for the mortgage lender to foreclose its lien. This second assumption, however, has significantly changed over time, since lenders now take much longer to foreclose their liens (whether for the reasons stated above or due to their need to first engage in government-mandated “mediation” programs that are intended to assist buyers from losing their homes in foreclosure (7)).

Even with these extended mortgage foreclosure times, however, the “limited” super-priority assessment lien, when utilized properly, can force mortgage companies to either pay the assessment arrearage or foreclose – either way, a new “paying” co-owner is placed in the unit as quickly as possible, again reducing or eliminating the association’s lost revenue. For instance, under the foregoing uniform language, once a co-owner is 6 months in arrears in the payment of assessments, the association can undertake “action” to foreclose the superior portion of its assessment lien. Since the prior-recorded first mortgage would be rendered “junior” to the association’s lien, the mortgage holder must generally receive notice of the foreclosure action. Once it receives notice, the mortgage holder will almost always take some type of action to avoid having its security interest wiped out by the association’s foreclosure. This will usually consist of:

1. paying the superior portion of the lien, and then
2. initiating its own foreclosure. If, for some reason, the mortgage holder fails to initiate its foreclosure within 6 months of paying off the superior assessment lien, the association would have a new 6-month lien and need only begin taking action again to force the mortgage holder to pay another 6 months worth of assessments (and so on until the mortgage holder finally forecloses (8)).

In the foregoing example, all parties are generally “protected”, as long as they take timely action to protect and/or enforce their rights – the condominium association needs to act no later than every 6 months, while the mortgage holder needs to promptly proceed with its own action once it receives notice of the association’s foreclosure. While the mortgage holder will be required to reimburse up to 6 months worth of assessments before it (or another third-party purchaser) buys the unit in foreclosure, this is a relatively modest amount compared to the mortgage debt and there are generally other “protections” granted to the mortgage holder (such as the ability to apply all advances paid by the lender to the debt amount so that they can potentially be recovered as part of the mortgage foreclosure). In addition, while the lender might not “realistically” be able to recover this assessment amount, it is just as “realistic” that the association will lose something in the process, even though it must protect the lender’s property via the services it provides to all co-owners. Thus, in the end, this would seem to be an appropriate balance and compromise on both sides.

The banks fight back

Most recently, however, we have started to see mortgage lenders fight back against this “limited” super-priority concept. In particular, the Federal Housing Finance Agency (FHFA), conservator for Fannie Mae and Freddie Mac, threatened to take legal action against the enforcement of so-called “limited” super-priority liens, claiming that such liens “force” Fannie Mae or Freddie Mac liens into a secondary position, which FHFA says increases the risk of loss to taxpayers. This is in accord with a recent decision from a federal district court in the Ninth Circuit, which held that a mortgage interest in real estate is “federal property” that is protected by the Constitution of the United States. Since only Congress can make rules or regulations governing the disposition of property owned by the United States, these courts reasoned that state laws allowing assessment liens to “leap frog” federally-insured loans improperly divest the federal government of its interest under the Property Clause of the Constitution. The federal court also held that such state statutes limit the effectiveness of the federal government’s available remedies, thus violating the Supremacy Clause of the Constitution (9).

The time has come for “limited” super-priority assessment liens

Given the above-referenced delays in first mortgage foreclosures, it is time that Michigan join the ever-growing number of states that are adopting “limited” super-priority assessment liens.

It is to be expected that those who are placed in a secondary position by “limited” super-priority liens will object, since this merely creates the possibility that a large first-mortgage security interest could be wiped out by a relatively-small assessment lien. The federal government’s objections notwithstanding, however, these so-called “problems” only arise if one side or the other “drops the ball” and fails to timely act to enforce its rights. Indeed, litigation on this issue only appears to come up when the lender fails to respond to a notice it receives from the condominium association, thereby allowing the association’s foreclosure to proceed and wipe out the interest made junior by the “limited” priority lien. Had the lender acted timely, at worst, it would have only had to pay 6-months in assessments as part of its foreclosure process.

Of course, the most likely underlying objection is that lenders will be forced to timely foreclose on properties they might otherwise sit on. It seems quite disproportionate, however, to allow co-owners to remain in units without paying assessments or to allow mortgage lenders to sit on abandoned properties, thereby depriving condominium associations their much-needed revenue, simply because lenders do not want to ultimately be responsible for paying their fair share of the condominium’s expenses. In fact, by allowing these properties to avoid the payment of expenses for an extended period of time, this merely punishes the other common owners by forcing them to pay a disproportionate share of expenses.

The “limited” super-priority lien, by installing equity and fairness into this process, will only help maintain values for this ever-increasing segment of property ownership. Indeed, without assurances that they will not be forced to pay their neighbors’ obligations, it is likely that purchasers (and, thus, borrowers) will soon begin to shy away from owning common interest property. Moreover, by placing additional burdens upon existing co-owners to make up lost assessments, this only increases the chances that more co-owners will be unable to meet their obligations, thereby increasing foreclosures for all concerned. It is hard to imagine that this result would be good for the taxpayers, not to mention the significant number of condominium owners.

1. The Six Month “Limited Priority Lien” for Association Fees Under the Uniform Common Interest Ownership Act. Report of the Joint Editorial Board for Uniform Real Property Acts, June 1, 2013.
2. Its predecessors were known as the Uniform Condominium Act, the Model Real Estate Cooperative Act, and the Uniform Planned Community Act.
3. Alabama, Alaska, Colorado, Connecticut, Delaware, Minnesota, Missouri, Nevada, Pennsylvania, Rhode Island, Vermont, Washington and West Virginia.
4. Florida, Hawaii, Illinois, Maryland, Massachusetts, New Hampshire, New Jersey, Oregon, Tennessee, and the District of Columbia.
5. Kentucky, Maine, Nebraska, New Mexico, North Carolina, Texas and Virginia.
6. Arizona, Arkansas, California, Georgia, Idaho, Indiana, Iowa, Kansas, Louisiana, Michigan, Mississippi, Montana, New York, North Dakota, Ohio, Oklahoma, South Carolina, South Dakota, Utah, Wisconsin and Wyoming.
7. Indeed, the federal Housing Finance Authority (FHFA), conservator for Fannie Mae and Freddie Mac, has published foreclosure timelines for all 50 states. In its 2012 report, FHFA found the national average for processing mortgage foreclosures in each state was 396 days, ranging from 270 days (a common timetable in non-judicial foreclosure states such as Georgia, Michigan, Minnesota and Missouri) to 750 days in New Jersey and 820 days in New York.
8. Lake Ridge Condominium Association, Inc. v Vega, Case No. NNHCV116021568S (Conn. Super. Ct., June 25, 2012).
9. Washington & Sandhill Homeowners Association v Bank of America, N.A., Case No. 2:13-CV-01845-GMN-GWF (U.S.D.C., Nevada Division, September 25, 2014).

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