



## **Renting or Selling Association-owned Units Subject to Senior Encumbrances**

By Steve Guerra

The Michigan Condominium Act automatically grants condominium Associations a lien against those units which are delinquent in the payment of assessments. In most instances, the Association's statutory lien is subject to that of a first mortgage. Historically, if an Association was unable to collect delinquent assessments directly from the co-owner or via co-owner's income/assets, the Association typically foreclosed its statutory lien either because there was substantial equity in the Unit to satisfy the delinquent assessments, or because the foreclosure would likely hasten the first mortgagee's foreclosure and "stop the bleeding" (that is, the Association's acquisition of title typically resulted in a co-owner's default in first mortgage payments followed by a timely foreclosure by that first mortgagee, with the first mortgagee being responsible for ongoing assessments from the date of its foreclosure sale forward). These days, Associations are dealing with units whose first mortgages often exceed the value of the unit (i.e. the unit is "upside down"), and with banks that are dragging their foreclosure process or not taking any foreclosure action at all, despite the Association foreclosing its own lien and even though the co-owner has stopped making mortgage payments or has gone as far as to even abandon the unit.

Over the past several years banks have specifically delayed or stopped moving forward with the foreclosure of mortgages secured by condominium units. This is sometimes done in an effort to avoid paying ongoing Association assessments, which banks are required to pay from the date of their foreclosure sale through the six month redemption period, in what may be a "soft" or non-existent resale market. Other times the bank may have written off the debt because of a bankruptcy or the bank may not even be aware of the debt as the debt may have been assigned to the bank after it acquired the assets of a failed lender. In those situations, Associations should effectively utilize their lien and foreclosure rights to place the Association in a position to more quickly capture assessments on a going forward basis as well as perhaps recapture a portion, if not all, of the delinquent assessments.

### **I. Foreclosure by Advertisement**

In order to obtain title to the Unit, the Association must foreclose its lien. There are two types of foreclosure: foreclosure by advertisement, and judicial foreclosure. The major difference between a foreclosure by advertisement and a judicial foreclosure is the fact that there is no court proceeding required to complete the foreclosure by advertisement process. Because the courts are not involved, the Association saves the cost of the judicial proceeding and the time involved (usually about three months). Because of these time and cost savings, when the owner is uncollectible and when there is a first mortgage the preferred method is foreclosure by advertisement. Following is a brief overview of the foreclosure by advertisement process:

- A Foreclosure notice is prepared and sent to the unit and the co-owner's last known address, published in the Legal News 4 consecutive weeks at least once each week in a

newspaper published in the county where the unit is situated, and posted in a conspicuous place at the unit within 15 days of first publication.

- After the notice is published for 4 consecutive weeks, the unit is sold by the Sheriff to the highest bidder (if there is a first mortgage, the Association will typically be the highest bidder; if there is no mortgage or if there is sufficient equity in the unit/lot, a third-party will likely be the highest bidder).
- Once foreclosed, there is a 6 month redemption period during which the co-owner can redeem the unit by paying the amount paid at the foreclosure sale. During this redemption period, the Association cannot take possession of the unit. The redemption period may be shortened to 1 month if the unit is deemed abandoned.

The Association's foreclosure wipes out all interest except for tax and first mortgagee liens. If there is a first mortgage or any tax liens, the Association is not responsible for paying the lien amounts. Rather, the Association takes subject to these liens (i.e., if the first mortgagee or taxing authority forecloses, the foreclosure would wipe out the Association's title to the Unit).

## II. Rental of Unit

If the particular community's rental market is favorable, an Association may find that a portion, if not all, of the delinquent assessments can be recovered via the cash flow generated through the Association's rental of a foreclosed unit. Once an Association forecloses its lien, it is permitted to rent the unit at the time it obtains "possession" of the unit. An Association can obtain possession of the unit in as short as one month from the foreclosure sale if the unit is confirmed abandoned or, if the unit is occupied, six months after the Association's foreclosure sale.

First, we recommended that Associations not enter into any lease if the first mortgagee forecloses prior to the time the Association takes possession of the unit, as any remaining rental period will be too short-term. If the first mortgagee has foreclosed prior to the Association obtaining possession, the Association will have at least achieved the historical goal of "stopping the bleeding" and the first mortgagee will be responsible for ongoing assessments from the date of its foreclosure sale forward.

Once the Association obtains possession and assuming the first mortgagee hasn't foreclosed, the Association will have a minimum of six months to rent the unit as any bank foreclosure will have an associated six month redemption period. Any lease should be for a maximum term of six months, which can be renewable on a month-to-month basis or such longer period depending on whether the bank has yet foreclosed.

The amount of rent the Association receives will ultimately be driven by the rental market and the timing of the bank's potential foreclosure sale. Once the bank's foreclosure has taken place and its six month redemption period has expired, the Association's title and the tenant's possessory interest in the unit will be extinguished. If the bank's foreclosure takes a matter of years, the Association may find that it not only covered ongoing assessments, but that it also recovered all arrearages and perhaps even deposited excess amounts into the Association's general account. If it is a matter of six months, the Association will have at least covered ongoing assessments and hopefully offset a meaningful portion of any assessment arrearage.

### III. Quiet Title Action

As indicated above, our firm has seen numerous situations where the mortgage company has not foreclosed because it may have written off the debt as a result of a bankruptcy or because the bank was not even aware it had a mortgage as it may have been assigned to the bank after it acquired the assets of a failed lender (think back to the numerous bank failures and bulk mortgage assignments in 2008-2010). In those situations, the mortgage company will likely never foreclose. A quiet title complaint ultimately asks a court to declare that the first mortgagee has no interest in the property because the mortgagee has written off the debt or because it would be inequitable to continue to allow the mortgage lien to impede the use of the property. Assuming we obtain a judgment in the Association's favor, the Association is then permitted to sell the unit free and clear of the mortgage.

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With banks delaying or stopping foreclosure of their mortgages, Associations need to consider taking proactive steps to ensure that delinquent units do not continue to drain association finances. If the Association determines that it is beneficial to utilize its statutory liens and foreclosure rights to turn once delinquent units into units providing cash flow to the Association, the Association should contact our office to ensure that a proper action plan is implemented.