

The Tail Wagging the Dog

Nevada's 9-month Super-priority Dilemma

BY MICHAEL R. BROOKS, MANAGING PARTNER, BROOKS BAUER LLP & ALIA A. NAJJAR, PRINCIPAL, THE LAW OFFICES OF ALIA A. NAJJAR, M.D., J.D.



Over the past 18 months, real estate investors in Nevada have been purchasing properties at homeowner's association auctions for a fraction of their fair market value, renting them out and hoping to clear an exponential profit. Interestingly, the phenomenon is not brought on by changes in the HOA foreclosure laws but in the deed of trust foreclosure laws that started in 2009 with the Nevada Foreclosure Mediation Program (the "FMP"). The impact of the FMP followed by the Affidavit of Authority (aka AB284) have expanded foreclosure timeframes from 200 days to over 400 days according to RealtyTrac's 2013 Q1 Nevada numbers. When Nevada's Homeowner's Bill of Rights are factored in, it appears that the timeframe will be extended even further. As a result, HOA's, which had simply waited for lenders to pay the delinquent assessments when the foreclosure was completed, now found themselves compelled to proceed with foreclosures to try to recover their on-going losses. These sales were conducted pursuant to

existing laws which provide for "super-priority liens" for HOAs for the "9-months immediately prior to the institution of an action to enforce the lien." The purchasers proceeded to institute legal actions alleging that they bought the super-priority portion of the lien and wiped out even the first position deed of trust holder.

Hundreds of these super-priority lawsuits have been filed in Nevada claiming that the purchase acquired title free and clear of the first deed of trust. The first few cases have made their way to the Nevada Supreme Court which is scheduling oral argument. Ultimately, the Nevada Supreme Court's ruling on one of the multiplicity of lawsuits will likely answer many questions and may actually create more.

Origins of HOA Super Priority Liens

Super priority lien rights originated in the Uniform Condominium Act, adopted by the Commissioners on Uniform State Laws in 1980, and the Uniform Common Interest Ownership Act ("UCIOA") and the Uniform Planned Community Act ("UPCA"), which were adopted by the Commissioners in 1982. The Official Comments to these Uniform Acts state the purpose of this super priority status is to strike

an equitable balance between the need to enforce collection of unpaid assessments and the necessity of protecting the priority of security interests of mortgage lenders. The comments note that, as a practical matter, mortgage lenders would most likely pay the assessments demanded by the association rather than having the HOA foreclose on the property.

Super Priority Liens in Nevada

In 1991, Nevada adopted modified provisions of the Uniform Common Interest Ownership Act (1982), which govern HOAs in Nevada. See, NRS Chap. 116, *et seq.* Specifically, NRS 116.3116(2) provides that the HOA's lien is prior to all other liens, except (a) liens recorded against the property before the Declaration of Covenants, Conditions and Restrictions ("CC&Rs"), (b) **first deeds of trust**, and (c) real estate taxes or other governmental assessments. NRS 116.3116(2) also sets forth an exception to this, which makes a portion of the HOA lien prior to the first deed of trust, thus creating "super priority" status in these instances. NRS 116.3116 provides that the HOA lien is prior to those security interests previously described to the extent of any charges incurred by the association on a unit for maintenance

CONTINUED ON PAGE 35

pursuant to NRS 116.310312, and to the extent of the assessments for common expenses based on a budget that must be adopted by the association annually pursuant to NRS 116.3115, and which would have become due in the absence of acceleration during the six¹ months immediately preceding institution of an action to enforce the lien.

Super Priority Litigation in Nevada

Successful HOA bidders filed suits to quiet title to their property alleging that they purchased these properties free and clear of the first deed of trust. There are hundreds of lawsuits and at last count more than 50 appeals currently pending in the Nevada Supreme Court on HOA super priority liens and HOA foreclosures.

Several judges have offered conflicting interpretations of the confusing law. Some judges have held that the super-priority only exists where there is a judicial action filed. Other judges have held that the super-priority lien is only a payment priority after the foreclosure of the property. Still others have held that proper notice must be given before the foreclosure will effect title. On the other hand, some courts have held that the properly served notice of default and notice of sale wipes out the first deed of trust regardless of any language affirming that the super-priority rights are being asserted. Finally, there is even one judge who has held that the entire statute is unconstitutional because it violates the principles of due process.

One of the main issues in this

continuing debate between third party bidders and banks involves NRS 116.3116(2), which states that the HOA's super priority lien arises at the time of "institution of an action to enforce the lien." The issue is whether the term "action" refers only to judicially commenced action or if it also includes non-judicial foreclosure actions. On this issue, a Washington State court held that a HOA's judicial foreclosure of its super priority lien completely extinguished a first deed of trust. *Summerhill Village Homeowners Association v. Roughly*, 166 Wash. App. 625, 270 P.3d 639 (2012). Banks argue that this case is inapposite in Nevada, where almost all HOA foreclosures are non-judicial foreclosures and NUCIOA does not require notice to a first position bank in order for a HOA to foreclose non-judicially.

Third party bidders have also relied on Nevada Attorney General Opinion AG13-01. This opinion addresses which costs an HOA can include in the calculation of the dollar amount of its super priority lien, but it fails to cite any authority for its position. Dep't of Business and Indus., Real Estate Div., Adv. Op. No. 13-01 (Dec. 12, 2012).

Several Nevada federal district court decisions have found in favor of banks holding first position deeds of trust, holding that the HOA's super priority lien does not extinguish a first position deed of trust. See *Diakonos Holdings, LLC v. Countrywide Home Loans, Inc.*, 2:12-cv-00949-KJD-RJJ, 2013 WL 531092 (D.Nev. Feb. 11, 2013); *Bayview Loan Servicing, LLC v. Alessi & Koenig, LLC*, 2:13-cv-00164-

RCJ, 2013 WL 2460452 (D. Nev. June 6, 2013); *Weeping Hollow Ave. Trust v. Spencer*, 2:13-cv-00544-JCM-VCF, 2013 WL 2296313 (D.Nev. May 24, 2013); *Kal-Mor-USA, LLC v. Bank of America, N.A.*, 2:13-cv-0680-LDG-VCF, 2013 WL 3729849 (D.Nev. July 8, 2013); *Premier One Holdings, Inc. v. BAC Home Loans Servicing LP*, 2:13-CV-895 JCM GWF, 2013 WL 4048573 (D. Nev. Aug. 9, 2013).

Other arguments advanced by banks are equitably based arguments focused on the economic impact wiping out their interests would have on the lending industry in Nevada. Lenders also point to arguments based upon HOA's lack of cooperation in providing payoffs to lenders and failure to accept payment in satisfaction of a past due balance unless lenders obtain written approval from borrowers. Banks have also advanced due process arguments based upon the lack of notice and the significant difference between the HOA sale price and the amount secured by the deed of trust.

While it is not clear how the Nevada Supreme Court will rule, it is clear that third party bidders will continue to cash in on these properties and lawsuits will continue piling up in Nevada courts until the issue is resolved by the Court. It is hoped that there will be an answer in the second quarter of 2014. However, it is possible that the matter may get pushed to the latter part of 2014.

1 The six-month super-priority was extended to 9-months in 2009.