The Perfect Storm

Impact of Mortgage Foreclosures on Community Associations

by Lisa A. Magill, Esq.

Stories about mortgage foreclosure rates and related issues stemming from the cratering real estate market seem to appear daily in newspapers and magazines and on websites and television. We have all seen pictures of "foreclosure tours," where realtors with fancy limousines drive potential investors and home buyers around neighborhoods to look at bank owned properties, all hoping to glean significant discounts. We have empathized with homeowners forced to relocate after adjustable rate mortgages escalated, ultimately resulting in foreclosure. We have seen pictures of communities littered with "for sale" signs.

Those involved with community association operations understand that one further result of the mortgage foreclosure crisis is the difficult challenge community association manager and boards now face as a result of declining revenue.

In order to gauge the effect of mortgage foreclosures upon community associations and their operations, the Community Association Leadership Lobby (CALL) conducted an online survey of community association members from March 25 to April 8, 2008. Almost 500 property owners in Florida community associations participated in the survey. The results demonstrate the compound effect the real estate credit collapse has on common interest ownership housing throughout the state.

How did we get here? The Perfect Storm...

Borrowing the phrase from *Perfect Storm* author Sebastian Junger, it is not difficult to understand how several factors over the past six to eight years or so, taken together, precipitated current conditions. Property values in Florida increased exponentially—developers, excited about the rise in property values, implemented aggressive plans to develop, build, and market residential properties; lenders offered new products and expanded underwriting guidelines; and buyers turned into investors, often purchasing several properties at a time. Good times for all? Maybe for the short term, but consider:

Increased Expenditures Due to Hurricanes

Florida Community Associations faced tough issues after the rash of hurricanes in 2004 and 2005. Many associations levied significant assessments to fund insurance deductibles, emergency mitigation expenses, and to repay loans or lines of credit obtained to fund restoration costs. Assessments levied to repay loans or lines of credit are typically spread out over several years. Some associations funded debt repayment with a dedicated line item in their budget. Community leaders expected insurance proceeds to fund repairs and reduce or eliminate this debt. However, many learned obtaining enough proceeds was difficult, expensive, and time consuming, leading some to accept inadequate adjustments.

Market Changes

When home values were on the rise, community associations weren't necessarily adversely affected by mortgage foreclosures. The 2007 changes to HOA law (Chapter 720, Florida Statutes) created joint and several liability, precluding buyers and mortgagees obtaining title as a result of foreclosure or deed in lieu of foreclosure from saddling homeowners associations with delinquencies. Mortgagee protection in the Condominium Act[1] rarely impacted associations, as third parties were anxious to purchase condominium units auctioned on the courthouse steps.

When market values decline, however, associations are often left without recourse. Over fifty-five (55%) percent of the survey respondents indicated that financial institutions did not pay current maintenance fees and special assessments. Lenders in condominium properties only have to pay the lesser of one percent of the original mortgage debt or six (6) months of regular assessments when they obtain title to a unit due to foreclosure, leaving associations unable to collect delinquent maintenance or the special assessments mentioned above. Homeowner associations will experience similar losses when changes to the homeowners association law[2] adopted this legislative session become effective on July 1, 2008.

Financing Options

Adjustable rate mortgages (ARM) with artificially low "teaser" introductory rates, interest only payment options, subprime loans, and zero-down or no money down loans without down payment attract significant attention as factors in the mortgage foreclosure crisis. Investor owners, unable to meet expenses of ownership by renting or leasing units; abandon both single family homes and condominium units, failing to satisfy financial obligations to community associations in addition to their lenders.

Disputes with Contractors

Adding insult to injury, many communities are now embroiled in costly legal disputes with contractors, subcontractors, and others regarding post casualty reconstruction work, payments to subcontractors, material suppliers, equipment suppliers, warranty claims, and disputes regarding the adequacy of the work, etc. Inexperienced community leaders were typically given with proposals to perform work as authorized by their insurance carrier, then invoiced for a plethora of change orders and work outside the scope of applicable coverage. Unlicensed contractors, as is often reported after a substantial casualty, in some cases took deposits without restoring the premises and in others, failed to obtain permits and/or governmental approvals for the work performed, forcing community associations to hire licensed contractors to fix or re-execute the work to comply with code requirements. If contractors didn't pay subcontractors and material suppliers, liens were filed and claims brought against associations, in some instances long after the contractor was nowhere to be found.

Impact on Associations

The survey findings indicate 66 percent of community leaders plan to or have increased monthly assessments and levied special assessments to fund shortfalls resulting from mortgage foreclosures.

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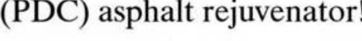
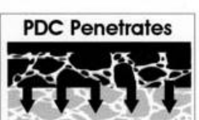

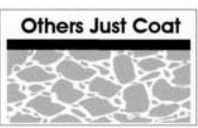

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Al-most 60 percent of respondents said that mortgage foreclosures have increased in their communities. There are vacant homes/units in more than 50 percent of communities and 20 percent of those properties have been vacant for over a year. Failure to maintain the vacant homes detracts from the neighborhood and as a result some survey respondents diverted emergency funds to lawn care. Others have suspended common grounds maintenance and put off projects such as tree trimming before hurricane season, lowered the pool temperature, and eliminated pressure washing altogether. Some respondents rely on volunteers to perform maintenance, rather than pay vendors or contractors for services. Many respondents lamented over an inability to regulate the occupancy of homes/units in foreclosure, citing examples of occupancy by drug dealers and other problematic residents who ignore community rules and regulations.

The survey findings show how clearly mortgage foreclosures impact community associations. The results begin on page 91.

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[1] Section 718.116(1)(b), Florida Statutes provides:

(b) The liability of a first mortgagee or its successor or assignees who acquire title to a unit by foreclosure or by deed in lieu of foreclosure for the unpaid assessments that became due prior to the mortgagee's acquisition of title is limited to the lesser of:

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1. The unit's unpaid common expenses and regular periodic assessments which accrued or came due during the 6 months immediately preceding the acquisition of title and for which payment in full has not been received by the association; or

2. One percent of the original mortgage debt. The provisions of this paragraph apply only if the first mortgagee joined the association as a defendant in the foreclosure action. Joinder of the association is not required if, on the date the complaint is filed, the associ ation was dissolved or did not maintain an office or agent for service of process at a location which was known to or reasonably discoverable by the mortgagee.

[2] SB 1986 modifies Section 720.3085, Florida Statutes in a manner similar to Section 718.116(1)(b), Florida Statutes, limiting first mortgagee liability for delinquencies to one percent of the original mortgage debt or the unpaid common expenses that accrued during the 12 months preceding the acquisition of title.

Lisa A. Magill, Esq. is a shareholder in Becker & Poliakoff's Statewide Community Association Law Practice Group. She was selected by peers in 2005 and 2006 for Florida Trend's "Legal Elite" and currently serves as President of the Southeast Florida Chapter of Community Associations Institute. ■