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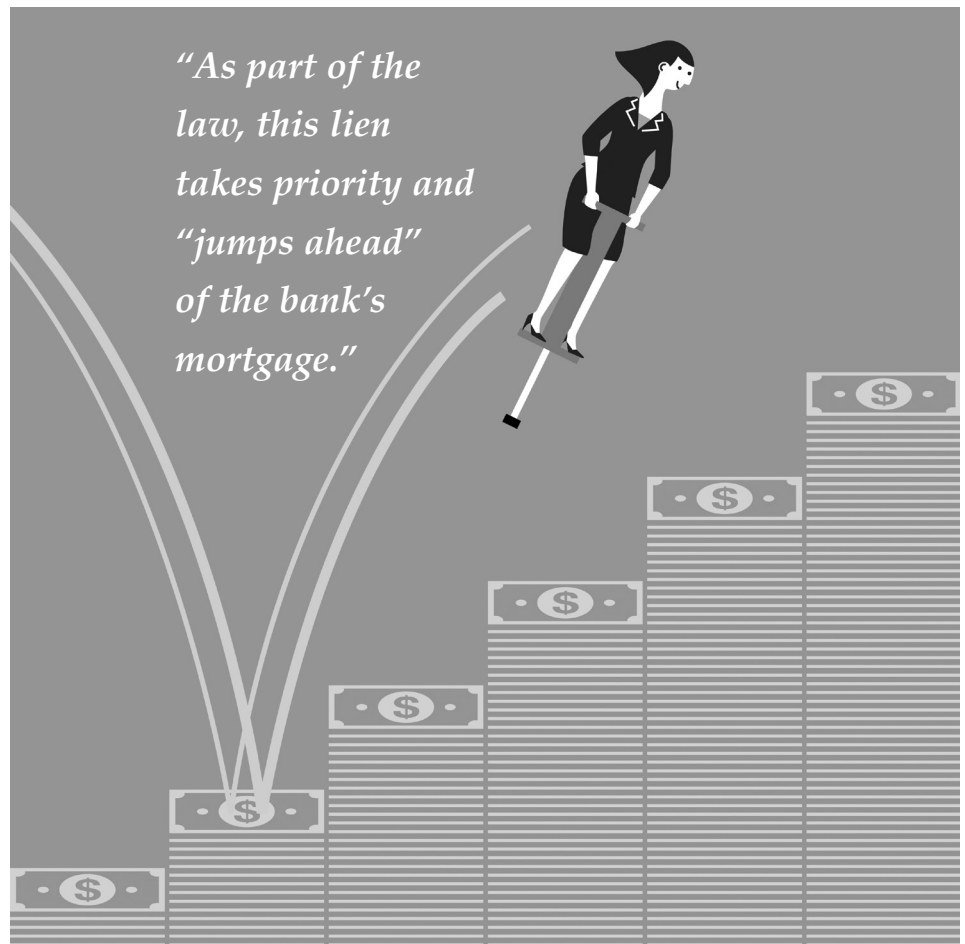
What Are Priority Liens — *How Do They Affect Community Associations?*

By Sherri Hall

When faced with delinquent unit owners, community associations can turn to priority liens to help protect their interests against unpaid assessments. A priority lien is one that is given priority over other liens, and is utilized in a number of states. Priority liens give associations the opportunity to recoup some of the back association fees that are owed by these delinquent unit owners.

According to Attorney A. Christopher Florio of Stark & Stark, in Lawrenceville, New Jersey, the New Jersey Condominium Act allows (as amended in 1995) for an association's lien to take priority over other liens, including the bank's mortgage. Florio explained that in the case of a bank foreclosure of a unit, the association's lien entitles it to a payment of six months of assessment fees. As part of the law, this lien takes priority and "jumps ahead" of the bank's mortgage.

But what about delinquent owners who are not being foreclosed upon by the bank? An association should still take action, said Florio. However, filing a lien is not the first thing that's done. Typically, the association sends a delinquent owner a notice letter first to elicit payment. Each association has its own policy, but most of the time liens are placed on a property once the assessment fees are three months past due, Florio explained. He noted that he is surprised by the number of unit owners who don't contact their association to say they are running



into problems and would like to set up a payment plan. Doing so could help them avoid having liens placed on their properties.

Each year, associations go through their budgeting process and as part of this, they have to factor delinquent owners into the equation. Therefore, assessments can go up not only because of

the natural increase in services, but also because of these delinquencies. "The sooner you give notice and take action to collect, the better off you'll be," Florio noted. He added that it is also important for associations to file liens every year on delinquent unit owners' properties.

What about repeat offenders? If a lien is placed on a delinquent owner who

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subsequently pays off the lien, and then goes back to not paying the assessment fees again, another lien can be placed on the property. "If they finally pay and then stop paying again, you start the whole process over," said Florio.

What type of costs are incurred by associations filing liens? According to Florio, the fees vary by law firm, but typically, the costs are around a few hundred dollars. The money initially comes out of the association's funds, but most documents require the debtor to pay for reasonable attorney fees in addition to the unpaid assessment fees. In addition, late fees can accrue and some documents allow interest to be charged as well, explained Florio. Sending notice letters and placing liens early can help avoid excessive late fees and interest.

What happens in the case of bankruptcy? According to Florio, if an association does not have a lien on a delinquent unit owner's property at the time the person files for bankruptcy, the association is considered an unsecured creditor. By having a lien in place, the association is deemed a secured creditor, which elevates the association's status.

Florio used baseball as an example. "If you're playing baseball and you don't have a lien, you're sitting on the bench; you'll never get up to bat. And if you don't get up to bat, you'll never get a hit. If you do have a lien, however, at least you can get up to bat and you have a chance to get a hit."

According to Florio, the two types of bankruptcies, Chapter 7 and Chapter 13, are handled differently. He explained, in a Chapter 7 case, which is considered a liquidation of debt, the debtor is essentially declaring that he or she cannot pay the association any money owed prior to and including the date of the filing. Due to bankruptcy protection laws, the association cannot go after the debtor for the money. However, if a lien had been placed on the property prior to the

bankruptcy filing, that lien still exists after the filing. Therefore, at some point, the association can foreclose on that lien if it chooses to do so. The only way to stop the foreclosure is for the debtor to pay the money required in the lien. The situation could also progress to the point that the association can hold a Sheriff's Sale and gain title to the property.

On the other hand, Florio explained, in a Chapter 13 bankruptcy case, the association is going to get paid the amount of pre-petition money that was due. All of the debt a person has incurred up to and including the date of filing for bankruptcy is considered pre-petition debt. The Bankruptcy Court reviews the pre-petition debt and has to approve all of the dollars that are going to be paid in a Chapter 13 bankruptcy repayment plan. "Having a lien on the property increases the chance that an association will get paid those dollars that were due to it," Florio said.

Florio pointed out one recent ruling that involved a Chapter 13 bankruptcy case and a community association's lien in New Jersey — *In Re Rones*. In this case, the Bankruptcy Court made the determination that the association's lien would be "stripped off" as it was not considered a security interest, but more of a promise to pay, said Florio.

However, the United States District Court for the District of New Jersey ruled against this decision and determined that the lien could not be "stripped off" and that it was, in fact, a security interest, and should be paid in full. "If the bankruptcy judge's position had been upheld, the statutory lien that the New Jersey Condominium Act provides would essentially no longer exist," explained Florio.

He noted that this would have created a serious problem for associations, and would essentially have a domino effect, causing associations to no longer be entitled to being paid as part of a Chapter 13 bankruptcy plan. "It was a very good ruling for condominium associations in New Jersey," said Florio. It determined that the lien an associa-

tion puts on a unit is valid and can't be 'stripped off.' It's a security interest, and it has to be dealt with," he said.

According to Florio, it is important to note that *In Re Rones* is a case of first impression. "This is the first case we're aware of where a bankruptcy judge essentially wanted to 'strip off' the lien," he said. Fortunately, he added, the district court judge recognized the importance of the lien and upheld its validity.

"If it had gone the other way, it would be very bad for condominium associations. It's like a wall. Once you find a weak point, the rest of the wall will start crumbling," said Florio.

For example, if there is a 100-member association and only 80 unit owners are paying their assessments, the system is still set up for 100 and the money is still necessary for the association to run properly. If the association can't enforce its liens on the delinquent owners, the fees for the members who are paying would go up, and they might not be able to afford the increase. There would be no tool to enforce payment and therefore, less and less people would pay their assessments, Florio explained.

He noted that at this time, it has not been determined whether the plaintiff in the *In Re Rones* case is going to appeal the district court judge's decision. If there is an appeal though, he said the case will go to the United States Court of Appeals for the Third Circuit, which encompasses New Jersey, Pennsylvania, Delaware and the Virgin Islands. However, no one is aware of any plans for an appeal.

According to Florio, the most important thing for an association to keep in mind is to give notice to delinquent unit owners as soon as possible. "The longer it goes and the higher the amount that's owed can cause people to just raise their hands up and say 'I can't afford it.' The sooner you give notice, the better your chances are of collecting," he said. The priority lien laws in place can ultimately help protect a community association's interest when it comes to unpaid assessments. ■