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NEVADA HOA UPDATE: WILL THE NEVADA SUPREME COURT LIMIT THE NEGATIVE IMPACT OF THE SFR DECISION TO HOA SALES OCCURRING AFTER SEPTEMBER 18, 2014?

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On September 18, 2014, the Nevada Supreme Court (NSC) turned the mortgage industry on its head when it held that a foreclosure on an HOA lien would eliminate what was previously (and universally) viewed as a first priority deed of trust on the property. SFR Investments Pool 1 v. U.S. Bank, 334 P.3d 408 (Nev. 2014). Nearly two years later, the NSC has agreed to revisit the devastating and expansive impact of its decision in the case of K&P Homes v. Christiana Trust et al., NSC Case No. 69966. Specifically, the NSC will decide whether the SFR decision should be applied retroactively to all HOA sales or, should it be applied prospectively to only HOA sales occurring after the date of the SFR decision. Since most HOA sales occurred pre-SFR, a positive decision by the NSC could revive billions of dollars of potentially lost mortgage loans.

Without recounting everything that has been written about Nevada's HOA debacle and the NSC's SFR decision, some background is necessary to put the "retroactivity" issue in the proper context. For close to 20 years, lenders, title companies, borrowers, HOAs and buyers at HOA sales interpreted NRS 116.3116 to mean that an HOA lien for delinquent dues was junior to a first priority deed of trust. Accordingly, the buyer of a property at an HOA foreclosure sale would take title subject to the first priority deed of trust. In the last five years, several groups of investors started buying properties at HOA sales for pennies compared to the outstanding loans on the properties. Slowly, these investors started advancing a novel, yet startling, theory – citing ambiguities in NRS 116.3116, the investors

argued that the HOA's lien was actually senior to the first priority deed of trust and that, therefore, the HOA's foreclosure wiped out the lender's deed of trust and the investor held title free and clear of the deed of trust. As shocking at this sounded at the time, the NCS confirmed the investors' theory on September 18, 2014, in its SFR decision.

An onslaught of litigation followed the SFR decision. Investors, lenders, title companies, borrowers and the Federal Housing and Finance Authority (FHFA) filed thousands of lawsuits over, among other things, the impact of the SFR decision, whether NRS 116.3116 was constitutional, whether an HOA foreclosure sale could have any effect on assets of the FHFA or HUD and, whether the HOA and its foreclosing agent are liable for the loss of the first priority deeds of trust. Another, more fundamental, issue was also being litigated – whether the NSC's interpretation of NRS 116.3116 in SFR should be applied retroactively or is it limited to HOA sales occurring after that decision. In early 2015, just months after SFR, the Nevada Legislature attempted to remedy some of the infirmities of NRS 116.3116, brought to light by SFR, by enacting Senate Bill 306, effective October 1, 2015, which added a requirement that HOA foreclosure notices to be mailed to the holder of a first deed of trust and provided for a limited right of redemption. While these revisions to the statute were necessary in light of the potential impact of an HOA foreclosure on secured lenders, they did nothing to clarify how pre-SFR HOA sales should be handled.

In mid-2015, Wright, Finlay & Zak, LLP, on behalf of Christiana Trust, successfully argued that, due to a variety of factors discussed below, the NSC's interpretation of NRS 116.3116 in the SFR decision should not be applied retroactively. Christiana Trust v. K & P Homes, et al., Case No. 2:15-cv-01534-RCJ, 2015 WL 6962860. Specifically, on November 9, 2015, Judge Robert Jones of the U.S. District Court, held that HOA foreclosure sales completed prior to September 18, 2014, could not extinguish a first deed of trust. He stated that the SFR decision was not clearly foreshadowed because no Nevada Courts prior to 2012 had ever addressed the issue. Even the SFR decision recognized, "Nevada's state and federal district courts are divided on whether NRS 116.3116 establishes a true priority lien." In reaching this decision, Judge Jones looked to three factors announced in the U.S. Supreme Court case Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), to be considered in a civil case to determine if a new rule is applied retroactively: "(1) whether the decision 'establish[es] a new principle of law'; (2) 'whether retrospective operation will further or retard [the rule's] operation' in light of its history, purpose, and effect; and (3) whether [the] decision 'could produce substantial inequitable results if applied retroactively.'" He found that all three Chevron factors weighed in favor of non-retroactivity.

While Judge Jones's decision only directly impacted one loan, it has significant implications for the thousands of loans potentially lost as a result of HOA sales prior to SFR. So much so, that on April 8, 2016, the Nevada Supreme Court certified the following question of law:

Does the rule of SFR Investments Pool 1, LLC v. U.S. Bank, N.A., 334 P.3d 408 (Nev. 2014) that foreclosures under NRS 116.3116 extinguish first security interest apply retroactively to foreclosures occurring prior to the date of that decision?

The HOA buyer's brief, filed on April 16, 2016, argued that SFR should be applied retrospectively because it did not create new law; instead, it merely interpreted a statute that has been in effect since 1991. Further, it argued that "reasonable lenders did not misunderstand the statute; they chose to interpret it in a manner that suited their dialogue when arguing with HOA's."

Our Answering Brief, filed on July 11, 2016, hammered hard on the pre-SFR industry-wide interpretation of NRS 116.3116, that an HOA lien was junior to a first priority deed of trust and that a foreclosure by the HOA would not wipe out the deed of trust. The Brief included a broad survey of legislative history, state and federal district court decisions, statistics from NRED and the Foreclosure Mediation Program, and newspapers, journals and other secondary references showing that the SFR decision was not reasonably foreseeable – indeed, it surprised the whole industry including lenders,

servicers, HOAs and their collection agents, foreclosure trustees and attorneys, and the investors themselves and the courts. The FHFA, conservator for Fannie Mae and Freddie Mac, and the Mortgage Bankers Association, Nevada Mortgage Lenders Association and Nevada Bankers Association filed briefs as Amicus Curiae ("friends of the court"), all supporting the position that SFR should not be given retroactive effect to HOA foreclosure sales noticed before the decision. The purchaser's Reply Brief is due August 10, 2016.

We expect a decision from the Court in late 2016 or early 2017. A loss will have little effect on the present battle in the courts. Arguments such as NRS 116.3116 is unconstitutional, HOA sales are not commercially reasonable, HOA sales cannot eliminate GSE or HUD loans, etc. will all still exist. But a win on the retroactivity argument would mean that HOA sales occurring prior to September 18, 2014, which is the vast majority of sales, would have no impact on first priority deeds of trust. Millions of dollars of loans, arguably eliminated by HOA sales, would be indisputably valid. The HOA sales themselves would still be valid and the HOA buyers would be entitled to collect rents. But lenders and servicers would once again have the right to enforce their deeds of trusts. Whatever the Court's decision, there will be far-reaching consequences for the entire industry and the judicial system.

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