The Increasing Threat to Lender Priority Rights by HOA Foreclosure Sales in Nevada

By: R. Samuel Ehlers, Esq. and Dana Jonathon Nitz, Esq., Wright, Finlay & Zak, LLP
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Pull quote: *"Until there is a decision by the Nevada Supreme Court or action by the Legislature, the first position lienholders must be very diligent and attentive, if not proactive, to protect their rights."*

Introduction

In the last few months in Nevada there has been a wave of quiet title and declaratory relief actions by third party buyers who acquired their interest at Home Owner Association (HOA) lien foreclosure sales. They claim the lender's first deed of trust is trumped by the statutory HOA nine-month super-priority lien through which they claim their interest. While Nevada case law and statute still weigh in favor of the lenders' priority the third party buyers' hopes have been buoyed partially by a Washington State case where the bank lost its first position lien to an HOA judicial foreclosure sale and a recent Nevada Attorney General Opinion which suggests the lender may lose its secured interest if it does not pay the HOA lien. Without any Nevada Supreme Court case or statute on point, third party buyers are relying on these secondary authorities for some legal basis to strip a first mortgage holder of its lien, or at least try to exact inordinately large settlements. This challenge must be met with diligence and might to discourage further actions and to prevent a few errant district court judges' decisions to snowball into the de facto rule.

Prior state of the law regarding HOA liens.

The established law in Nevada is that an HOA enjoys a super-priority lien up to 9 months for prior HOA dues once the bank forecloses on real property, but the first lienholder retains a superior right to the property. NRS 116.3116(2)(b) states, "2. A lien under this section is prior to all other liens and encumbrances on a unit except: … (b) A first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent…." In addition to this statute, almost all Conditions, Covenants and Restrictions ("CC&Rs") contain mortgagee protection clauses that give the first lien holder superiority over any HOA lien or interest.

Creative attorneys for third parties who are buying the properties at HOA lien foreclosure sales are currently attempting to persuade the courts that this statute created a "stand-alone lien" which can itself be foreclosed upon, rather than creating merely a payment priority in the event of sale. Once the sale occurs, the buyers then file suits to extinguish any interest by the first lienholder in the property.

The Washington Appellate Decision *Summerhill Association v. Roughly*

A Washington Appellate Court case has given some support to third party buyers' position. In *Summerhill Vill. Homeowners Ass'n v. Roughly*, 289 P.3d 645, 649. (Wash. Ct. App. 2012), the court found that because a lender did not respond to a *judicial* HOA lien foreclosure, they lost their interest in the property. Third party buyers argue this case supports an HOA lien foreclosure right to invalidate the first deed of trust through a *non-judicial* foreclosure sale. This case is not binding on Nevada, and even if it were, this dealt specifically with a *judicial* HOA lien foreclosure. This distinction is significant because a judicial foreclosure is an "action" where the lender would be served with a complaint and could respond and protect its interests. In *Summerhill*, the bank simply had failed to respond.

In Nevada, almost all the HOA lien foreclosure sales are done non-judicially, and the third party buyers are acquiring their interests at these types of sales. The language of NRS 116.3116(2)(c) should control as it requires that an "action" must be instituted in order for an HOA foreclosure sale to have the "super-priority" effect:

> The lien is also prior to all security interest described in paragraph (b) to the extent of any charges incurred by the association on a unit pursuant to NRS 116.310312 and to the extent of the assessments for common expenses based on the periodic budged adopted by the association pursuant to NRS 116.3115 **which would have become due in the absence of acceleration during the 9 months immediately preceding institution of an action to enforce the lien**…. (Emphasis added)

If the third party buyer relies on *Summerhill* in Nevada courts, the lender must emphasize this fundamental difference between a judicial HOA lien foreclosure sale and the non-judicial HOA lien foreclosure sales. The lender must argue that there is no "action" to enforce the lien unless it is judicial, under Nevada case law and statutes. NRCP 2 and 3. *See also* S*eaborn v. First Judicial Dist. Court*, 55 Nev. 206, 29 P.2d 500, 505 (Nev. 1934), and *BP Am. Prod. Co. v. Burton*, 549 U.S. 84, 991 (2006). Despite the fact that almost all HOA lien foreclosures on non-judicial, many lenders have simply agreed to pay the statutory nine-month super-priority amount claimed as a cheaper, quicker alternative.

The *Summerhill* case likely contributed to the inaccurate statement by the Nevada Attorney General's Office on an HOA lien foreclosure sale as stated in the Nevada Attorney General Opinion AG13-01.

<u>The Effect of Nevada Attorney General Opinion AG13-01.</u>

This Nevada Attorney General Opinion was primarily directed to the Nevada Real Estate Division opinion on what costs an HOA can include for an HOA super-priority lien. It was not an opinion that primarily dealt with the HOA lien foreclosure lien being superior to a first deed of trust. However, during the analysis the Attorney General's Office offered the following:

> **The ramifications of the super priority lien are significant in light of the fact that the superior liens, when foreclosed, remove all junior liens. An**

association can foreclose its super priority lien and the first security interest hold will either pay the super priority lien amount or lose its security.

This language is similar to language used in *Summerhill*. There is no further analysis of this statement and it appears to be almost an afterthought. The Attorney General's Office gives no analysis of the word "action" under NRS 116.3116(2)(c). Essentially, this statement is given without any context of when a first security interest would actually lose its security. In practice, the only time a lender is presented with the lien super-priority issue is when the lender forecloses on the property and is looking to sell the property as REO. One must question the practical experience of the drafter of this Opinion in the day to day operations of resolving these liens issues from the casual reference to an HOA line foreclosure removing all junior liens.

Despite the Opinion's incomplete reference to an HOA lien status it has given some small basis for third party buyers to seek to quiet title to the property. As stated in the Opinion itself, it is **not binding** on any Court. However, the Nevada Supreme Court has found that the Nevada Real Estate Division possesses the authority to interpret NRS 116.3116. We have seen a split in the District Courts as to how much authority to AG13-01.

Nevada Federal District Court's treatment of the HOA lien super-priority issue.

The most recent Nevada federal case law regarding third party buyers is found in *Diakonos Holdings, LLC v. Countrywide Home Loans, Inc. et al,* 12-CV-00949. There, Judge Kent Dawson found that NRS 116.3116(2)(c) was unambiguous that created only a limited super priority lien for nine months of HOA assessments but does not eliminate the first security interest. Judge Dawson also pointed out that plaintiff did not address NRS 116.3116(2)(b) which explicitly states that the HOA lien does not extinguish a first security interest.

The plaintiff in *Diakonos* is currently seeking a Motion for Reconsideration and an appeal of Judge Dawson's decision.

Nevada State District Court's treatment of this HOA lien super-priority issue.

In Clark County, state district court judges have, for the most part, sided with first lien holders regarding the HOA lien foreclosure priority issue. It is believed the judges met recently to see if a common approach could be fashioned as so many of these actions had been brought before the courts.

Most state district court judges are now ruling in the first lienholder's favor. The following departments have either already ruled in the first lienholder's favor or have given indications at hearings that the first lienholder's interpretation of the law and statutes is sounder. Departments 1, 4, 12, 13, 16, 17, 27 and 31 have all recently found in favor of the first lienholder – even if they had previously found the third party buyers had a reasonably likely chance of prevailing on the merits and granted preliminary injunctions. This list is subject to change as this matter is litigated in Nevada courts.

When one judge found in the first lienholder's favor, the case was appealed to the Nevada Supreme Court by the third party buyer. In *Villa Palms Court 102 Trust v. Deutsche Bank et al*,

Clark County District Court Case No. A-12-674595-C, Department 16, Judge Timothy Williams denied a Temporary Restraining Order sought by a third party buyer at an HOA lien foreclosure sale who was seeking to quiet title. The TRO sought to enjoin an imminent first lienholder foreclosure. The judge denied the TRO as the court felt there was little likelihood of success on the merits, which the plaintiff then appealed on January 28, 2013. The appeal is pending, Nevada Supreme Court Case No. 62528.

While normally only a final order would be appealable, Rule 3A(b)(3) of the Nevada Rules of Appellate Procedure expressly permits an immediate appeal from an order granting or refusing to grant an injunction or dissolving or refusing to dissolve an injunction. Even if that rule were deemed inapplicable, the third party buyers could seek relief from the Nevada Supreme Court by petitioning for a writ to compel the district court to enter a TRO or preliminary injunction to enjoin first lienholder's foreclosure sale or to preclude the district court from extinguishing the buyer's interest. These options should also be available to the first lienholder if the TRO or preliminary injunction is granted and the foreclosure stopped.

In *SFR Investments Pool 1, LLC. v. U.S Bank et al*. Case No. A-12-673671-C Department 27, Judge Nancy Allf denied a Motion for a Preliminary Injunction to enjoin US Bank from proceeding with a foreclosure sale and granted the Countermotion to Dismiss the Complaint on the basis that the Nevada Attorney General Office Opinion does not have the force of law and that the Court was not bound by authority from another jurisdiction, such as the Washington *Summerhill* case.

Because so many cases are currently being filed by third party buyers, and are either being dismissed or are being denied preliminary injunctions, the number of appeals on their behalves is quickening. One buyers' attorney announced his intention in court to consolidate his multiple appeals. The Nevada Supreme Court, seeing the number of cases before them with the same issue, may act sooner than the more typical one-and-a-half to two years to decision because it a decision soon would clear its dockets, as well as the district courts'.

There are no known cases where the state district courts have actually found in favor of the third party buyer on this issue, but there a few cases where the courts have not yet dismissed the actions outright and instead have ordered the cases to move to discovery.

We have however followed various cases in the Clark County District Court where the judges have yet to dismiss the third party buyers' quiet title actions. In a few cases, the judges have denied motions to dismiss filed by the lenders and ordered that the case enter the discovery phase. In others, the judges have pushed the cases into discovery and set preferential trial dates just months away. While the judges seem to be leaning towards dismissal, they wanted to try the cases on their merits for judgment so there is "a nice clean trial judgment on the merits that can be appealed and ruled upon by the Nevada Supreme Court."

Many more of these cases are in their infancy and this office will continue to follow them at the federal and state district court level, as well as the Nevada Supreme Court level.

<u>An Interim Solution: Pay the HOA Amounts Due Prior to an HOA Lien Foreclosure.</u>

A decision from the Nevada Supreme Court would clarify the HOA lien position. Most likely, based on the case law and statutes above, the Nevada Supreme Court will find in the first lienholder's favor. But this decision could be months or possibly years away. Consequently, an interim solution is needed to best protect the first lienholders' interests.

The best first option at this time appears to be to contact any HOA which is trying to foreclose and *try* to pay off the HOA liens. This approach is not guaranteed success as some HOAs in Nevada will not accept payments from the banks unless the banks have a Power of Attorney from the borrower. Also, the HOA's may demand the entire amount of assessments due, rather than just the nine months protected by the super-priority statute, and may try to exact other fees and costs, believing they have the upper hand in negotiations with the lenders trying to minimize their costs and delay. The alternative is a more proactive approach: file an action for declaratory relief to get a court order mandating the acceptance of payment. A suit to confirm the bank's ability to pay off the HOA liens prior to the HOA lien foreclosure is the subject of *Bank of America* v. *Allure Homeowner's Ass'n et al.*, Case No. A-12-670230-B, presently pending in Clark County District Court.

Litigation Strategy for Addressing a Third Party Buyer Suing To Quiet Title.

If the HOA foreclosure sale has already gone forward, the best option at this time appears to be to respond to any quiet title action with a motion to dismiss. Should the motion to dismiss be granted, there is a high likelihood that the third party buyer will appeal the decision as in *Villa Palms,* because the buyer's purchase price which simply covers the assessments is likely dwarfed by the fair market value of the property; the potential windfall is too great to abandon the claim.

In a situation where the third party buyer seeks an injunction to stop a potential first lien foreclosure and the court grants the injunction, then the first lienholder should appeal or petition for writ on the injunction issue.

Getting Insurable Title from a Title Company in the Face of Third Party Buyers' Claims.

Based on a discussion with the head underwriter of a major title company in Nevada, we believe it will be required that a quitclaim deed or some other type of disclaimer of interest from a third party buyer of an HOA lien be provided to the lender before the property will be insured. The banks would then have to contact the third party buyers to see if they would be willing to quitclaim their interest to the bank. Some negotiations with the third party buyers will likely follow. The potential windfall for the buyer may make negotiations difficult.

This underwriters' requirement will likely only last until either the Nevada Supreme Court or the legislature takes action on these situations. The Nevada Legislature is of course in session at the time of this writing and is set to adjourn in early June until the next Session commences in January 2015.

In conclusion, these are uncertain times, with much at stake for holders of first position liens. They are under attack by investors and others looking to reap a windfall, with dozens of quiet

title actions being filed weekly by third party buyers at HOA lien foreclosure sales. Until there is a decision by the Nevada Supreme Court or action by the Legislature, the first position lienholders must be very diligent and attentive, if not proactive, to protect their rights. What worked last year is being challenged this year. Firms like ours are ready to assist at each phase or proceeding.
