



Clayton & McCulloh
ATTORNEYS AT LAW

HELP - WE ARE GOING BROKE!

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Countless condominium, homeowner and co-operative associations are struggling just to survive financially in today's economic environment. With plummeting property values, countless owners are not only failing to pay their mortgages, but are also failing to pay their assessments. Consequently, many associations and their boards of directors are faced with having to fulfill their on-going fiduciary duties of maintaining common properties as well as performing the functions, duties and obligations of their associations, but with an ever decreasing pool of funds. This impossible dilemma and predicament has forced associations to go back to the drawing board to come up with new and creative ways to address the ever rising number of delinquent accounts and the increasing burden such delinquencies are placing on the remaining unit owners (i.e., those who are paying their assessments). Moreover, this has placed greater and greater demands on the boards of directors to cut legal costs while at the same time pressing their legal counsel to engage in "super aggressive" approaches to collect the delinquent accounts. The consequence has been the emergence of law firms and collection agencies purporting to offer new and innovative collection techniques that will save associations' money and produce faster results. Consequently, Clayton & McCulloh is quite concerned about the misinformation being circulated about these so called "new approaches for collections" especially where they are represented to be a panacea. In the final analysis, these so called "new approaches" are really nothing more than the same options that associations have had all along.

Ultimately, each association needs to independently evaluate their options given their particular facts and circumstances. No one approach is perfect for every association. Nevertheless, this does not mean that pursuing a different approach may not make sense for your association. As such, consulting with counsel to discuss the pros and cons of the various approaches has merit. It should be recognized, however, that, though Clayton & McCulloh has for years been undertaking the various collection approaches on behalf of our clients, the vast majority of our association clients still prefer what we will refer to as the traditional approach to collection (or at most prefer a slightly modified traditional approach) .

While, in today's world, the traditional approach is proving less effective than it was in years past, for many if not most associations it may still be the best approach. Consequently, while associations should evaluate the collection approach they are having their law firm undertake, please do not believe that any one approach is the panacea for each case and each community as each approach has benefits and detriments.

The approaches most commonly being touted and the benefits and detriments attributable to each are discussed in this Article.

1. The "Traditional Approach". Usually, once an owner becomes delinquent in paying assessments, the association (e.g., via its manager) sends out 2 to 3 demand letters. If there is no resolution, the delinquent account thereafter is transferred to the association's law firm to pursue collection. Upon receiving the delinquent account, the law firm will write a demand letter, after which a lien is placed on the property. If the delinquent account is not brought current, then a second letter is provided by the law firm to the delinquent owner enclosing a copy of the lien and apprising the owner that the association intends to proceed with foreclosure (e.g., litigation) unless the account is paid within a specified time period. If the account still remains unpaid after that date, usually foreclosure proceedings are commenced by the Association.

In the past, the Traditional Approach generally resulted in the owners stepping up and paying off

their debts to the association as the owners did not want to lose their property. Please remember, when associations previously filed their foreclosures, the owner commonly had significant equity in their property (i.e., significant equity above and beyond the amount of the mortgages). In addition, the mortgages were often not delinquent. As such, proceeding with the association's foreclosure made great sense as it highly motivated owners to pay the delinquent assessment to avoid losing their property or having to pay more and more attorney fees, costs, interest, etc., in order to bring their account current.

Unfortunately, with the ever increasing number of owners that are not paying their mortgages or their association's assessments, coupled with plummeting property values, numerous mortgage holders are delaying filing their mortgage foreclosure actions or once the action is filed, the mortgage companies are not completing their mortgage foreclosure proceedings. In large part, delay by the mortgage companies' are designed to avoid (at least temporarily) being responsible for the property, including the liability for past and future assessments. Stated differently, a lot of the mortgage companies are sitting on the side line saying "we do not want to take title, because if we take title, then we have liability and we must start paying assessments." Please remember, in our prior robust economy, a mortgage company was far more likely to timely file and complete its foreclosure if mortgage payments were not timely made. Consequently, an owner, who could not or would not pay his mortgage, tended to have his mortgage company foreclose separately and expeditiously. Therefore, an association would often forego completing its foreclosure once a mortgage company filed its own foreclosure action. Please understand that, mortgage companies generally used to complete their foreclosure actions promptly, resulting in payment of some or all of the prior assessments owed to the association and thereafter payment of all of the future assessments. Unfortunately, associations today may be forced to wait 2, 3 or more years before a mortgage company files and completes their foreclosure. During this interim, the burden of funding the association will fall on fewer and fewer of the owners that are paying assessments.

2. Completing the association's foreclosure. An option that has always been available (and technically is really part of the Traditional Approach) is for the association to complete its foreclosure notwithstanding there being a mortgage which is in default. Actively pursuing a foreclosure often pressures an owner who refuses to respond to demand letters and liens, to bring an account current. Previously, the association on rare occasions would complete its foreclosure resulting in the property being sold at a judicial sale, however, even then the owner often wanted to repurchase the property from the association.

Today, perhaps more than ever before, an association should consider actively proceeding with its foreclosure despite the increased cost and despite the threat of a mortgage foreclosure. Why? The reason is due to the extensive delay(s) which may occur prior to the mortgage company filing or actually completing its foreclosure, as well as the corresponding loss of assessments. Please understand that upon taking title, the association can rent out the property pending the mortgage company completing its foreclosure. Of course, the owner could bring his mortgage current (i.e., resolve/pay off his delinquency with the mortgage company) in which case, the owner may be compelled or at least motivated to immediately work things out with the association (e.g., pay his delinquent assessments or enter into a payment plan). Even after an association takes title to a unit, the previous owner may still want to work things out and reacquire the property. In which case, the prior owner will need to negotiate a price with the association to repurchase the property. Of course, proceeding with the association's foreclosure generally entails more attorneys' fees, but it does open up a number of options not otherwise available. Moreover, the association will want to pursue actively renting the unit upon the association taking title via its foreclosure action unless the association can timely sell it. The type of lease that the association needs to enter into should afford the association the ability to terminate the lease upon the completion of the foreclosure by the mortgage company. Of course, if the mortgage company surprises the association by more timely filing and completing its foreclosure, the association will be gambling to some extent on whether the association will be able to obtain title and rent the unit long enough to recoup its funds. If the unit is already occupied, whether it be by the owner or a tenant, the

association may already have a potential and prospective lessee to whom the property can be leased. This, of course, would enable the association to immediately start recouping its funds.

3. Receiver of rent. Another option to recover monies for the association prior to anyone completing a foreclosure is to seek to secure and collect rent from an existing occupant whether that be the owner or a tenant. More specifically, either within the mortgage company's foreclosure action, or within the association's foreclosure action, the association can petition the court for a receiver to be appointed to collect rent from an occupant and have the courts distribute those rents to the association. Again, this entails greater cost to the association, and there may be other competing entities, such as the mortgage company, that may likewise seek to have the rents distributed to it.

4. Personal judgment action. Most all associations' governing documents and Florida law afford an alternate remedy to the association by permitting the association to file and pursue a personal monetary judgment. Think of this as a breach of contract action with the declaration being the contract. More specifically, think of the requirement to pay assessments as being a provision within the contract which has been violated. The association can certainly file against the delinquent owner and obtain a personal judgment. However, once the judgment is obtained, the association still needs to be able to collect from the delinquent owner. If the delinquent owner is in bankruptcy, or is entitled to the head of the household exemption from creditors (i.e., for the owner's bank accounts and other assets) or if the delinquent owner does not have funds from which the judgment may be recovered, a personal judgment may simply have a cost associated with it without any benefit. Furthermore, obtaining a personal judgment does nothing to divest the owner of his ownership interest in the property nor does it compel him to vacate the property. Nevertheless, if the delinquent owner does own assets free and clear (e.g., a car, etc.) for which no head of the household exemption exists, then it may be possible to recover some or all of the association's fees, assessments, etc. The advantage of this option is that it costs less initially and proceeds more quickly. On the other hand, the disadvantages are many, primarily, that the association will usually be unsuccessful in actually collecting the funds pursuant to the monetary judgment.

While other potential options can be considered, the above are the most well recognized. Ironically, 5 years ago, almost all of our clients pursued the Traditional Approach including proceeding with a foreclosure suit if pre-foreclosure efforts were unsuccessful. However, in today's world where a mortgage company may not even start a foreclosure or may not complete a foreclosure for years, the association is literally left with having to fund its operational costs from the remaining owners while often a delinquent owner or a tenant remain in occupancy. Sometimes even worse, no one remains in occupancy and no one maintains the property while the mortgage foreclosure languishes. Needless to say, this is an extraordinary and unfair burden. Additionally, 3 years ago we would never have expected a mortgage company to knowingly sit on a delinquent mortgage and not pursue its foreclosure rights for years. As such, the second option referenced above of proceeding with the foreclosure and even taking title in the face of a pending or threatened mortgage foreclosure is producing some very good results for many of our clients.

However, remember that for this option to be viable, your association needs to be willing and prepared to do the following:

1. fund the additional expense;
2. accept the additional risk; and
3. actively pursue renting or reselling the property once the association takes title.

Similarly, pursuing a receiver of rent may actually have merit in cases where a current occupant is interested in staying in possession and willing to pay rent. Needless to say, there are significant other factors which should be considered with respect to which approach an association should take. Clients that are unsure which approach is appropriate for them should discuss this matter more fully with us as numerous factors could impinge upon and potentially dictate which option makes the most sense. By way of example, does the association have

the funds to pursue completing its own foreclosure or appointing a receiver of rent? Will the association actively rent the property or engage a Realtor (potentially even its own management company) to rent the property? Understand, in the event the association undertakes to rent the property, it will be acting as a landlord. Additionally, acting as the landlord and receiving the rents can have income tax consequences associated with it. As such, the tax ramifications associated with renting property needs to be bridged with your association's CPA or tax attorney. Please understand that recognizing that there may be tax ramifications is not meant to suggest that the association should be precluded from undertaking this exercise. To the contrary, the association may be able to rent the property and receive income. However, the implications and ramifications especially the reporting of income to the IRS and paying taxes on that income need to be understood and weighed as an additional factor.

Clayton & McCulloh wishes it could have presented this Article from a standpoint of making each of the options set forth above very palatable, reasonable and simple. However, much of the hype that is going on about these alternative approaches, and even the traditional approach, we believe are unfair and biased. The approach and option chosen by each association needs to fit its needs and its particular facts and circumstances. As such, we hope that associations will not be swayed into believing the hype that some "new" method is clearly best or that an aggressive approach is the only way or even the preferable way to proceed with collections. In conclusion, we do not wish to see our association clients penalized because of unrealistic claims and/or a perceived panacea which only puts the association in a worse position.

THE ONLY REAL, NEW AND CRITICAL REMEDY: Now that the above has discussed the primary options with respect to collections (once such matters have been turned over to the law firm), let us now focus on perhaps the most critical and beneficial option that most associations may be able to undertake to recover significant funds from delinquent owners. As discussed above, Clayton & McCulloh can seek to have a receiver of rents appointed via the courts in an effort to obtain rents that are being paid on delinquent units. Unfortunately, as that process involves the courts, it probably will not be quick or inexpensive. Therefore, associations should consider implementing automatic provision(s) within their documents entitling the association to collect rents directly from tenants and obligating tenants to pay rent directly to the association when an owner's account becomes delinquent. Given the above, Clayton & McCulloh has and is continuing to recommend that our association clients seriously consider having Clayton & McCulloh draft amendment(s) to their Declarations which expressly authorize and mandate that tenants (residing in units whose owners are delinquent in paying their assessments) must pay their rent directly to the association. While there is a cost associated with such amendment(s), and while the association would have to obtain the requisite approval to implement such amendment(s), once implemented, the probability as well as the ease of recovering delinquent assessments associated with leased units should significantly improve. Moreover, the probability of obtaining payments directly from delinquent owners of rental units should increase. Please understand that a properly drafted amendment to the association's Declaration may be able to empower the association to avoid even going to the courts to recover rent.

We hope that associations appreciate that such amendments would ostensibly provide and entitle associations not only to collect the rents directly from the tenant, but in fact, require the tenants to pay such rents directly to the association. Please remember that both the Condominium Act (i.e., Florida Statute 718.303), as well as the Homeowner Association Act (i.e., Florida Statute 720.305), both require tenants to comply with the association's governing documents. Therefore, to the extent that such a provision is properly drafted and inserted into the Declaration, ostensibly the tenant must comply with it and if the tenant fails to comply with it, not only is such tenant in violation of the association's governing documents, but such tenant would ostensibly be in violation of Florida law as well. Additionally, in the event a mortgage foreclosure is started, the association ostensibly could still require the tenant to pay directly and if the tenant refused to pay, such a provision in the declaration hopefully would be given great precedential value and one which we hope the court would honor. We hope that each association further understands that especially for those units which are investor owned, such investors may be far more amenable to paying their delinquent assessments if they become apprised that their tenants will be compelled and forced to pay their rents directly to the association. As such, we encourage each and every one of our clients to consider this option and contact us to discuss it further and/or to proceed with such amendments.

TIMESHARES: As our clients should be aware, Clayton & McCulloh engages in all types and methods of collections for our association clients. While this Article has not focused on assessments associated with timeshare units, it is critical that we point out that not only does Clayton & McCulloh perform this service, and in

fact, has significantly geared up for this service (i.e., for our timeshare clients), but as a result of statutory changes to the Timeshare Act, we are able to do timeshare collections in bulk. As timeshare collections are totally unique including their process, procedure and the flat rates associated with them, this Article will not go into such matters in greater depth. Nevertheless, we encourage our clients that have timeshare collection accounts to contact us as we have developed a highly specialized and cost effective system to effectively handle timeshare delinquencies.

COOPERATIVES: As the vast majority of community associations within the State of Florida are either condominiums or homeowner associations, this Article has primarily been geared towards them. Nevertheless, Clayton & McCulloh likewise represents a number of cooperatives. While some of the options referenced above relate or apply to cooperatives (at least in part), other and/or additional collection options exist for them as well. Consequently, our cooperative clients who do not fully appreciate their options should contact us to specifically address their collection nuances.