RB REES BROOME, PC
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Community Associations Newsletter

Collections and Bankruptcy Update

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As you are probably well aware, community associations have faced numerous challenges over the last few years regarding their ability to effectively collect assessments. Aggressive consumer rights advocates, heightened scrutiny from the courts and narrow restrictions have all made it more difficult to pursue claims for unpaid assessments.

However, there is some good news, at least in Virginia. Virginia associations which were previously hamstrung by prohibitions against the collection of fees not specifically set out in their declarations received a small reprieve this year by the adoption of a statutory late fee provision. Virginia law now provides that a 5% late fee may be assessed against assessments that are more than 60 days past due. If your declaration does not provide for imposition of a late fee, you may now charge a late fee by adopting a collection policy or updating the one currently in effect. For those associations that have governing documents which specify a late fee amount higher than 5% or which authorize the board of directors to establish a late fee amount as the board sees fit, the 5% statutory maximum would not apply.

One unfavorable development in Maryland is the amendment made by the legislature to § 14-204 of the Maryland Contract Lien Act. Under the new law, which applies only to liens recorded on or after October 1, 2013, a condominium or homeowners association may foreclose on a lien <u>only if</u> the damages secured by the lien consist solely of delinquent periodic or special assessments and reasonable attorney's fees and costs. However, under the statute, the attorney's fees and costs <u>must be directly related to the filing of the lien and must not exceed the amount of delinquent assessments secured by the lien</u>. Moreover, the lien being foreclosed upon cannot include any monetary fines or attorney's fees related to such fines.

The new law raises a number of questions which have not yet been answered. For example, it is unclear whether late fees and interest are recoverable from the foreclosure of the lien and whether attorney's fees incurred outside of "filing the lien" (such as filing a Circuit Court petition, arranging for the foreclosure sale and conducting post-sale accountings) are recoverable.

We anticipate that there will be a strong effort to revise or rescind the law in next year's

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General Assembly session. But, for now, the changes made to the statute may make foreclosure a less attractive option for some associations, particularly those with smaller annual assessments, who wish to foreclose on a lien recorded after October 1st.

As the economy slowly recovers, associations have also reported improved collections and fewer delinquencies. Many associations had stopped recording liens due to plummeting property values and skyrocketing foreclosures. We are now encouraging those associations to resume recording liens as property values appear to be rebounding to some extent. Properties are gaining equity, and the liens secure the association's claim in the event of a sale or mortgage refinance. We have even handled some cases where the property has foreclosed and the association's claim is paid from the excess proceeds from the foreclosure auction.

The increase in property values also benefits associations in instances where debtors are filing for bankruptcy protection. An increased property value results in a greater likelihood that a lien will be considered secured under the bankruptcy code. As such, the liens are less susceptible to being stripped in bankruptcy proceedings, so that they can be collected at a later date when the property is refinanced or sold.

Another bright light for community associations is that owners are filing fewer bankruptcies. Nationwide, bankruptcy filings are down by 13.2% for the 12-month period ending in June 2013. The District of Columbia saw a decrease of 16.8% and Virginia saw a decrease of 13.5%. The Northern District of West Virginia reported a decrease of 13.6%. Unfortunately, Maryland has seen a drop of only 4.5% for that period, but we hope that they will soon experience a similar decrease.

In Maryland, D.C., and West Virginia, debtors are predominantly filing Chapter 7 liquidation cases to eliminate their debts. In Virginia, Chapter 7 cases account for about 61% of bankruptcy filings, with Chapter 13 debt repayment cases accounting for most of the remaining cases filed.

In all bankruptcies, a "stay" (prohibition of collection actions) is imposed against all creditors for amounts owed prior to the date the bankruptcy was filed. In Chapter 7 cases, the stay extends only to those debtors who filed for bankruptcy. In Chapter 13 cases, the stay extends to other co-debtors, whether or not they filed for bankruptcy protection. The stay continues until either the debtor is discharged or the bankruptcy is dismissed. In Chapter 7 and Chapter 13 cases, the debtor remains liable for assessments that accrue after the date they filed for bankruptcy (post-petition).

There are, however, several situations where the stay may be abbreviated. First, in a Chapter 13 case, the stay may be lifted as to a co-debtor where the repayment plan does not provide for full payment to the Association. The court typically limits the relief granted in this instance to amounts not being paid under the repayment plan and amounts that come due after the bankruptcy filing.

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A second situation exists where a Chapter 13 debtor accrues post-petition debt. The Association must first obtain a judgment against the debtor. After obtaining the judgment, the Association must request relief from the stay in order to collect on the debt. The court weighs these situations very carefully because the debtor's income is being used to repay creditors under a reorganization plan. If there are additional assets, the association is likely to be permitted to pursue only those additional assets. The primary benefit of this lifting of the stay may be getting the debtor to pay the ongoing assessments so that the delinquency does not continue to extend on post-petition debts.

The stay may also be lifted in both Chapter 7 and Chapter 13 cases when specific property is not critical to a debtor's reorganization plan. Most typically, this is pursued when the association wants to foreclose its lien on the property located within the association. As Chapter 7 bankruptcy cases tend to only last approximately 4 months, an action to lift the stay as to property usually makes more sense in a Chapter 13 case, as the case may extend for up to 5 years.

If you have questions regarding any of the issues discussed above, please feel free to contact one of the attorneys in our Community Associations department.

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