November 10, 2015

Thomas J. Curry
Comptroller
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, DC 20219

Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Statement of Position Regarding Home Owners' Association "Super-Priority" Liens

Dear Comptroller Curry, Chairman Gruenberg and Chair Yellen:

We, the undersigned trade associations, write to you in your capacity as one of the "appropriate Federal Banking Agencies" ("Banking Agencies") as defined under Section 3(q) of the Federal Deposit Insurance Act ("FDIA"), charged under Section 39 of the FDIA with prescribing standards, by regulation or guideline, to ensure the "safety and soundness" of the nation's insured depository institutions ("banks").

The "safety and soundness" issue which we bring to your attention concerns the risks posed to banks, as originators and/or servicers, as whole-loan investors and as securitization sponsors and/or investors, in residential mortgage loans and/or residential mortgage-backed securities ("RMBS"), by certain state law provisions that allow homeowners' association ("HOA") liens, in certain cases, to achieve a "super-priority" status that permits the extinguishment of a prior perfected and recorded first mortgage lien on the related property, sometimes without prior notice to the lienholder and often at a small percentage of the first mortgage balance. For purposes of this letter, the term HOA shall refer broadly to homeowners' associations, condo owners' associations, planned communities, real estate cooperatives, and other common interest communities.

The HOA lien issue has been in the news for the past year, primarily as a result of the September 14, 2014 ruling by the Nevada Supreme Court in *SFR Investments Pool 1 v. U.S. Bank*, 334 P.3d 408, 409 (2014), denied (Oct. 16, 2014) ("*SFR*"). In this case, the Court held that, under Nevada law, a portion of a homeowners' association lien (relating to the last nine months of unpaid dues owed by the property owner and related collection costs) has a lien priority prior to that of a duly recorded first deed of trust on the related property, which can be foreclosed non-judicially in a manner that can *extinguish* the recorded first deed of trust pursuant to a process that did not require adequate prior notice be given to the deed of trust lienholder.

In the Nevada Supreme Court case noted prior, a homeowners' association foreclosure sale was executed for $6,000, in order to satisfy a delinquent $4,500 "super-priority" lien amount. This resulted in a loss of $885,000 for the otherwise superior first lien mortgagee through lien extinguishment.

Although the Nevada law has been subsequently amended in part,[1] more than twenty other jurisdictions have laws that make a "super-priority" lien available to HOAs, allowing those liens to be superior, to varying extent, to the lien of a duly recorded first deed of trust or mortgage. Specifically, most of these liens have been traditionally enforced as a "payment priority" from the proceeds of a foreclosure sale conducted by a superior lienholder or encumbrancer, but the aforementioned Nevada decision, along with recent court decisions in Washington State[2] and the District of Columbia,[3] have opened the door in these jurisdictions to HOA liens with "true priority" (i.e. the aforementioned capacity to extinguish) and are cause for *even greater* concern.

As the Banking Agencies may be aware, the *SFR* decision prompted the Federal Housing Finance Agency ("FHFA"), in its capacity as the conservator of Fannie Mae and Freddie Mac, to issue a "Statement on HOA Super-Priority Lien Foreclosures" ("FHFA Statement") on April 21, 2015. In the FHFA Statement, the Agency cited 12 USC Section 4617(j)(3), which provides that while the FHFA acts as conservator, "[no] property of the Agency shall be subject to any levy, attachment, garnishment, foreclosure, or sale without the consent of the Agency." The FHFA further stated that it would not consent to the extinguishment of any lien of Fannie Mae or Freddie Mac by an HOA purporting to foreclose such a "super-priority" lien, and that the cited federal law preempts any state law that purports to allow such an extinguishment.

The FHFA's views were confirmed by a judge within the U.S. District Court for the District of Nevada on June 24, 2015 --- in *Skylights LLC v. Bryon* (Case No.:2:15cv-00043-GMN-VCF). In addition to *Skylights*, other court decisions have upheld the priority of federally-related liens over HOA and other liens on a supremacy/preemption basis, see, *e.g.*, In re County of Orange, 262 F. 3d 1014 (9th Cir. 2001) (lien of the FDIC in its capacity as a receiver under 12 U.S.C. Section 1875(b)); and *Saticoy Bay LLC v. SRMOFII 2012-I Trust*, Case No. 2:13-cv-1199 JCM(VCF) (D. Nev. 2015) (liens securing Federal Housing Administration ("FHA") insured

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[1] The Nevada law at issue, NRS Section 116.3116, was amended on May 28, 2015 by Senate Bill 306. The revisions to the law took effect October 1, 2015 and, among other things, provide for: prior notice to the first lienholder; a five-day period prior to the home owners' association foreclosure sale to satisfy the super-priority lien amount; and a 60-day right of redemption by the property owner and the first lienholder following a home owners' association foreclosure sale.

[2] *See Summerhill Village Homeowners Ass 'n v. Roughley, 166 Wn. App. 625, 270 P.3d 639, 289 P.3d 645 (2012).*

[3] *See Chase Plaza Condo. Ass'n, Inc. v. JPMorgan Chase Bank, N.A., Nos. 13-CV-623, 13-CV-674, ___ A.3d ___, 2014 WL 4250949 (D.C. Aug. 28, 2014).*

loans). However, the aforementioned court decisions are not necessarily controlling in other jurisdictions, nor are other judges necessarily bound by these rulings.

In light of this context, we strongly agree with the proposition that HOA liens should not be permitted to enjoy a "super-priority" over the duly recorded first lienholder under *any* circumstance, in line with the longstanding real estate principle of "first in time, first in line."

Moreover, of even greater urgency, we strongly agree with the proposition that HOA liens should not be permitted to hold a "super-priority" that could lead to extinguishment, especially without notice or an opportunity to cure, of a duly recorded first lien; thus, our views are aligned with those of the FHFA (acting as conservator), the FDIC (acting as receiver) and the FHA. **Allowing a duly recorded first lien to be subject to extinguishment by a small lien, potentially without notice or even the opportunity to cure, will directly undermine the value of the collateral securing a loan --- a result that will lead to subsequent concerns over access to credit and higher costs ultimately borne by consumers.**

As we have indicated, this argument has been made successfully in some jurisdictions by federal agencies such as the FHFA, FDIC and FHA, and for mortgage owners and investors in loans or RMBS that own or invest in loans having a federal interest, such as the loans considered in the *Byron Skylight* and *County of Orange* cases. Thus, we bring our concerns before the Banking Agencies, as private mortgage loan owners and "private label" RMBS investors remain *fully* exposed to the risks of HOA "super-priority" liens.

Since banks are, collectively, the largest originators and servicers of these private (non-federally related) mortgage loans in the nation, we believe that this HOA lien issue may pose "safety and soundness" issues to banks similar to the issues identified by the FHFA, FDIC and FHA. In other words, we believe the HOA "super-priority" lien doctrine, particularly in an aggressive "true priority" form, could adversely impact any financial institution that lends money secured by mortgaged properties or takes an economic interest in such loans, and therefore the integrity of the deposit insurance system.

We further believe that an appropriate response by the Banking Agencies to this risk would *not* be a prohibition on financial institutions from making loans (or investing in RMBS) where the loans may relate to properties located in an HOA. That approach would surely make homeownership in HOAs less attractive at the consumer level, by decreasing the availability of mortgage credit to those consumers. We see no reason to impose that burden on those consumers, who often fall into the first-time homeowner, or low- to moderate-income category.

Instead, we urge the Banking Agencies to consider implementing standards or guidelines within this space, in order to at a minimum prevent HOA "super-priority" liens from having the capacity to extinguish the prior perfected and recorded non-federally related mortgage liens --- preempting any state law that purports to allow such an extinguishment.

For your convenience, we the undersigned trade associations have attached our joint "Statement of Principles" on this HOA issue, which additionally includes a history and summation of the existing dangers.

We look forward to working with you to resolve this critical issue and remain a resource for you should you need it.

Very truly yours,

American Bankers Association
American Financial Services Association
Association of Mortgage Investors
Housing Policy Council of the Financial Services Roundtable
Mortgage Bankers Association
Securities Industry and Financial Markets Association
Structured Finance Industry Group

cc:

Melvin L. Watt, Director, Federal Housing Finance Agency
Dr. Michael Stegman, Senior Policy Advisor, National Economic Council

STATEMENT OF PRINCIPLES

HOA SUPER PRIORITY LIENS

Within state legislatures and the courts, a debate has been taking place over whether priority lien status should be granted to one private party over another private lienholder that has followed proper procedures to record a first lien. In some jurisdictions, the debate over "super priority" liens has even extended to whether or not the subordinately filed lien should be granted the ability to extinguish liens recorded first in time.

The trade association signatories to this statement affirm the following as their joint public policy position on super priority liens for common interest communities, including condominiums, planned communities, and real estate cooperatives (referred to here, collectively, as HOAs):

- We support the bedrock principle in real estate finance of "first in time, first in right," that any private lien secured after origination of a property's first lien mortgage or deed of trust should not take priority over that mortgage or deed of trust in foreclosure (i.e. "payment priority"), or have the ability to extinguish the mortgagee's interests (i.e. "true priority").

- We are opposed to policy initiatives that seek to give priority lien status to one private party ahead of another private lienholder that has followed proper procedures to record their lien. These initiatives run contrary to the very heart and nature of secured lending, and can destabilize the entire real estate finance system by undermining the value of the collateral securing a loan — resulting in higher costs that will ultimately be borne by consumers.

- If state policymakers decide to proceed contrary to this core principle and allow for an HOA super priority lien within their jurisdiction, this lien should exist as a payment priority that is satisfied from the proceeds of a foreclosure sale conducted by a superior lienholder or encumbrancer. At no time should this lien hold true priority status with the capacity to extinguish a mortgagee's superior interests in a property. Additionally, if a payment priority HOA super lien exists:

    - What is included within this lien must be expressly defined.

    - The associated costs must be reasonably limited. Included in the HOA super priority lien should only be the following:

        - Six months of delinquent regular assessments owed to the HOA by the homeowner, based on the HOA's current periodic budget year, and excluding special assessments;

- An interest rate based on the lien amount that is commercially reasonable and based on interest rates for other collection actions; and

- Reasonable collection costs for the aforementioned six months of delinquent assessments, which should be defined by prescribed limits. The costs should be similar to amounts incurred in other collection actions, and must not be framed within generic statements of law — examples of generic statements of law include "attorney's fees" or "necessary costs."

- The maximum amount of an HOA super priority lien should be capped at one percent of the mortgage amount.

- An HOA's super lien should lose its payment priority status if the HOA sells its lien interest to a third party.

American Bankers Association
American Financial Services Association
Association of Mortgage Investors
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APPENDIX

HOA SUPER PRIORITY LIENS

July 23, 2015

Issue History:
In 1982, the Uniform Law Commission (ULC) developed the *Uniform Common Interest Ownership Act* (UCIOA)[4] as model law. UCIOA contained language for the formation, management, and termination of common interest communities, including condominiums, planned communities, and real estate cooperatives (referred to here, collectively, as HOAs). Prior to UCIOA, the ULC developed related models in the late 1970s: the *Uniform Condominium Act* (UCA)[5] and the *Uniform Planned Community Act* (UPCA).[6] Since their creation, more than 20 jurisdictions have adopted variations of these acts or their amended versions — in whole or in part.[7]

Notably, the ULC suggested in each model that HOAs should hold a "super priority" lien on a property for several months of delinquent assessments. Typically, adopting jurisdictions have quantified the super priority lien as between six and nine months of unpaid amounts and related collection costs.

For decades, HOA super priority liens have been enforced as a "payment priority" from the proceeds of a foreclosure sale conducted by a superior lienholder or encumbrancer. However, in 2014 the Nevada Supreme Court[8] and the District of Columbia Court of Appeals[9] ruled that HOA super priority liens are "true priority" liens — meaning an HOA may conduct a foreclosure sale on this lien and if an otherwise superior lienholder or encumbrancer does not act to satisfy it, their otherwise advanced lien interest will be extinguished.

Existing Dangers:

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[4] http://www.uniformlaws.org/Act.aspx?title=Common%20Interest%20Ownership%20Act%20(1982).

[5] http://www.uniformlaws.org/Act.aspx?title=Condominium%20Act.

[6] http://www.uniformlaws.org/Act.aspx?title=Planned%20Community%20Act.

[7] According to the ULC's website, as of July 23, 2015 nine states have adopted UCIOA: AK, CO, CT, MN, NV and WV (1982 version); and CT, DE and VT (2008 version). Additionally, 14 states have adopted UCA: AL, AZ, KY, ME, MN, MO, NE, NM, PA, RI, TX, VA, WA and WV. Pennsylvania has also adopted UPCA. However, it is likely that the ULC's aforementioned list is not definitive, given that Tennessee's existing condominium law and the District of Columbia's existing condominium law are both similarly structured to the UCA model and are not listed on the ULC's website.

[8] *SFR Investments Pool 1, LLC v. U.S. Bank, N.A.*

[9] *Chase Plaza Condominium Assoc. Inc. v. JPMorgan Chase Bank, N.A.*

These rulings[10] — shifting HOA super liens from a payment priority to a true priority — have created profound, unintended consequences for mortgage lenders, the servicers of their loans, and the housing industry at large:

- In a true priority jurisdiction, a relatively diminutive HOA super priority lien amount — likely totaling in the thousands of dollars — now has the capacity to wipe out a mortgage or deed of trust worth hundreds of thousands of dollars. In the prior noted Nevada Supreme Court case, an HOA foreclosure sale was executed for $6,000, in order to satisfy a delinquent $4,500 HOA super priority lien amount.[11] This resulted in a loss of $885,000 for the otherwise superior first lien mortgagee through lien extinguishment.

- HOAs do not always provide appropriate notice to a superior lienholder or encumbrancer that a super priority lien amount is delinquent — resulting in mortgage servicers being unaware of lien concerns until well after the HOA foreclosure sale has been conducted. Inadequate state notice requirements exacerbate this problem.

- Even if a servicer does determine that a property is subject to an HOA super priority lien, communication with HOAs is often difficult. Most HOAs do not have current registered agent information on file with their secretary of state and less than 20 percent are managed by a professional company.

- Numerous "payoff" issues have also arisen, including HOAs improperly rejecting servicers' tender to satisfy the statutorily mandated super priority lien amount — in order to instead collect their full delinquent costs in foreclosure. In certain instances, some HOAs have even affirmatively refused to disclose to servicers the amount owed.

- Further, there is no mechanism to dispute the super priority lien amount purportedly owed by the homeowner, which essentially represents a private dispute with no judicial finding of the validity of the HOA's claim.

- Moreover, speculative investors have begun capitalizing on HOA foreclosure sales in order to experience windfall profits upon resale.

- Over 1,000 Nevada cases are being litigated to determine whether clear title existed for purchasers at HOA foreclosure sales, and subsequently whether proper notice was given by HOAs to first lien mortgagees before these sales were executed. If the courts determine notice was proper under Nevada law and clear title exists, holders of first lien

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[10] In 2012, a Washington State case — *Summerhill Village Homeowners Assoc. v. Roughley* — also established true priority for that State's HOA super liens. Note that these are state interpretations of their laws, and these decisions are only controlling in states where and when they are made.

[11] *See supra* note 5 (the specific lien amount owed ranged from $1,149.24 when the notice of delinquency was recorded to $4,542.06 when the notice of sale was sent).

deeds of trust will lose hundreds of millions of dollars.

If other jurisdictions begin adopting a true priority standard, many of the aforementioned consequences will inevitably result there as well, leading to serious financial impacts that will directly harm consumers:

- Lenders in true priority jurisdictions will need to financially account for the risks related to possible extinguishment in order to continue originating mortgage loans. The impact this might have on a consumer's loan will depend on an individual lender's risk mitigation strategy. For example, a lender might price the related risk into higher interest rates, mitigate it through higher down payment requirements, or completely exit risky jurisdictions altogether. Inevitably, any option will have a negative impact on consumers seeking mortgage credit or refinance options in a time when the market is experiencing the lowest interest rates in decades. It may even impact homeowner property sales as consumers are offered less favorable loan terms for homes in HOA-managed areas.

- Aside from access to credit and property sale impacts, homeowners are also vulnerable to additional risks in a true priority jurisdiction. They could inadvertently lose their homes (and their hard-earned equity) in the course of an assessment dispute with their HOA. Added concerns arise when a

  homeowner is out of town, sick, etc. for an extended time period and inadvertently neglects to stay current on their HOA assessments. These concerns exist even if a homeowner is mortgage-free.

Notably, true priority HOA super liens significantly affect several public programs and federal government interests, including the Federal Housing Administration's (FHA) mortgage insurance program — which helps create sustainable homeownership opportunities for first-time and low- to moderate-income homebuyers, and the Federal Housing Finance Agency's (FHFA) conservatorship of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Given the magnitude of these concerns, numerous legal actions have been undertaken to challenge the appropriateness of true priority HOA super liens:

- In September 2014, the U.S. District Court for Nevada marginally limited the Nevada Supreme Court decision, barring HOA foreclosure sales on first lien deeds of trust in Nevada that are insured through FHA. The District Court held in *Washington and Sandhill Homeowners Association v. Bank of America N.A.* that the U.S. Constitution's Supremacy Clause bars foreclosure sales of this type and renders them invalid.

- Additionally, FHFA has directly intervened in several actions on this true priority issue. In June 2015, FHFA and Fannie Mae successfully challenged the ability of HOA super priority liens to extinguish federal government property interests in a case before the U.S. District Court for Nevada. In *Skylights LLC v. Byron et al*, FHFA and Fannie Mae did not dispute that recently upheld Nevada law allows an HOA's foreclosure of its super priority lien to extinguish an otherwise first position deed of trust if that lien is not properly satisfied by an otherwise superior lienholder or encumbrancer. However, FHFA and

Fannie Mae counterclaimed that provisions of the federal *Housing and Economic Recovery Act of 2008* (HERA) prohibit an HOA from foreclosing on Fannie Mae's property interests without the consent of its conservator, FHFA. Given that FHFA did not consent to the extinguishment in question (and has publically stated it will not do so),[12] the District Court determined that the HOA's foreclosure sale did not extinguish Fannie Mae's property interests, nor allow the property to be conveyed free of this encumbrance.

  - Importantly, the District Court's decision included language indicating that the ruling could be limited to a scenario where Fannie Mae was the deed of trust's record beneficiary at the time of the HOA's foreclosure. However, three cases decided in July 2015 expanded the ruling to the more common scenario for Fannie Mae <u>or</u> Freddie Mac — where either own the debt but are not the recorded beneficiary of the deed of trust. These cases are *Elmer v. JPMorgan Chase Bank, N.A*; *Premiere One Holdings, Inc. v. Fed. Nat'l Mortg. Ass'n*; and *Williston Inv. Group, LLC v. JPMorgan Chase Bank, N.A.*

- While the aforementioned District Court decisions are not controlling in other jurisdictions, nor are other judges within the U.S. District Court for Nevada bound by these rulings, they do provide exceedingly favorable precedent for these arguments.

- Importantly, even if HOA super liens are eventually unable to extinguish FHFA and FHA property interests in any jurisdiction that adopts a true priority standard, loans made with private capital will remain vulnerable to extinguishment and investors will not have as much of an incentive to invest in homeownership, creating a <u>major</u> barrier to full housing market recovery and the ability of consumers to purchase homes in true priority states.

[12] FHFA Statement on HOA Super-Priority Lien Foreclosures, *available at* http://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-on-HOA-Super-Priority-Lien-Foreclosures.aspx (April 21, 2015).