

Homeowners and Condo Owners Associations Should Not Be Granted “Super Lien” Priority

Strict adherence to lien priorities—the concept of “first in time, first in right”—is critical to the functioning of the U.S. housing market, especially one dependent on an active, liquid secondary mortgage market. As a core principle, private liens recorded after origination of a first lien mortgage/deed of trust (mortgage) should not be able to move ahead of the first position mortgagee in foreclosure priority, nor be able to extinguish the mortgage when that private lien is unsatisfied. Allowing homeowners associations and condo owners associations—(referred to here, collectively, as HOAs)—to have “super lien” priority runs contrary to this bedrock housing finance principle on both grounds.

OVERVIEW

- In fall 2014, the Nevada Supreme Court and the District of Columbia Court of Appeals ruled that homeowners association and condo owners association super liens, respectively, are “true priority” liens—holding a higher priority in foreclosure than a property’s first lien mortgage.
 - **Pre-decision:** HOA super liens were deemed a “payment priority” entitling them to their super lien amount in advance of the first lien mortgagee when a foreclosure was initiated by a superior lienholder or encumbrancer.
 - **Post-decision:** If an HOA properly conducts a foreclosure sale of their super lien in Nevada or DC, and the mortgagee does not act to redeem its interest by satisfying the HOA super lien, the mortgagee’s interests will be extinguished.
- More than 20 states having laws similar to Nevada and DC, as they are based in whole or in part on a model law, the *Uniform Common Interest Ownership Act*. This raises concerns over the future interpretation of these other state laws, which still largely ascribe to the payment priority view.
- Additionally, the *Act*’s drafters—the National Conference of Commissioners on Uniform State Laws—produced amendments in 2014 seeking to clarify their support for the Nevada and DC court interpretations.

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- Multiple bills were subsequently introduced in the 2015 state legislative sessions, which would have implemented versions of the model Act's amendments, in order to make the Nevada and DC court interpretations the "new normal."
- In September 2014, the U.S. District Court for Nevada marginally limited the Nevada Supreme Court decision, barring HOA foreclosure sales of first position Department of Housing and Urban Development (HUD)-insured mortgages in the State.
- In April 2015, the Federal Housing Finance Agency (FHFA) stated that federal law "precludes [the] involuntary extinguishment of Fannie Mae or Freddie Mac liens while they are operating in conservatorships and preempts any state law that purports to allow holders of [HOA] liens to extinguish a Fannie Mae or Freddie Mac lien, security interest, or other property interest." This statement is more definitive than a statement they made in December 2014 highlighting their related concerns, as it "confirms [FHFA] has not consented, and will not consent in the future, to the foreclosure or other extinguishment of any Fannie Mae or Freddie Mac lien or other property interest in connection with HOA foreclosures of super priority liens."
- FHFA also filed suit in the U.S. District Court for Nevada and has been successful on its case merits. According to FHFA, the existence of HOA super liens in any priority position increases the risk of losses to taxpayers through Fannie Mae's and Freddie Mac's conservatorship, in violation of the *Housing and Economic Recovery Act of 2008*. In June 2015, the District Court for Nevada rendered court decisions in favor of this assessment.
- Importantly, 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. And even if HOA super liens were unable to extinguish FHFA and HUD property interests in all jurisdictions, loans made with private capital would remain vulnerable to extinguishment, and investors would not have much incentive to invest in homeownership—creating a major barrier to full housing market recovery and the ability of consumers to purchase homes in true priority states.
- Notably, Moody's has stated that the Nevada and DC court interpretations are credit negative for residential mortgage-backed securities and single-family rental transactions. However, Moody's has indicated that credit improvements have been made in Nevada, as MBA and Nevada-based stakeholders—including the Nevada Mortgage Lenders Association—successfully advocated for May 2015 passage of State legislation that mitigates many of the risks from Nevada's true priority HOA super liens (new law became effective on October 1, 2015).

IMPACT

- Over 1,000 Nevada cases continue to be litigated to determine whether clear title existed for property 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 and clear title exists, these mortgagees could lose hundreds of millions of dollars from this change in interpretation.
- If other states adopt this true priority super lien standard, the risks of originating and servicing loans in HOA communities will increase significantly.
- Where any HOA super lien authority exists, lenders may be forced to price risk through higher interest rates, mitigate it through larger downpayment requirements, or exit risky jurisdictions altogether. Property owners may even be unable to sell or refinance their homes.

MBA'S POSITION/NEXT STEPS

- MBA supports the principle of “first in time, first in right,” that any private lien added after origination of a property’s first lien mortgage should not take priority over the mortgage in foreclosure, or have the ability to extinguish its interests.
- MBA strongly disagrees with the Nevada and DC court interpretations, which run counter to the aforementioned notion. In response, MBA is taking the following actions:
 - Conducting outreach with members who operate in Nevada and DC, and in other states with similar laws, to educate about related risks and mitigation strategies; and
 - Working with state and local mortgage banking associations and other industry trade groups to advocate for state legislation that would either mitigate mortgagee risk from this new super lien priority (e.g. industry efforts in Nevada), retain the super lien as a payment priority, or remove the super lien outright—depending on the political climate.
- MBA is additionally monitoring bills introduced in states that aim to align their laws with the DC and Nevada court interpretations. The aforementioned strategy is also being utilized where these bills arise. MBA led advocacy efforts in 2015 to defeat legislation in Maine, New Hampshire, Tennessee, Vermont and West Virginia, and will again seek to do so where bills are introduced in 2016.
- MBA’s overall strategy is grounded in its [“Statement of Principles”](#) on HOA super liens—which is co-branded with MBA by six other national financial services trade associations. This document forms the basis of MBA’s advocacy objectives before policymakers on this subject.

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