

Let me begin by offering you, dear reader, my sympathy. Your decision to read this article identifies you as someone suffering from extreme insomnia, or a person in need of the information set out below. In either case your situation is lamentable. I hope you will find some relief in the following paragraphs; though please read only for your particular condition. It would be a disappointment if this article elicited responses from informed insomniacs and drowsy bank officers, instead of the other way around.

One more preliminary matter: the title to this article is a bit misleading. When you're finished, you may think the deception relates to its inclusion of the word "brief." Really, though, the problem with the title is that it fails to clarify that the scope of this article is limited to successor special declarant's rights regulated under Chapter 116 of the Nevada Revised Statutes (the "Act"). "Unregulated" successor special declarant's rights certainly exist, and there are issues that a foreclosing lender should consider when contemplating such rights. However, these "unregulated" successor special declarant's rights, along with quality writing and clever humor, are not presented in this article.



A BRIEF GUIDE TO SUCCESSOR SPECIAL DECLARANT'S RIGHTS FOR THE FORECLOSING LENDER

BY DOUGLAS C. FLOWERS, ESQ.

Successor Special Declarant's Rights

An understanding of successor special declarant's rights requires a basic understanding of common-interest communities, and an almost completely empty social calendar. A common-interest community, for purposes of the Act, is a community in which each owner, by virtue of owning a unit in that community, shares in the expense of maintaining some other part of the community.¹ Such a community is formed by recording a declaration of covenants conditions and restrictions (CC&Rs) against the real property comprising the community.²

In some cases, the person or entity recording this declaration may choose to reserve certain rights over the community, generally for the purpose of facilitating real estate development and sales in the community, and preventing the spread of yard gnomes. If the reserved rights include any privileges defined as "special declarant's rights" under the Act, then the person reserving those rights is a "declarant" (pronounced de-clair-ant, with a James Carville accent).³

Rights constituting "special declarant's rights" under the Act include all of the following:



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- (1) the right to complete certain improvements in the community;
- (2) the right to maintain sales offices, management offices, models and signs in the community;
- (3) the right to use easements through the community's common elements for the purpose of making improvements;
- (4) the right to subject the community to a master association;
- (5) the right to merge or consolidate the community (but not its individual owners) with another community;
- (6) the right to appoint officers and directors for the owners association formed for the community; and
- (7) the right to:
 - (i) add real estate to the community,
 - (ii) create units, common elements or limited common elements in the community,
 - (iii) subdivide units,
 - (iv) convert units into common elements, or
 - (v) withdraw real estate from the community.⁴

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Putting these concepts together provides a useful definition of successor special declarant's rights. In essence, successor special declarant's rights are simply those special declarant's rights acquired from a declarant by that declarant's successor-in-interest.

The Act's process for transferring special declarant's rights to a foreclosing lender is relatively simple.

How to Transfer Special Declarant's Rights

According to section 116.3104 of the Act, there are two ways to transfer special declarant's rights.⁵ Which method of transfer to apply under section 116.3104 depends on whether the relevant transfer is made at the declarant's election, or at the election of a party with the power to compel sale of the property to which the special declarant's rights relate.

In the former situation the method of transfer is by written assignment.⁶ This assignment must be executed by both the transferor and the transferee and must be recorded in every county in which any portion of the community is located.⁷

In the latter situation – which could arise in connection with a receivership, a sale for non-payment of taxes, a bankruptcy proceeding or, most likely, a judicial or non-judicial

foreclosure – the method of transfer (unless any applicable mortgage, deed of trust or other security agreement provides otherwise) is by assignment in the judgment or instrument conveying title to the real property.⁸ The judgment or instrument transfers only those rights specifically requested by the transferee.⁹ The request should be made to the party conducting or ordering the sale as, given the circumstances, the declarant will probably be occupied with more pressing concerns. Furthermore, in order to protect against the possibility that a court may interpret a transfer under section 116.3104(3) as also being subject to the terms of section 116.3104(1), the judgment or instrument should be executed by the transferee or its designee and should be recorded in every county in which any portion of the community is located.

Effect of Transfer

As the foregoing indicates, the Act's process for transferring special declarant's rights to a foreclosing lender is relatively simple. The Act's rules governing the effect of transfer are only slightly more involved and turn on the substance of the rights being conveyed. Specifically, the results of the transfer vary depending on whether the transfer includes:

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- (i) only the special declarant's right to maintain models, sales offices and signs (hereinafter, "sales rights");
- (ii) all special declarant's rights; or
- (iii) more than just sales rights but less than all special declarant's rights.¹⁰

Notwithstanding such variation, one outcome accrues in all three cases: the transferring declarant ceases to have any special declarant's rights following the transfer.¹¹

In the case of a transfer involving only sales rights, the foreclosing lender holds those rights and nothing more. By the express terms of the Act, the foreclosing lender cannot exercise any other special declarant's rights, and any existing special declarant's right to appoint the officers and directors of the community's owners association automatically terminates.¹² While this may seem a bit restrictive, the Act compensates for these limitations by exempting the successor from any liability or obligation as a declarant or successor declarant, other than the obligation to provide a public offering statement under NRS 116.4102, and liability related thereto.¹³

Regarding a transfer involving all special declarant's rights, the foreclosing lender, as one might suspect, succeeds to all special declarant's rights, including the right to appoint the owners association's officers and directors (assuming this right was validly held by the transferor, and has not expired under the "control turnover" provisions of NRS 116.31032).¹⁴

Possession of these rights provides a foreclosing lender with a number of tools for pursuing development and sales in the community that would not otherwise be available if only sales

rights are acquired. These tools, however, come at a cost. A foreclosing lender succeeding to all special declarant's rights takes on a number of liabilities and obligations. These include all the liabilities and obligations imposed on a declarant under the Act and the community's CC&Rs, as well as liabilities and obligations imposed by the Act and applicable CC&Rs on the transferor other than those related to the transferor's:

- (i) misrepresentations;
- (ii) warranties;
- (iii) breach of fiduciary duty (or breach of fiduciary duty by the transferor's appointees to the owners association's executive board); or
- (iv) acts or omissions after the transfer.¹⁵

A foreclosing lender can avoid liability for its acts and those of its predecessor, but only by recording an instrument stating that it intends to hold the special declarant's rights solely for transfer to a third party.¹⁶ Following recordation of this instrument, until such time as the foreclosing lender either conveys the special declarant's rights to a third party, or records an instrument revoking the earlier instrument, the foreclosing lender may not exercise any of the special declarant's rights (save any existing right to appoint directors to the owners association's executive board), but also has no liability or obligation as a declarant or successor declarant (other than liability related to executive board appointments).¹⁷

In the third and final case of a transfer involving more than sales rights, but less than all special declarant's rights, the effect is to leave the foreclosing lender in what seems to be the worst of all worlds. As in the case of a transfer of just the sales rights, any

existing special declarant's right to appoint the officers and directors of the community's owners association automatically terminates, whether or not it is one of the rights enumerated in the transfer.¹⁸

Unlike a transfer of just sales rights, however, the foreclosing lender is subject to all the liabilities and obligations imposed on a declarant under the Act and the community's CC&Rs, just as if all special declarant's rights had been transferred.¹⁹ Unfortunately for the foreclosing lender, in this instance of a transfer of only some of the special declarant's rights, there is no option to avoid liability by declaring the foreclosing lender's intent to hold the special declarant's rights for transfer to a third party. In sum, the effect of a transfer of more than sales rights, but less than all special declarant's rights, is to leave the foreclosing lender in a situation where it has all the liabilities associated with a transfer of all special declarant's rights, but lacks owners association control and the ability to opt out of liability.

Selecting Special Declarant's Rights

Because the effect of a transfer of special declarant's rights depends on the nature of the rights being transferred, a foreclosing lender and its counsel must give careful thought in selecting special declarant's rights for acquisition. Ultimately, the foreclosing lender will want to select a combination of special declarant's rights the value of which exceeds the obligations and liabilities attendant to assuming those rights. The correct combination will vary from case to case, but in each instance certain data will be key to the analysis, including:

- (i) the nature, extent, and condition of physical improvements in the community, with particular emphasis on the community's common elements;
- (ii) the form and content of plans and marketing materials previously prepared for the community;
- (iii) the financial condition and liabilities of the community's owners association;
- (iv) whether control of the owners association has been transferred to owners within the community, or the current anticipated timeline for such turnover; and
- (v) the foreclosing lender's plans for disposition of property in the community, including any plan the foreclosing lender may have to conduct a "bulk sale" of its property.

An example may help to illustrate how this data can be used to balance the value of special declarant's rights against the declarant's liabilities, and thereby help a foreclosing lender to arrive at the correct selection of special declarant's rights for transfer.

Assume a common-interest community consisting of 100 single-family residential lots, 73 of which have been improved and conveyed to consumer homebuyers, and 27 that are graded and stubbed with utilities, but otherwise unimproved and in the hands of the original declarant. The common elements for this community include private streets, an entry gate and related monuments, and a small clubhouse. However, the common elements do not, as yet, include a swimming pool that was referenced in early marketing materials for the community. Nevertheless, all of the common elements have been conveyed by the declarant to the community's owners association, which has operating (but not reserve) funds to carry out its activities, and is not a party to any pending litigation.

Now assume that the declarant defaults on a loan secured by its 27 lots, and its lender elects to move forward with a non-judicial foreclosure under NRS Chapter 107. In preparing the trustee's deed in connection with that foreclosure, the trustee notes that the declarant reserved in the CC&Rs all those privileges defined as special declarant's rights under the Act, and asks the lender which of these rights, if

any, the lender would like to have transferred in connection with the conveyance. How should the foreclosing lender respond?

Applying these hypothetical facts to the considerations noted above, the foreclosing lender should probably request a transfer of only the sales rights. Opting for this limited transfer would deprive the lender of the right to appoint the owners

association's officers and directors, the right to use easements through the common elements, the right to expand or contract the community, and the right to combine the owners association with another association.²⁰ However, given the advanced stage of build-out in the community and the number of non-declarant lots, these rights appear of little value (the existing 27 lots appear ready for construction, and pursuant to NRS 116.31032, the appointment right would expire after the sale of two more lots). The simple right to maintain models, sales offices and signs should be sufficient to complete and sell out the community. Moreover, by taking only the sales rights, the foreclosing lender can avoid any liability that might exist in connection with the original declarant's failure to construct the swimming pool, or its possible failure to fully fund reserve accounts for the owners association.²¹

Of course, additional facts might alter this analysis. If, for example, the owners association intends to be difficult, and if the ability to withdraw the 27 lots from the community still exists, the lender might elect to take all special declarant's rights and then pursue

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withdrawal (or possibly just hold that as an option for marketing the property to a third-party builder/developer). In any case, however, the goal will remain the same. The prudent foreclosing lender will gather as much information about the community as possible, use that information to weigh the value and cost of taking any special declarant's rights, and then select the special declarant's rights to be transferred accordingly.

Conclusion

Whether you picked up this article for its soporific or informative qualities, I hope you found it helpful. Issues associated with a foreclosing lender's acquisition of special declarant's rights, of limited importance in better economic times, have become more relevant in today's market. Furthermore, changes to improve, alter or simply flesh out the relevant provisions of the Act may be taken up in Nevada's 2011 legislative session. Staying abreast of these issues and developments, through articles like this one (or, even better, joining the state bar's Real Property Section), makes sense for interested parties and insomniacs alike. ■

DOUGLAS C. FLOWERS is a partner in the firm of Holland & Hart LLP, where he works in the real property and financing practice groups. He is a member of the Real Property Section's executive board, and chairs its real estate finance subcommittee. The editorial assistance of Karen Dennison and Rich Williamson with this article is gratefully acknowledged.

- 1 NRS 116.021 (2009).
- 2 *Id.* § 116.2101.
- 3 *Id.* § 116.035.
- 4 *Id.* §§ 116.039, 116.089.
- 5 *See id.* § 116.3104.
- 6 *Id.* § 116.3104(1).
- 7 *Id.*
- 8 *Id.* § 116.3104(3).
- 9 *Id.*
- 10 *See id.* §§ 116.3104, 116.31043.
- 11 *Id.* § 116.3104(4)(a).
- 12 *Id.* §§ 116.3104(4)(b), 116.31043(3).
- 13 *Id.* § 116.31043(3).
- 14 *See id.* § 116.3104(4)(b).
- 15 *Id.* § 116.31043(2).
- 16 *Id.* § 116.31043(4).
- 17 *Id.*
- 18 *See id.* § 116.3104(4)(b).
- 19 *See id.* § 116.31043(2), (3).
- 20 *See id.* § 116.31043(3).
- 21 *See id.* §§ 116.31038(3), 116.4119(1).