

THE SUPER PRIORITY OF HOMEOWNERS' ASSOCIATIONS

BY KATIE MCCONNELL, ESQ.

For the last four years, in Nevada, homeowners' associations, lenders and property owners have been battling over the interpretation and application of NRS Chapter 116, concerning the priority of homeowners' association liens with respect to first deeds of trust and foreclosures. In 2014, the Nevada Supreme Court issued a landmark decision, *SFR Investments Pool 1 v. U.S. Bank*,¹ discussing the so-called "superpriority" lien that an HOA has above a first deed of trust. The Nevada Legislature clarified some of these issues in 2015 by amending NRS 116.3116, effective October 1, 2015. While the changes in the laws have certainly cleared up some murky waters, many questions regarding how to address these unique liens moving forward still remain.

How HOA Liens Work

Under NRS 116, a Common Interest Community (commonly known as a homeowner's association or HOA) has the ability to place a lien on a homeowner's property once the homeowner falls behind in the periodic assessments. The

recording of the HOA's Declaration of Covenants, Conditions and Restrictions constitute notice and perfection of the lien, which means that once a homeowner becomes delinquent on assessments², the lien automatically attaches to the property, without notice.

Once a homeowner becomes delinquent, the HOA must mail a notice of delinquent assessment to the homeowner, including: the amount of the assessments and other sums due (this should also contain a breakdown of the amounts claimed, a description of the unit against which the lien is imposed and the name of the record owner of the unit (property)).³

Should the homeowner fail to pay the amounts due after at least 30 days, the HOA must then record and serve a notice of default and election to sell, in the office of the County Recorder where the unit is located. An HOA can move forward with a judicial or non-judicial foreclosure on the unit if the homeowner remains in default to recover the past due amounts.

The SFR Decision

NRS 116.3116 provides that at least a portion of an HOA lien is prior to other security interests, including a first deed of trust against the unit. Conceivably an HOA can foreclose on its lien for back-due assessments above a first deed of trust. Essentially, a lien for a few thousand dollars could extinguish a six-figure mortgage.



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The confusion and conflict surrounding these practices led to the Nevada Supreme Court's decision in *SFR Investments Pool 1 v. U.S. Bank*, which addressed some of the issues raised by lenders and HOAs. In this case, a homeowners' association foreclosed on a unit for a \$4,500 "superpriority" lien, which resulted in an \$885,000 first deed of trust being extinguished.⁴ The court, in a 4-3 decision, held that the statute splits the HOA lien into a "superpriority piece" and a "subpriority piece."⁵ The superpriority piece of the lien consists of the last nine months of unpaid HOA dues, and maintenance and nuisance-abatement charges, and is prior to the first recorded deed of trust. The subpriority piece consists of "all other fees or assessments," and is subordinate to the first recorded deed of trust.⁶ Most importantly, a superpriority piece can be foreclosed non-judicially and will extinguish a first deed of trust.⁷

The *SFR* decision also seemed to imply to lenders that if they wanted to clear title and avoid disputes with an HOA, they should simply pay the HOA all demanded amounts, stopping any HOA foreclosure sale and, therefore, any chance of extinguishing the security interest of a first deed of trust.

The *SFR* decision caused lenders to immediately settle past due accounts of units in which there was a first deed of trust in order to secure their interest in the property. However, the *SFR* decision left much unresolved, such as what can be included in the superpriority portion, and to what extent an HOA is required to give lenders notice of HOA liens if lenders are expected to pay them off.

SB 306: 2015 CHANGES TO NRS 116

In May, SB 306 was signed into law, amending Chapter 116 as a follow-up to some of the questions raised in the *SFR* case. The law took effect on October 1, 2015, and clarified some of the issues regarding amounts that can be included in the superpriority portion of the lien and the type of notice the lender must receive.

NRS 116.3116 was amended to provide that an HOA has a lien on any unit for the unpaid amount of assessments, not to exceed an amount equal to assessments for common expenses (based upon the periodic budget adopted by the association) that would have come due, in the absence of acceleration, during the nine months immediately preceding the date on which the notice of default and election to sell is recorded. This was previously codified as "the institution of an action to enforce the lien," which left some ambiguity when it came to determining

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the date upon which to calculate the superpriority. Therefore, the HOA is entitled to seek amounts incurred nine months prior to the recording of the HOA's notice of default and election to sell, not nine months from the lender's foreclosure notice.

Additionally, the statute now states that the actual costs incurred by the association to enforce the lien are also included as part of the superpriority, so long as they do not exceed specific amounts listed in the statute. For example, a demand letter shall not exceed \$150, and a notice of delinquent assessment shall not exceed \$325. These amounts, under *SFR*, would have arguably been included only in the subpriority piece of the lien. The amendment clarifies that only these specific delineated costs shall be included in the superpriority portion, and specifically excludes attorneys' fees as being prior to the first deed of trust.

Finally, NRS 116.31162 was amended to require that HOAs inform each lender with notice, of the Notice of Default and Election to Sell, and the Notice of Sale, by certified mail. The notice must specify exactly what the superpriority portion of the lien is and what any subpriority portion is. The law also allows a first lien holder a 60-day right of redemption in the event that the HOA actually forecloses on a unit.

Lingering Issues

The Supreme Court issued another decision in January 2016, *Shadow Wood Homeowners Association, Inc. and Gogo Way Trust v. New York Community Bancorp, Inc.*, indicating that courts have equitable authority to look at the fees and costs charged in an HOA foreclosure in order to determine whether or not the amounts are reasonable.⁸ The opinion further indicates that, while many of these cases must be handled on an individual, factual basis, the HOA must not reject funds tendered from lenders, regardless of whether or not they satisfy the claimed deficiency.

At a time when lenders are wary of HOAs and the handling of liens, *SFR* and SB306 have prompted many of them to pay the HOA immediately following the generation of a notice of a delinquent

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assessment or of a lien. *Shadow Wood* implied that the HOA must take the payment from the lender and apply it to the unit's account. This results in homeowners working with their lenders to pay delinquent assessments, instead of dealing with the HOA.

While the court's decisions and SB306 clarified many issues, there is still much confusion regarding the relationship between HOA liens and first deeds of trust and, in turn, the likelihood of further litigation. The only certainties when dealing with HOA liens are that they are real, they do have priority, and they will continue to be a challenge for homeowners, lenders and lawmakers alike. **NL**

1. 130 Nev. Adv. Op. 75, 334 P.3d 408 (2014).
2. A lien under NRS 16.3116 includes any assessment levied against the property, or any fines imposed against the property owner, from the time the construction penalty, assessment or fine becomes due. This can include penalties, fees, charges, late fees and interest, as well as the costs of collecting the past due obligation.
3. NRS 116.31162.
4. 130 Nev. Adv. Op. 75, 334 P.3d 408 (2014).
5. *Id.*
6. *Id.*
7. It is also notable that the *SFR* decision determined that "mortgage protection clauses," or provisions in the CC&Rs that subordinate the HOA lien to a first deed of trust, are unenforceable. These clauses are found in the governing documents of many older HOAs.
8. 122 Nev. Adv. Op. 5 (Jan. 28, 2016).



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