WHOA:
Homeowner Association Liens Generate More Litigation

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Nevada residential real estate has undergone a radical change over the past decade. The bust may be over, but it resulted in a seismic shift in the understanding of home loans.

In 2014, the Nevada Supreme Court held that a homeowner association holds a senior statutory right to foreclose for unpaid dues, wiping out a lender's deed of trust securing its debt. If the lender held a "first" deed of trust, the name became a misnomer. Hundreds of decisions have interpreted the ruling.

In 2016, things changed again as the Nevada statute was declared unconstitutional by the U.S. Ninth Circuit Court of Appeals. The circuit held that the statute fails to give lenders their constitutional due process under the 14th Amendment of the U.S. Constitution. A homeowner association (HOA) can foreclose, but the property remains subject to the lender's deed of trust.

The change may not be world-altering for homeowners or HOAs. But it has significant implications for lenders, as well as parties buying homes at HOA foreclosures. The buyers were effectively acquiring homes at HOA foreclosures for pennies on the dollar, if the lender's secured debt was wiped out. But if the home remained subject to the lender's deed of trust, the buyers may have just acquired a property with a debt that exceeds its value. The buyers either just got a steal, or they got robbed, depending on the judicial interpretation.

The issue remains in flux. The Nevada Supreme Court expressly rejected the rationale of the Ninth Circuit. The circuit's decision was 2-1, with a dissent from the former circuit chief judge, J. Clifford Wallace. The U.S. Supreme Court declined to grant certiorari in June 2017. Nevada's federal district courts have applied the circuit's decision in determining the rights of lenders after HOA foreclosures.

The federal district court also has certified a question to the Nevada Supreme Court, seeking further direction about the notice under the state statute. The question remains pending, with briefing continuing through the end of 2017. Without a clear conclusion, this article reviews the history of the change regarding homeowner association liens and the competing rights of secured lenders.

The common belief for years was that a lender was in the catbird seat if it recorded a deed of trust first in time against a borrower's home. When the house sold or was foreclosed, the lender got paid before all other creditors, with two exceptions, from statutory liens. Property taxes received priority repayment before the lender's first deed of trust. An HOA also received repayment of certain defaulted association dues prior to the lender. The bulk profit from any sale still went to the lender with the first deed of trust.

But just as homeowners stopped paying their mortgages during the Great Recession, they also stopped paying their HOA dues. HOAs had no realistic source of funding aside from dues from the association's homeowners. As a result, HOAs began conducting their own foreclosures under their statutory liens for non-payment of dues.

The twist came when the buyers at the HOA foreclosures began looking at Nevada's statutes. They discovered that Nevada declared the HOA lien to be "prior to all other liens and encumbrances." NRS 116.3116(2). The buyers began claiming that the foreclosure on the HOA lien wiped out all junior liens, including the "first" deed of trust held by lenders. This argument did not sit well with those who had loaned out hundreds of thousands of dollars secured by the deed of trust recorded against the homes, but it was a dream to parties buying homes that were free and clear of the lenders' secured debt.

A series of quiet title actions arose around the state, seeking to determine whether a buyer at an HOA foreclosure held clean title because the

foreclosure wiped out the junior secured debt, or if, as the lenders claimed, the buyer took title from the HOA foreclosure, but the home remained subject to the lender's first deed of trust.

In 2014, the Nevada Supreme Court resolved the dispute in favor of the homeowner associations and the buyers at their foreclosure sales. *SFR Investments Pool 1, LLC v. U.S. Bank, N.A.*, 130 Nev. A.O. 75, 334 P.3d 408 (en banc). The court held that under Chapter 116 of the Nevada Revised Statutes, governing common-interest communities, the plain language of the statute gave the HOAs an untrumpable senior secured debt for nine months of unpaid dues and related fees. The court further held that if an HOA foreclosed on that secured debt, it wiped out all junior secured debt. The court also held that a nonjudicial foreclosure did not interfere with the lender's rights under their "first" deed of trust.

In 2016, the Ninth Circuit disagreed, holding the statute did interfere with the lender's rights. *Bourne Valley Court Trust v. Wells Fargo Bank, N.A.*, 832 F.3d 1154 (9th Cir. 2016). The statute did permit a lender to get notice about a HOA foreclosure, but only if the lender opted in by affirmatively requesting notice from the association. The majority held that this requirement facially violated the lender's constitutional due process under the 14th Amendment to the U.S. Constitution. Wallace dissented, claiming that due process failed because there was no state action in the HOA foreclosure. Wallace also asserted that, even if there was due process, the statutory scheme in fact required the association to give foreclosure notice to any secured lenders. The U.S. Supreme Court denied the writ of certiorari on June 26, 2017. 582 U.S. ---, 137 S.Ct. 2296, 198 L.Ed.2d 726 (2017).

At the time of this writing, the issue remains unresolved. On January 26, 2017, the Nevada Supreme Court rejected the Ninth Circuit's evaluation of due process. *Saticoy Bay LLC v. Wells Fargo Home Mortgage*, 133 Nev. A.O. 5, 388 P.3d 970 (en banc). The Supreme Court renewed its position from *SFR*, consistent with Wallace's initial dissent. The statute, it held, "does not implicate due process absent some additional showing that the state compelled the HOA to foreclose on its lien, or that the state was involved with the sale." 388 P.3d at 973. The Supreme Court declined to follow the Ninth Circuit's majority position. *Id.* at n.5.

As the matter remains disputed, the federal district courts have followed the Ninth Circuit's position, maintaining the lender's liens even after HOA foreclosure. *See, e.g., U.S. Bank N.A. v. Thunder Properties Inc.*, Case No. 3:15-cv-328-MMD-WGC (D. Nev. Sept. 14, 2017). There has been a move to clarify the matter, with U.S. District Court Judge Richard F. Boulware, II, certifying the following question to the Nevada Supreme Court: "Whether NRS § 116.31168(1)'s incorporation of NRS § 107.090 requires homeowners[']associations to provide notices of default to banks even when a bank does not request notice?" *Bank of New York Mellon v. Star Hill Homeowners Association*, Case No. 2:16-cv-2561-RFB-PAL, 2017 WL 1439671. The Nevada Supreme Court accepted the question on June 13, 2017. Case No. 72931. The case is still pending at the time of this publication.

The outcome of these issues has very little effect on homeowners or HOAs. But as a matter of commercial law, with competing interests seeking to recover the value of the home, the rights of purchasers and secured lenders are critical. Since the Nevada Supreme Court issued its initial decision in 2014, the court has taken up related questions and distinctions at least nine times. The matter has made it to the Ninth Circuit Court of Appeals at least 10 times, although primarily resulting in unpublished decisions. Given the continued disputes on the topic, the courts appear to be primed for ongoing litigation arising from foreclosures conducted by homeowner associations. **NL**

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