



SHAW & LINES, LLC
HOA & CONDO LAWYERS

The Collections Conundrum Effective Strategies to Collect Association Assessments and other Moneys Owed

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Recent changes in the laws have affected the way Arizona Community Associations collect funds owed to it. This seminar will discuss how Arizona Community Association can collect assessments, fines, late fees, collections costs, attorney's fees and other fees owed to it in light of recent law changes.

- I. Assessment Collection
 - a. Need for Association Collections Policy
 - b. 30-day letter
 - c. Statement of Account
 - d. Notices of Claim of Lien
 - e. Personal Money Judgments
 - f. Foreclosures
 - g. Excess Proceeds
 - h. Bankruptcy

- II. Post Association Collections Options
 - a. Collections Agencies
 - b. Traditional Attorney Collection
 - c. Deferred Attorney Collection

COLLECTING ASSESSMENTS

The most important function of an Association is the collection of special and annual assessments. Assessments are the financial life-blood of the Association and without assessments an Association would be unable to function. An Association's rights and abilities to collect assessments are provided in both the Association's CC&Rs and Arizona statutes.

By operation of law, Associations have automatic, statutory liens pursuant to A.R.S. § 33-1256(A) (Condominiums) and A.R.S. § 33-1807(A) (Planned Communities). They also have contractual lien rights under the restrictive covenants (CC&Rs) of the Association.

The Statutory Lien

The Arizona Condominium Act and Planned Communities Act define what charges constitute an Association's lien and its rights to foreclose. For example, A.R.S. § 33-1807 of the Planned Community Act, which, in relevant part mirrors A.R.S. § 33-1256 of the Condominium Act, provides:

The Association has a lien on a unit for any assessment levied against that unit from the time the assessment becomes due. The Association's lien for assessments, for charges for late payment of those assessments, for reasonable collection fees and for reasonable attorney fees and costs incurred with respect to those assessments may be foreclosed in the same manner as a mortgage on real estate but may be foreclosed only if the owner has been delinquent in the payment of monies secured by the lien, excluding reasonable collection fees, reasonable attorney fees and charges for late payment of and costs incurred with respect to those assessments, for a period of one year or in the amount of one thousand two hundred dollars or more, whichever occurs first. Fees, charges, late charges, monetary penalties and interest charged pursuant to section 33-1803, other than charges for late payment of assessments are not enforceable as assessments under this section. If an assessment is payable in installments, the full amount of the assessment is a lien from the time the first installment of the assessment becomes due. The Association has a lien for fees, charges, late charges, other than charges for late payment of assessments, monetary penalties or interest charged pursuant to section 33-1803 after the entry of a judgment in a civil suit for those fees, charges, late charges, monetary penalties or interest from a court of competent jurisdiction and the recording of that judgment in the office of the county recorder as otherwise provided by law. The Association's lien for monies other than for assessments, for charges for late payment of those assessments, for reasonable collection fees and for reasonable attorney fees and costs incurred with respect to those

assessments may not be foreclosed and is effective only on conveyance of any interest in the real property.

There are several differing portions of this statute to consider as to the Association's lien:

- The lien arises when “the assessment becomes due.” This does not necessarily coincide with when the delinquency arises. If you have an annual assessment “payable in installments, the full amount of the assessment is a lien from the time the first assessment installment becomes due.”
- The assessment lien includes “assessments for charges for late payment of those assessments,” and “reasonable collection fees” and “reasonable attorney fees and costs incurred with respect to those assessments” incurred in connection with collecting on the unpaid lien. These charges all comprise the lien and are, therefore, subject to foreclosure.
- The assessment lien may only be foreclosed “if the owner has been delinquent in the payment of monies secured by the lien, excluding reasonable collection fees, reasonable attorney fees and charges for late payment of and costs incurred with respect to those assessments, for a period of one year or in the amount of one thousand two hundred dollars [\$1,200] or more, whichever occurs first.”
- Subsection H of this statute mandates: “A judgment or decree in any action brought under this section shall include costs and reasonable attorney fees for the prevailing party.” A frequent argument raised by defendants is that attorney fees are not recoverable unless and until a principal amount owing is reduced to judgment. From a practical standpoint, this argument does not make sense because subsection A provides that reasonable attorney fees and costs are a part and portion of the lien, which may be foreclosed. The statute does not say that the lien amount must be first adjudicated and attorney fees may only be awarded upon receipt of a final judgment. Following that argument, an Association would have no incentive or reason to conclude its foreclosure action short of securing a final judgment and would, therefore, be forced to incur additional attorney fees for which the homeowner would eventually be liable to pay, so long as such fees are reasonable. The apparent conflict between the language of these provisions seems to resolve in favor of a common sense understanding that fees are included in the lien without securing a judgment, but the fees are limited by a reasonableness standard. Arizona case law identifies the factors for determining the reasonableness of attorney fees. *See, Schweiger v. China Doll Restaurant, Inc.*, 138 Ariz. 183, 673 P.2d 927 (App. 1983). In *Schweiger*, specific guidelines are enumerated for courts in considering attorney fee applications (a/k/a *China Doll* applications) in matters where the parties have agreed, by contract, that the prevailing party is entitled to recover “reasonable” attorneys’ fees.

The Contractual Lien

In addition to the statutory lien, an Association has a “consensual” or contractual lien pursuant to its CC&Rs. The CC&Rs are a contract under Arizona law, regardless of whether an

owner reads or signs them. The contractual lien includes those fees and charges specifically listed in the CC&Rs. For example, fees and charges could include assessments, late fees, collections costs, attorney's fees and costs of enforcement. Normally, one may determine what fees are included in the CC&Rs contractual lien by looking at the assessments section of the CC&Rs.

Lien Priority

In Arizona, an Association's lien is second in priority to the following liens:

1. Liens and encumbrances recorded prior to the recordation date of the CC&Rs;
2. Recorded first mortgages or contracts for sale;
3. Liens for real estate taxes and other governmental assessments directly related to the property; and
4. Property taxes.

Mechanics' and materialmen's liens and liens of other assessments Associations are exceptions from this priority scheme.¹

Collection of Association Assessments - Enforcement of Association Liens

When an owner in an Association fails to pay Association assessments, the Association has several means to effectuate collection of the delinquent assessment. Some collections options are based on the fact, as discussed above, that the Association has a lien regarding the assessments.

Requirement to Provide an Account Statement.

This law takes effect January 1, 2020 and only applies to community Associations with more than 50 Units or Lots and community Associations with less than 50 Units or Lots that are professionally managed.

Applicable community Associations must provide a statement of account in lieu of a periodic payment book to the owner with the same frequency that assessments are provided for in the declaration (meaning, if the assessments are due monthly, then a statement of account must be provided monthly. If the assessments are due quarterly, then a statement of account must be provided quarterly).

The statement of account shall include the current account balance due and the immediately preceding ledger history. The term "immediately preceding ledger history" is not defined, therefore, it is suggested that at least one year's worth of ledger transactions be included.

The statement of account may be electronically mailed to owners if the own opts to receive the statement via e-mail. This means that the Association must specifically ask an owner if the owner desires to receive the statement of account via e-mail.

¹ See A.R.S. § 33-1256(C)(Condominiums) and A.R.S. § 33-1807(C)(Planned Communities).

Initial Collection Demand Letter

The Association, or the Association's managing agent, may send owners an initial collection demand letter when owners are delinquent in paying their assessments. Most Associations send an initial collection demand letter when owners are more than thirty (30) days delinquent in paying their assessments. Please note that a collection demand letter is subject to the provisions of the Federal Fair Debt Collections Practices Act ("FDCPA") and Associations (or its agent) should familiarize itself with the requirements of the FDCPA.

In addition to sending an initial collection demand letter, an Association may also impose a late fee for late payment of assessments. Pursuant to A.R.S. § 33-1803 (Planned Communities) "[A] payment by a member is deemed late if it is unpaid fifteen or more days after its due date, unless the community documents provide for a longer period. Charges for the late payment of assessments are limited to the greater of fifteen dollars or ten percent of the amount of the unpaid assessment." And, A.R.S. § 33-1242 (Condominiums) provides an Association with the ability to impose late fees but does not limit the amount of late fees. As such, Condominiums must look toward their CC&Rs to determine the amount of the late fee.

Subsequent Collection Demand Letters

The Association may send subsequent collection demand letters if it so desires. The Association, however, must determine whether subsequent demand letters are effective versus other collections tools.

The Filing of a Notice of Claim of Lien

Although Arizona law does not require an Association to record a lien or "Notice of Claim of Lien," filing a "Notice of Claim of Lien" is nonetheless a widespread practice and an effective collections tool. An Association's lien arises automatically and is deemed "recorded" as of the recording date of the CC&Rs. However, recording a "Notice of Claim of Lien" when a delinquency arises does not adversely affect the automatic lien and does provide some additional benefits. For instance, recording a "Notice of Claim of Lien" provides notice to title companies insuring transfers of title. Additionally, a recorded ensures that any payoff requests will be supplied to the proper address.

Some older CC&Rs require 30-days' notice before acting to enforce a lien or may require the Association to first send a "notice of intent to lien letter". CC&Rs should be carefully examined for these procedural requirements before commencing with any lien enforcement action.

Notice to Delinquent Owner Prior to Sending Account to Attorney or Collection Agency.

This change in the law will likely require a revision to the Association's collection policy.

For a delinquent account for unpaid assessments or for charges related to unpaid assessments, the Association shall provide the following written notice to the member at the member's address as provided to the Association:

YOUR ACCOUNT IS DELINQUENT. IF YOU DO NOT BRING YOUR ACCOUNT CURRENT OR MAKE ARRANGEMENTS THAT ARE APPROVED BY THE ASSOCIATION TO BRING YOUR ACCOUNT CURRENT WITHIN THIRTY DAYS AFTER THE DATE OF THIS NOTICE, YOUR ACCOUNT WILL BE TURNED OVER FOR FURTHER COLLECTION PROCEEDINGS. SUCH COLLECTION PROCEEDINGS COULD INCLUDE BRINGING A FORECLOSURE ACTION AGAINST YOUR PROPERTY.

The above notice:

- i. Must be sent at least **thirty days (30) before authorizing an attorney or a collection agency** to begin collection activity on behalf of the Association;
- ii. Must be sent by certified mail, return receipt requested, and may be included within other correspondence sent to the member regarding the member's delinquent account;
- iii. The notice shall be in boldfaced type or all capital letters; and
- iv. The Notice shall include the contact information for the person that the member may contact to discuss payment.

Personal Money Judgments Lawsuits

If the collection letter does not resolve the dispute, the Association may seek to collect the debt through court action. Under general CC&R provisions, an owner is personally liable for unpaid assessments and the Association may file a lawsuit against the owner to collect the delinquency. For collection of relatively small delinquencies (less than \$10,000), many Associations choose to file personal judgment lawsuits in Justice Court. Justice Court can provide a less expensive and more efficient means of obtaining a personal money judgment against an owner, as opposed to the more costly route of filing in Superior Court.

Once the personal judgment lawsuit is filed and served, the defendant has twenty (20) days (or 30 days if served out of state) to file an answer. If the defendant fails to file an answer, the Association may file an application for entry of default. The defendant then has ten (10) business days from the date the application for default was filed to respond with an answer or responsive pleading. If no answer is filed within this timeframe, "default" is automatically entered in the case and the Association may then request a default judgment in the Association's favor. In the event of default, judgment can generally be obtained in as little as two to three months. If the defendant

appears and contests the personal judgment lawsuit, the Association can often prevail on a motion for summary judgment. In rare circumstances, a trial may be necessary.

Personal judgment actions are generally less expensive than a foreclosure suit because of the differing level of complexity. With that said, an Association is entitled to recover its reasonable attorney fees and costs in the case and therefore, an Association should not rule out a foreclosure action based solely on increased legal expenses.

Once a judgment is obtained and recorded, it becomes a lien on any real property (not just the property located within the Association) owned by the defendant in any county in Arizona where the judgment is recorded. This “judgment lien” may be subject to the statutory homestead exemption and is generally dischargeable in bankruptcy. An Association may, however, utilize the money judgment to pursue wage garnishments and bank garnishments to collect on the judgment. Additionally, if the Association finds its collection efforts on the money judgment unfruitful, it is not precluded from proceeding with foreclosure.

Foreclosure Lawsuits

As discussed above, unpaid assessments are secured by a lien against the owner’s property, which may be foreclosed upon in the same fashion as a mortgage on real estate.² In Arizona, Associations do not have the “power of sale” to conduct foreclosures in the same way that mortgages are foreclosed (*i.e.*, through a “trustee sale”). An Association must proceed with “judicial foreclosure.” In other words, the Association must file a lawsuit in Superior Court seeking a judgment on foreclosure.

Because the lawsuit affects title to the property, a “Notice of *Lis Pendens*” must be filed and recorded. This notice informs any potential buyer or transferee that he/she will take the property subject to the pending foreclosure lawsuit and any final judgment entered in that case, unless the litigation is satisfied and a “Release of *Lis Pendens*” is recorded. This also notifies title companies that may be handling a sale or refinance of the property that the lien must be cleared before transferring title.

Unlike a personal money judgment lawsuit, a foreclosure lawsuit may typically name several defendants, including the record title owners and any junior lien holders (*i.e.*, a second mortgage, judgment liens, liens for unpaid income taxes, etc.). If the Association has reason to believe that the record owners are deceased, the unknown heirs and devisees should also be named.

The Association’s lawsuit would seek a judgment foreclosing all interests in the property that are junior to the Association’s lien interest in the property. (*see* “Lien Priority” above). It is not unusual for a junior lien holder with a sizable interest in the property (such as a second mortgage) to contact the Association and pay the full balance of the delinquency, including attorney fees and costs, to protect its interest from the threat of foreclosure.

² *See*, A.R.S. § 33-1256 and A.R.S. § 33-1807. Also see, *Cypress on Sunland Homeowners Ass’n v. Orlandini*, 227 Ariz. 228, 253 P.3d 288 (App. 2011), which states “a lien may be foreclosed in the same manner as a mortgage on real estate but may be foreclosed only if the owner has been delinquent in the payment of monies secured by the lien.”

Similar to the money judgment lawsuit, a default judgment may be secured if the defendants fail to appear and contest the lawsuit. If a defendant appears and answers, the matter is generally resolved promptly on a motion for summary judgment in the Association's favor. Very few cases require a trial and, therefore, Associations generally secure judgments on foreclosure if the case is not resolved by payment in full or settlement. The judgment will generally include an award of the principal amount of unpaid assessments, together with the attorney fees and costs incurred and interest.

Once a judgment is obtained, the county Sheriff's office may be instructed to sell the property to satisfy the judgment to recover the delinquency. A "writ of special execution" is issued by the Court instructing the Sheriff to conduct the sale. After posting and publishing notice of the sale, the property is auctioned off to the highest bidder at the Sheriff's offices, or any other place designated in the notice. If no one bids on the property, the Association will take title to the property for the amount of its bid. The Association may then dispose of the property as it sees fit.

If a purchaser outbids the Association at the auction, the purchaser must deliver cash or a cashier's check to the Sheriff's office within five (5) days from the sale. Upon receipt of the sale price, the Sheriff will issue payment to the Association in the amount of its judgment, interest and costs incurred in connection with the sale. The Association is also responsible for payment of a commission to the Sheriff for successfully selling the property and satisfying the delinquency.

After the sale, the owner's interest is foreclosed, but he/she still has time to redeem the property. The owner has a statutory redemption period (generally six (6) months unless the property is abandoned, then thirty (30) days) in which the owner can redeem the property and regain full title to the property by paying the total amount of the sale price, plus interest and a penalty. Following the owner's redemption period, junior lien holders in their order of priority may also redeem the property and secure title by payment of the full redemption amount. The redemption payoff is generally provided by and handled through the Sheriff's office that conducted the sale. If the property is redeemed within the redemption period, the owner takes back all rights and interest in the property as if the foreclosure and sale never occurred; however, the Association is paid in full.

If the owner or any junior lien holder fails to redeem the property within the redemption period, the purchaser (including the Association if it was the successful bidder at the sale) may then request and the Sheriff must issue a "Sheriff's Deed" to the purchaser, subject to any liens that were not foreclosed through the foreclosure process or liens that may have attached during the redemption period. With a recorded Sheriff's Deed in hand, the purchaser is generally considered to hold good and marketable legal title as owner of the property.

Unforeseen Collections Issues:

First Mortgage Holder Foreclosure

The first question that comes to mind concerning first mortgage holder foreclosures is "when does an Association know a house is being foreclosed by a first mortgage holder?" Pursuant to law, first mortgage holders, prior to conducting a trustee sale (which is where the property will

be foreclosed and sold to remedy the delinquent mortgage), must send the Association a “Notice of Trustee Sale.” The Notice of Trustee Sale must also be recorded in the county where the property is located. The Notice of Trustee Sale must be sent to anyone who has a recorded interest or lien (such as an Association) in the property.

Once the Association has received the Notice of Trustee Sale, the Association should determine whether the owner is delinquent in their assessments. If the owner is delinquent in their assessments, the Association may make a claim to the trustee for any excess proceeds if the property is sold at a trustee sale. Excess proceeds are monies obtained by selling a property at a trustee sale that are over and above the amount owed to the first mortgage holder. Since, in most cases, an Association’s lien for delinquent assessments is second in priority to that of the first mortgage holder, any excess proceeds should go to the Association to satisfy any delinquent assessments and other statutorily collectible amounts owed.

In order to secure excess proceeds, the Association, pursuant to A.R.S. § 33-812 must make a written claim to the trustee (whom is the person who will be holding the money once the trustee sale takes place) requesting that the trustee release any excess proceeds gained to satisfy the owner’s delinquency with the Association. The letter should include:

1. The amount of the delinquency and proof of the delinquency (a customer ledger will usually suffice as proof of the delinquency);
2. A statement as to the Association’s lien priority; and
3. A statement showing the Association is entitled to excess proceeds (reference to the appropriate statute or CC&R provision regarding the Association’s assessment lien should suffice).

If the trustee, after receipt of the above notice letter, fails to deliver any excess proceeds to the Association, the Association’s right to collect attorney’s fees should it have to institute legal action to collect the excess proceeds will be saved. It is because of this that the above notice letter is so important and should be sent upon receiving a Notice of Trustee Sale.

In the event that there are no excess proceeds after the trustee sale and the property has reverted to a third party, then the Association’s lien will be extinguished. Consequently, the Association would not be entitled to collect any assessments or attorney fees incurred prior to the date of the trustee sale from the new owner. Nonetheless, the Association may still pursue a money judgment in the hope that the homeowner will obtain future assets that the Association could garnish in order to recover what it is owed.

Bankruptcy

Another unexpected collections issue occurs when an owner declares bankruptcy and ceases paying their assessments. Upon the receipt of a Notice of Petition for Bankruptcy (typically a Chapter 7 filing or a Chapter 13 filing), an Association should prepare a statement of the

declaring owner's account. Once the statement has been prepared, it should be sent to the Association's attorney.

At this point, the Association's attorney will intervene on behalf of the Association by filing a Notice of Appearance with the Bankruptcy Court informing the Court that the attorney is representing the Association. The attorney may also file a Proof of Claim with the Bankruptcy court that substantiates the debt owed by the owner to the Association.

If the owner files a Chapter 7 bankruptcy and decides to keep their home, the Association may petition to lift the bankruptcy stay of collections enforcement and foreclose on the property should the owner not pay the delinquent assessments.

If the owner files a Chapter 13 bankruptcy, the Association may petition the court to include the Association's delinquency in the payment plan created by the bankruptcy court.

Bankruptcy is a complicated matter. Because of this, it is important that the Association rely on the advice of its attorney to aid in navigating the process.



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