HOMEOWNERS ASSOCIATIONS AND BANKRUPTCY - STRATEGIES

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CREDITOR STRATEGIES IN REPRESENTING HOMEOWNERS ASSOCIATIONS

A. Condominium and Homeowners Associations and the Automatic Stay

The filing of the bankruptcy petition invokes the automatic stay. The first issue a creditor such as a condominium association faces involves what action can be taken to collect assessments, or to continue a foreclosure action. In each situation, we suggest filing a Notice of Appearance in the bankruptcy case so you will receive notice of filings made in the case. The following are common scenarios and suggested actions:

1. The owner files bankruptcy and is current with all assessments - Consider your client to be lucky. No need to file a proof of claim.

2. The owner files bankruptcy, but is in arrears on pre-petition assessments -

   Chapter 7 - File a Motion for relief from the stay in order to pursue foreclosure. No need to file a Proof of Claim unless the Court sets a claims bar date.

   Chapter 11 and Chapter 13 - File a Proof of Claim **as soon as possible**. Review the Plan to determine the treatment of the Association's claim. Determine whether the automatic stay in the Chapter 13 case continues in place (e.g. the debtor listed the property as exempt and the exemption is allowed, or a provision in the Plan, the Order Establishing Procedures, or Order confirming Plan provides stay relief). You may want to wait to see whether post-petition payments are made before filing a Motion to lift stay, since the Debtor is required to make adequate protection payments to secured creditors post-petition.

3. The owner files bankruptcy, was current at the time of filing, but now is in arrears on post-petition assessments

Chapter 7 - Determine whether the stay is still in effect by looking at the case docket. Where the stay continues in effect, consider whether to file a Motion for relief from the stay, or wait until the stay terminates as a matter of law under Section 362(c). If the stay has terminated as a matter of law (e.g. the case is closed, the debtor received a discharge and the Trustee filed a Report of No Distribution, or the debtor listed the property as exempt and the exemption is allowed), the Association can continue with an *in rem* foreclosure action. **As to whether the Association can pursue collection of the post-petition assessments (see discussion in Section B below**).

Chapter 11 and Chapter 13 - File a Proof of Claim as soon as possible. Review the Plan to determine the treatment of the claim. File a Motion to obtain stay relief or adequate protection.

Associations may face the issue of whether to continue to provide services to an owner who has filed bankruptcy and is in arrears on assessments**. BE CAREFUL**. In In re Cohen, 279 B.R. 626 (Bankr. N.D. N.Y. 2002), the Association had shut off the water to the debtor's unit. After being advised of the bankruptcy filing, the Association took 11 days to turn the water back on. The Court found that the Association's actions violated the automatic stay, and awarded the debtor over $3,000 in damages, plus attorneys fees.. The Court noted that it understood the Association's frustration, but that did not excuse a clear violation of the stay.

B. Condominium Associations and the Discharge

A discharge in bankruptcy relieves the debtor of personal liability for all pre-petition debts except certain debts listed in the Bankruptcy Code. The discharge operates to permanently stay any attempt to hold the debtor personally liable for discharged debts.

Post-petition condominium assessments – are they discharged in bankruptcy?

The question of whether a bankruptcy discharge encompasses **post-petition** assessments by condominium and homeowners' associations has been addressed by Bankruptcy Courts with various results depending on the facts, and which version of the statute was in effect at the time. The arguments and holdings in these cases generally follow one of these three theories:

- post-petition assessments are non-dischargeable because the obligation to pay assessments arises from a covenant running with the land. Other Courts adopt the same position on the grounds that an association's claim for post-petition assessments do not arise until they are assessed.

- post-petition assessments are dischargeable because they arose from a pre-petition contract. Under these cases, the covenant to pay assessments is a contract. Under this view, an association's right to payment arises when the contract is made and is merely contingent on the debtor's continued ownership of the property. Thus, a claim for post-petition assessments arises pre-petition and is extinguished by the bankruptcy discharge.

- a third line of cases takes a compromise position – post-petition assessments are dischargeable unless the debtor resided in or leased the unit.

In In re Rosenfeld, 23 F.3d 833, 837 (4th Cir. 1994), the Fourth Circuit found that post-petition assessments were not discharged because the debtor had not transferred title to the property, either by a deed in lieu of foreclosure or otherwise. The Court specifically found that the debtor's consent to an order lifting the automatic stay did not end his ownership interest:

> "We find that River Place's right to payment for the assessments at issue did not arise until post-petition, and we affirm the district court's holdings that Rosenfeld's liability for the post-petition assessments was not discharged and that River Place did not violate the permanent stay by suing to collect the post-petition assessments."

In In re Rivera, 256 B.R. 828 (Bankr. M.D. Fla. 2000), Judge Briskman looked at the three different lines of case authority on the dischargeability of postpetition assessments to community associations. The Court pointed out that in 1994, Congress attempted to resolve this split of authority by enacting § 523(a)(16), which set out exceptions to discharge of certain assessments.[1] It is interesting that the 1994 statute did not make a direct reference to homeowners' associations. Nevertheless, some courts suggested that the legislative history implied coverage for homeowners'

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[1] Prior to being amended in 2005, Section 523(a)(16) provided:

> A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt ... **for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a dwelling unit that has condominium ownership** or in a share of a cooperative housing corporation, **but only if such fee or assessment is payable for a period during which ... the debtor physically occupied a dwelling unit in the condominium or cooperative project; or ... the debtor rented the dwelling unit to a tenant and received payments from the tenant for such period,** but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case....

associations.[2]

Judge Briskman in In re Rivera did not reach this issue at all, and found it unnecessary to treat the obligation to pay post-petition homeowners' association assessments as an exception to discharge under § 523(a)(16), since the scope of the discharge pursuant to §§ 524(a) and 727(b) does not extend to this obligation. Judge Briskman held:

> "the obligation to pay postpetition assessments to homeowners' associations pursuant to a recorded declaration of covenants survives a Chapter 7 discharge, even without a reaffirmation agreement, unless the debtor timely relinquishes possession and ownership of the property subject to the obligation. A Chapter 7 debtor desiring relief of the personal obligation to pay assessments accruing postpetition to homeowners' associations, should follow the procedures for filing and carrying out the statement of intent to surrender the property within the time limits contemplated by Bankruptcy Code Section 521(2). The debtor should then cooperate with the Chapter 7 trustee, the homeowners' association or other creditors secured by the property to be surrendered, as appropriate, such that the debtor relinquishes possession and ownership of the property within a reasonable time. **The debtor may be held responsible for postpetition assessments, subject to further determination of the Bankruptcy Court, if the debtor deliberately engages in unreasonable delay**. A party in interest may address the particular problem with the Bankruptcy Court as necessary or appropriate, if the facts of a particular case create uncertainty whether the debtor remains responsible for postpetition assessments. **The debtor's obligation to pay assessments ceases accruing no later than the debtor relinquishing ownership and possession of the property**. Based on the foregoing, Association does not need to obtain a reaffirmation agreement from Debtor to preserve the Association's rights under the Governing Documents to collect postpetition assessments as a personal and in rem obligation from the Debtor." (emphasis added)

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[2] In In re Stone, 243 B.R. 40 (Bankr. W.D. Wis. 1999), the Chapter 7 debtor sought to recover sanctions for condominium association's alleged violation of automatic stay. The association sought to collect condominium maintenance fees which accrued post-petition. The Court found that the automatic stay was in effect; nevertheless, the Court did not impose sanctions for creditor's alleged violation of stay in attempting to collect debt given widespread disagreement among courts as to whether the debt was in nature of post-petition debt or a dischargeable pre-petition debt that simply matured post-petition.

The 2005 Change to Section 523(a)(16)

Whether the debtor lives in the property after bankruptcy is no longer the key consideration of dischargeability of post-petition association fees and assessments. While pre-petition assocation fees and assessments are still dischargeable, Section 523(a)(16) was amended in 2005 as part of BAPCPA, and now provides that homeowners' association assessments also are non-dischargeable unless the debtor ceases to hold a legal, equitable or possessory ownership interest in the property. 11 U.S.C. § 523(a)(16). In other words, this section was expanded to include post-petition condominium and homeowners association fees as nondischargeable by omitting any requirement that in order to be nondischargeable the debtor must reside in or be renting out the residence postpetition.[3]

The 2005 statutory change to Section 523(a)(16) was significant. Now, instead of limiting the discharge of fees and assessments only to those debtors who had tenants, or who were residing in the dwellings, Congress extended the exception from discharge to post-petition assessments to debtors who have a "legal, equitable or possessory ownership interest" in the real estate. Therefore, a debtor must do more in his bankruptcy case than simply express an intention to surrender the home in the bankruptcy case, since they may still be the "legal, equitable or possessory" owner of the property. Condominium owners who move out and file bankruptcy prior to any foreclosure on their

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[3] As amended in 2005, this section now reads:

> A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt ... for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership in a share of a cooperative corporation, **or a lot in a homeowners association, for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit, such corporation, or such lot,** but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case.... (emphasis added)

property could be responsible for post-petition condo fees and assessments.

C. Proofs of Claim

An issue arises as to whether an Association should file a **secured** or **unsecured** claim. The answer depends on several factors:

Chapter 7 - the Trustee disburses funds to unsecured creditors. When a secured claim is filed, the Trustee generally will submit an Order allowing the claim as secured, but provide for no distribution on the claim. In a situation where it appears there is no equity in the property to the Association's lien, the Association can file an unsecured deficiency claim so the Association receives some distribution along with other unsecured creditors.

Chapter 11 and 13 - the claim should be filed as secured, and set out the amount of the pre-petition arrearage. The claim should contain a reservation of rights, allowing the creditor to file an amended (unsecured) claim in the event the stay is lifted or the property is surrendered.

D. Association Liens

Under state law, a claim of lien filed by an association in the public records acts as a lien on the debtor's real property. As such, an association is entitled to be treated as a secured creditor. What happens where the claim for past due assessments has accrued, but the claim of lien is not filed or perfected under state law at the time of the bankruptcy filing.

In general, unless a lien is perfected at the time of filing it is not enforceable and subject to avoidance by the trustee or debtor in possession. In some situations, however, Courts have allowed creditors to perfect their liens post-petition, notwithstanding the automatic stay. Section 362(b)(3)

creates an exception to the automatic stay for "any act to perfect ... an interest in property to the extent that the trustee's rights and powers are subject to such perfection under § 546(b) of the title....". Under § 546(b)(1)(A), "[t]he rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law that permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection ..." Most Courts have found this relation-back provision inapplicable to Association liens.

In a 1986 Tampa case, a condominium association recorded a claim of lien post-petition with respect to pre-petition maintenance and special assessments. In re Maas, 69 B.R. 245 (Bankr. M.D. Fla. 1986)(Judge Paskay). The Court looked at the interplay between § 362(b)(3) and § 546(b), and found that, similar to mechanics liens, the post-petition recording of a lien against property of the debtor is not a violation of the automatic stay **if**, pursuant to applicable non-bankruptcy law, the lien relates back to a time pre-petition and would defeat the rights of a hypothetical lien creditor which is granted to the Trustee by § 544. *Id.* at 246-47. In In re Maas, Judge Paskay concluded, however, that filing the Association's lien had no retroactive effect under applicable Florida law, since the lien was only effective when recorded. *Contra*, In re Cohen, 279 B.R. 626, 635 (Bankr. N.D. N.Y. 2002)(applying New York law). Therefore, the post-petition recording of the lien by the association violated the automatic stay. The Court also found that even if violation of automatic stay by condominium association began innocently, the continuing violation of stay (i.e. not withdrawing the lien) was willful and warranted sanctions. The Court imposed sanctions of $500.

E. Lien Strip of Association liens

Following the 11th Circuit ruling in In re McNeal, 477 Fed. Apx. 562 (11th Cir. 2012), a

wholly unsecured Association lien may be stripped under Section 506(d). Creditor arguments to avoid this result so far have been unsuccessful. Three recent Florida cases reviewed whether a Chapter 7 debtor can strip an Association's lien on homestead, and rejected creditor arguments. In In re Bustamante, 2013 WL 1110886 (Bankr. M.D. Fla. 2013)(C.J. Jennemann), the Court found that "condominium association liens do not enjoy any special status under the Bankruptcy Code". Courts also have rejected the argument by Associations related to Florida Statutes, §718.116, which provide a condominium association certain rights against the lender which forecloses the first mortgage, with the Courts holding that those rights do not include subordination of the lender's lien on the residence. In re Aliu-Otokiti, 2013 WL 1163782 (Bankr. M.D. Fla. 2013)(J. Briskman); In re Almeida, 2013 WL 1163777 (Bankr. M.D. Fla. 2013)(J. Briskman); In re Plummer, 484 B.R. 882 (Bankr. M.D. Fla. 2013)(J. Williamson).

F. Sale of Property - Can the Trustee sell property subject to an Association's lien

In the absence of any equity in the property that may benefit the estate, the trustee generally will not sell the property, but instead will surrender the property by either (a) filing a notice of abandonment, or (2) not opposing relief from the stay.

In recent years, many Chapter 7 trustees have been selling for a nominal amount the debtor's interest in real property, including condominiums, subject to existing liens. Under Section 363, the trustee or the debtor, after notice and a hearing, may sell property of the bankruptcy estate outside the ordinary course of business, including property in which a secured claimant has a security interest.[4]

Several issues have arisen in this context. One is whether the holder of a secured claim

[4] 11 U.S.C. §363(b).

attaching to the property may credit bid, or otherwise offset the amount of the claim against the purchase price of the property sold.[5] Another argument relates to whether a "due on sale" clause in the mortgage would require payment in full of the mortgage in the event of a sale by the trustee.

F. Can the Debtor Transfer property to avoid post-petition liability for association assessments

Many debtors face the following situation – the debtor surrenders a condominium, and receives a discharge. The attorney for the association advises that while they will not be foreclosing on the property, they will move to collect future (post-petition) assessments from the debtor and the discharge does not protect the debtor. The issue is what, if anything, a debtor can do to avoid this future, post-petition liability.[6]

As set forth above, the Section 523(a)(16) provides that as long as the debtor retains possession or legal title to the property, the debtor is personally liable for post-petition assessments. Counsel for debtors have come up with a number of theories and arguments. These will be discussed in detail at the session.

G. Administrative Expense Claims for Post-petition use of the Property

Under Section 503(b), where a debtor incurs a post-petition debt to a creditor which provides

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[5] 11 U.S.C. §363(k). This provision permits a secured creditor to ensure that it will receive at least the lesser of the value of the property or payment in full.

[6] This could apply not only to post-petition assessments, but to such things as liability and assessments for property tax liens, impairments to credit, and local health department fines for weeds, long grass, and vandalism board-ups. Also, liability for any tort or negligence actions associated with the premises (especially where the client stops paying the insurance).

a benefit to the debtor's estate, this claim can be deemed an administrative claim which must be paid in full before unsecured claims are paid. Creditors can assert administrative expense claims for post-petition assessments, particularly in Chapter 11 and Chapter 13 cases where the debtor is residing in the property, or renting the property.