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No Free Ride: An Equitable Remedy to Protect Homeowner's Associations from Delayed Foresclosures

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NO FREE RIDE: AN EQUITABLE REMEDY TO PROTECT HOMEOWNERS' ASSOCIATIONS FROM DELAYED FORECLOSURES

*Courtney Newsom**

A bank can choose if and when to foreclose on a property in default. Usually, it will choose to foreclose quickly to guarantee that the property remains in the best possible condition for resale, even though foreclosure means the bank will incur the considerable financial obligation to insure and maintain the property until resale. However, a bank will often delay foreclosure, sometimes months or even years, when the property is part of a homeowner's association since the association must continue to insure and maintain the property regardless of whether the bank or the homeowner makes any contribution to the association. The bank is able to shed its financial obligation at the expense the property's innocent neighbors.

This Note suggests that a bank that purposely delays foreclosure on a property located in a homeowner's association is unjustly enriched by the association when the bank knows the homeowner has also defaulted on its homeowner's association dues. Because there is currently no recourse for the homeowner's association under California law, this Note proposes that the legislature create a statutory remedy modeled after the theory of unjust enrichment to balance the inequitable burden that a homeowner's association shoulders when a bank delays foreclosure.

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I. INTRODUCTION

"All over the county, I'm seeing the same. Nobody's winning at this kind of game."[1] Lyrics from the seventies rock song "Free Ride" perfectly describe the current foreclosure crisis in America. There are no winners. Everyone is a loser.

Imagine that you own a home in a moderately upscale neighborhood. When you moved in, perhaps a decade ago, everybody paid their homeowners' association dues like clockwork. The common areas (such as the street landscaping and the clubhouse) were immaculately maintained.

But then, the mortgage meltdown hit hard. Many of your neighbors are now "underwater,"[2] and many of them are in default. Their homes are vacant, pending foreclosure. But the banks, leery of having to pay the association dues on those vacant homes, refuse to foreclose. As a result, there are fewer and fewer homeowners paying their dues. Nevertheless, the cost of maintaining the common areas is as high as ever. The homeowners association (HOA) may have to raise the dues, precisely because so few homeowners are still paying them.

When the banks finally foreclose, they wipe out the unpaid assessments owed on each property.[3] The banks usually purchase the homes in the foreclosure and then resell them on the open market.[4] The banks get a premium price for each home because the homes are located in a well-maintained development with a well-run HOA, even though the banks did not pay a dime toward the expenses of the HOA.[5]

1. THE EDGAR WINTER GROUP, *Free Ride*, on THEY ONLY COME OUT AT NIGHT (Epic Records 1973).

2 The term "underwater" is commonly used to refer to a mortgage that is higher than the current value of the property, thus resulting in negative equity. *See* Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WIS. L. REV. 565, 579 n.39 (2009) 579 n.39.

3. *See infra* Part II.C.

4. *See, e.g.*, *Foreclosure Information & Alternatives*, BANK OF AMERICA, http://homeloanhelp.bankofamerica.com/en/foreclosure-help.html (last visited Aug. 21, 2012); *Foreclosure Overview & Foreclosure Process*, REALTYTRAC, http://www.realtytrac.com /foreclosure/overview.html (last visited Aug. 21, 2012).

5. *See infra* Part V.A.

If this sounds unfair, it is. This Note describes how we have arrived at this terrible state of affairs, explores various possible solutions, and ultimately advocates for the California legislature to provide HOAs with a statutory unjust enrichment claim against banks that have taken a free ride at the expense of the nondefaulting homeowners.

Part II provides background on the effects of foreclosure and explains the framework of California HOAs, the process of foreclosing homes within an HOA, and the effect of lien prioritization on the bottom-line of everyone involved. Part III outlines the unique complications HOAs have faced and will continue to face during the current foreclosure crisis due to delayed foreclosures. Part IV summarizes the benefits and drawbacks of judicial and legislative remedies currently used outside of California. Part V explains the theory of unjust enrichment as it applies to HOAs and to lenders holding a security interest in a property within an HOA. Ultimately, Part V calls for the state legislature to tip the scales and provide HOAs a remedy that will allow them to shed some of the excess burden that banks force upon them. This Note concludes that a cause of action available to HOAs modeled after the theory of unjust enrichment provides the optimal solution for preventing the continued disparity HOAs are realizing during the ongoing foreclosure crisis, because it can account for multiple factors and ensure the most equitable result for all involved.

II. BACKGROUND

Nearly 4.5 million homeowners have lost their homes to foreclosure since 2006,[6] and an estimated 1.4 million more are in the foreclosure process.[7] Foreclosures are at the heart of the current economic recession, which began with the proliferation of subprime

6. E-mail from Christine Sticker, Pub. Relations Consultant, RealtyTrac, to author (Mar. 5, 2012, 01:27 PST) (on file with author) (stating that as of January 1, 2012, there have been 4,374,886 homes foreclosed in the United States since 2006); *see Home Foreclosure Statistics*, STATISTIC BRAIN (July 24, 2012), http://www.statisticbrain.com/home-foreclosure-statistics/ (showing that there have been 4,653,352 home repossessions from 2006 to 2011).

7. *CoreLogic Reports More than 860,000 Completed Foreclosures Nationally in the Last Twelve Months*, CORELOGIC (Mar. 15, 2012), http://www.corelogic.com/about-us/news/corelogic-reports-more-than-860,000-completed-foreclosures-nationally-in-the-last-twelve-months.aspx (stating that as of January 2012 approximately 1.4 million homes were in the "foreclosure inventory").

mortgages in the first part of the last decade.[8] The mortgage crisis has sparked a global economic recession,[9] and no one is immune from the negative effects, regardless of culpability.[10] Foreclosures affect entire communities, with injuries ranging from monetary hardships[11] to environmental concerns[12] and even social problems.[13]

A. Effects of Foreclosure

The monetary effects of a depressed real estate market resulting from rampant foreclosures are far-reaching.[14] In California, 90 percent of homes have decreased in value because of the current foreclosure epidemic.[15] These homes will lose an estimated $627 billion in equity because of nearby foreclosures between 2009 and 2012, with the average home losing $51,174 in equity.[16] Equity loss, in turn, affects the local tax revenue.[17] Cities are forced to operate on skeletal budgets, while vacant homes create additional need for government involvement.[18]

8. *See* Ben S. Bernanke, Chairman, Fed. Reserve, Speech at the Women in Housing and Finance and Exchequer Club Joint Luncheon: Financial Markets, the Economic Outlook, and Monetary Policy (Jan. 10, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20080110a.htm.

9. Christopher J. Miller, Note, *"Don't Blame Me, Blame the Financial Crisis": A Survey of Dismissal Rulings in 10b-5 Suits for Subprime Securities Losses*, 80 FORDHAM L. REV. 273, 275–79 (2011).

10. *See* Kerri Ann Panchuk, *Fed's Duke Says Foreclosure Crisis Impact and Solutions Vary by City*, HOUSING WIRE (Apr. 28, 2011, 8:34 AM), http://www.housingwire.com/news/feds-duke-says-foreclosure-crisis-impact-and-solutions-vary-city (quoting Federal Reserve Governor Elizabeth Duke); *see also* Hay El Nasser, *Foreclosure Crisis Has Ripple Effect*, USA TODAY (Mar. 3, 2008, 12:08 AM), http://www.usatoday.com/news/nation/2008-03-11-foreclosures_N.htm ("Foreclosures create ramifications even in cities that have been spared the worst of the crisis.").

11. Levitin, *supra* note 2, at 569–70.

12. *See* John R. Emshwiller, *L.A. Blames Bank for Foreclosure Blight*, WALL ST. J. (May 5, 2011), http://online.wsj.com/article/SB10001424052748704322804576303320892386698.html.

13. *See* Levitin, *supra* note 2, at 569 (explaining that relocation tears apart community ties).

14. *Id.*

15. *Compare* CHRISTOPHER MAZUR & ELLEN WILSON, U.S. CENSUS BUREAU, HOUSING CHARACTERISTICS: 2010 (2011), *available at* http://www.census.gov/prod/cen2010/briefs/c2010br-07.pdf (identifying 13,680,081 housing units in California), *with The Cost of Bad Lending in California*, CENTER FOR RESPONSIBLE LENDING, http://www.responsiblelending.org/mortgage-lending/tools-resources/factsheets/california.html (last updated Aug. 2010) (identifying 12,249,824 California homes experiencing foreclosure-related decline).

16. *The Cost of Bad Lending in California*, *supra* note 15.

17. Levitin, *supra* note 2, at 569–70.

18. El Nasser, *supra* note 10 (quoting Cynthia McCollum, president of National League of Cities and councilwoman in Madison, Alabama).

Foreclosures cause environmental and social concerns that create a need for additional government programs and protections.[19] First, natural forces can turn a vacant house into a health and safety hazard.[20] Standing water in swimming pools becomes a breeding ground for mosquitoes, which can carry deadly diseases.[21] Rodents and other disease-carrying pests thrive in the overgrown lawns and abandoned interiors.[22] Second, vacant homes are prime targets for vandals and criminals, who break windows and strip copper piping and aluminum siding, leaving safety hazards behind.[23] These health and safety concerns require city officials to step in and protect the public at an increased cost to the taxpayers.[24] Third, vast amounts of foreclosures can lead to an increase in the homeless population[25]—or at least in the need for emergency and temporary housing options—which often falls on the local government to manage.[26] Last, the stress that the foreclosure epidemic causes for individuals affected—and the community as a whole—creates an additional need for counseling programs.[27]

All of these problems affect each of the 12.6 million households in California.[28] But for the 4.8 million California homes that are part of an HOA,[29] owners face all of the same problems and more.[30] The monetary cost to these individuals extends beyond theoretical home-

19. *Id.*; *see* Maureen Milford, *Foreclosures Become Forgotten Burdens in Neighborhoods*, USA TODAY, June 10, 2008, at 5A, *available at* http://www.usatoday.com/money/economy/housing/2008-06-09-foreclosure-upkeep_N.htm.

20. *See* Milford, *supra* note 19.

21. Casey Perkins, Note, *Privatopia in Distress: The Impact of the Foreclosure Crisis on Homeowners Associations*, 10 NEV. L.J. 561, 575 (2010).

22. *See* Milford, *supra* note 19.

23. *See id.*

24. *See* Perkins, *supra* note 21, at 574–75.

25. *See* El Nasser, *supra* note 10 (publishing results of a survey that indicated 22 percent of cities reported an increase in homelessness as a result of foreclosure).

26. *See id.*

27. "The problem affects the whole spectrum, not just people losing their homes." Stephanie Armour, *Foreclosures Take an Emotional Toll on Many Homeowners*, USA TODAY, May 15, 2008, at 1A (quoting LeslieBeth Wish, a psychologist and social worker in Sarasota, Florida).

28. MAZUR & WILSON, *supra* note 15.

29. Cal. Law Revision Comm'n, *Statutory Clarification and Simplification of CID Law*, 40 CAL. L. REVISION COMM'N REP. 235, 241 (2010).

30. *See* Trevor G. Pinkerton, Comment, *Escaping the Death Spiral of Dues and Debt: Bankruptcy and Condominium Association Debtors*, 26 EMORY BANKR. DEV. J. 125, 125–26 (2009).

equity loss to actual out-of-pocket expenses.[31] Most of the HOA members who are in default on their mortgages or in the foreclosure process have also defaulted on the regular assessment dues to the HOA.[32] This forces the nondefaulting homeowners to carry the burden of funding the HOA operations for their defaulting neighbors in order to keep the HOA solvent.[33] Costs are compounded when the bank holding the first mortgage on the property delays foreclosure.[34]

In the song "Free Ride," the Edgar Winter Group extended an invitation to "come on and take a free ride."[35] HOAs, however, have made no such invitation, yet banks have taken exactly that—a free ride. Banks are able to take a free ride—and cause additional hardship for homeowners in an HOA—because of the combination of laws governing California HOAs and lien prioritization. Additional background on these two factors provides the context of the problem.

B. Framework of the California HOA

An HOA is the entity that manages a common interest development.[36] The term HOA is often used to refer to both the development and the managing association.[37] A development requires an HOA when it is comprised of separate interests in individual units as well as a common area, which is owned either by the HOA or in common by the individual members of the HOA.[38] Low-end apartment conversions to high-end luxury communities all

31. *Id.*

32. Perkins, *supra* note 21, at 561.

33. Dan Immergluck & Geoff Smith, *The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime*, 21 HOUSING STUD. 851, 851–54 (2006); Levitin, *supra* note 2, at 570 (citing Christine Haughney, *Collateral Foreclosure Damage*, N.Y. TIMES, May 15, 2008, at C1).

34. *Infra* Part V.

35. THE EDGAR WINTER GROUP, *supra* note 1.

36. Davis-Stirling Common Interest Development Act, CAL. CIV. CODE § 1351(a) (West 2007) (repealed Aug. 17, 2012) (effective Jan. 1, 2014). In 2012, the California legislature voted to repeal Davis-Stirling's existing provisions, effective January 1, 2014, as part of a bill designed to "comprehensively reorganize and recodify" the act. AB 805, 2011–12 Sess. (Cal. 2012), *available at* http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201120120AB805.

37. HOA is used synonymously with Common Interest Development throughout this note.

38. Davis-Stirling Common Interest Development Act § 1352. Examples of these developments include community apartment projects, condominiums, planned developments, and stock cooperatives. *Id.* § 1351(c).

use the HOA framework[39] in order to "reap the benefits of collective action."[40]

In California, HOAs must operate in accordance with not only their governing documents but also the Davis-Stirling Common Interest Development Act ("Davis-Stirling Act"),[41] enacted in 1985.[42] This statute governs the creation of the developments, the contents of their governing documents, their management, the rights of the owners, and the transfer of interests within the developments.[43] Each HOA drafts unique governing documents that dictate its management, ownership rights, and rules. The governing documents must comply with the Davis-Stirling Act, but there can be great diversity among HOAs depending on how the governing documents are drafted. The mission or purpose of the HOA dictates how the HOA drafts its governing documents. Some communities draft their governing documents to be very strict in order to create uniformity in the neighborhood. Other communities may want to regulate only their common areas and draft their governing documents to leave individual owners more freedom.[44]

Regardless of the HOA's type or its mission, it must have income to achieve its goals.[45] HOAs produce income through assessments, and they enforce those assessments through liens and foreclosure.[46]

1. Assessments

HOA's governing documents, together with the Davis-Stirling Act, grant HOAs the power to create and collect assessments.[47] Regular assessments, also referred to as HOA dues, cover the costs

39. Rachel Furman, Note, *Collecting Unpaid Assessments: The Homeowner Association's Dilemma When Foreclosure is No Longer a Viable Option*, 19 J.L. & POL'Y 751, 752–53 (2011).

40. Pinkerton, *supra* note 30, at 125.

41. Davis-Stirling Common Interest Development Act §§ 1350–78.

42. *Id.* § 1350; Pinkerton, *supra* note 30, at 129.

43. 54B ELEANOR L. GROSSMAN ET AL., CALIFORNIA JURISPRUDENCE 3D REAL ESTATE § 1260 (2011).

44. ROBERT G. NATELSON, LAW OF PROPERTY OWNERS ASSOCIATIONS § 4 (1989).

45. Davis-Stirling Common Interest Development Act § 1366(a); Park Place Estates Homeowners Ass'n v. Naber, 35 Cal. Rptr. 2d 51, 53–54 (Ct. App. 1994).

46. Perkins, *supra* note 21, at 565.

47. *See* Davis-Stirling Common Interest Development Act § 1366.1. The Davis-Stirling Act requires that the amount levied does not exceed that necessary to cover the costs that the HOA will incur from exercising its approved duties. *Id.*

of running the association, maintaining and repairing common areas, and providing any benefits and amenities to the association's members.[48] Therefore, the amount of the assessment greatly varies depending on the type of HOA, the number of units, and the number and type of common areas and amenities.

For instance, a condominium HOA may collect assessments to cover (1) insurance on the entire structure including the exterior of the individually owned units;[49] (2) security; (3) landscaping maintenance; (4) maintenance and repair of amenities like pool, spa, elevator, driveway, and parking garage; (5) structure and common-area maintenance and repair including painting, cleaning, etc.; (6) services for trash removal and pest control; (7) utilities for common areas and, potentially, individual units if there are not individual meters; and (8) contributions to the reserve fund used to finance future large expenses such as a new roof or driveway.[50]

Planned communities, on the other hand, are set up differently than condominiums in that the individual units do not share common walls.[51] Each residence in a planned community usually looks like a single family home.[52] However, unlike a traditional single family home, the homeowners share the costs of maintaining and operating

48. *Id.* § 1366(a); *Park Place Estates Homeowners Ass'n*, 35 Cal. Rptr. 2d at 54 n.7.

49. Insurance is typically one of the largest line item expenses of an HOA. Greg Olear, *When HOA Insurers Don't Renew*, N.J. COOPERATOR: CONDO, HOA & CO-OP MONTHLY (Aug. 2007), http://njcooperator.com/articles/311/1/When-HOA-Insurers-Don039t-Renew/Page1.html.

50. Interview with Lee Newsom, President, Coll. Terrace Gardens Homeowners Ass'n, in Lancaster, Cal. (Nov. 21, 2011). College Terrace Gardens is a self-managed HOA consisting of twenty-eight units within seven housing structures. CTR. FOR CMTY. ASS'N VOLUNTEERS, AN INTRODUCTION TO COMMUNITY ASSOCIATION LIVING 18 (2006), *available at* http://www.caionline.org/info/readingroom/Publication%20Excerpt%20Library/community_association_living.pdf; Interview with Lee Newsom, *supra*.

51. In California, planned communities are defined to include both those in which title to the common areas are held by the individual homeowners as tenants in common and those in which the HOA holds title to the common area for the exclusive use and enjoyment of the individual members. Davis-Stirling Common Interest Development Act § 1351(k). In other states, this is the distinction between a condominium and a planned community. *See* STEVEN L. SUGARMAN & TRACY L. STEELE, DO THE HOA OR CONDO? HELPING THE DEVELOPER DECIDE 1–2 (2007), *available at* http://www.morganlewis.com/pubs/DotheHOAorCondo_HelpingtheDeveloperDecide.pdf; Jim Slaughter, *Condominium and Homeowner Association Statutes/Procedures*, ROSSABI BLACK SLAUGHTER, http://www.frb-law.com/HOAcondostatutes.htm (last visited Sept. 21, 2012).

52. Margaret Farrand Saxton, Comment, *Protecting the Marketplace of Ideas: Access for Solicitors in Common Interest Communities*, 51 UCLA L. REV. 1437, 1447 (2004).

the entire neighborhood infrastructure typically covered by the local government.[53] This may include roads, emergency services, street lighting, and recreational facilities such as parks, community centers, equestrian facilities, golf courses, skate parks, swimming pools, lakes, and more.[54]

Condominiums and planned communities are indistinguishable under the Davis-Stirling Act.[55] However, this Note describes their differences because the responsibilities of the HOA create different costs and problems for the members of the association in the event that some members are not paying assessments.[56] It follows that the more amenities and services available to the defaulting property in an HOA, the more a lender holding a security interest in that property is enriched.[57] In the condominium community discussed above, the property, despite its default status with the HOA, continues to have insurance coverage, security, a maintained structure and landscaping, and pest control.[58] When the lender ultimately forecloses, the benefit of having had these amenities transfers to the lender as the new owner. Yet, the cost of those services and amenities is absorbed by the nondefaulting homeowners.[59]

In all HOAs, regular assessments are the responsibility of all of the members and are the main source of income for the HOA.[60] In fact, the HOA budget is based solely on assessment income.[61]Regular assessments are figured on an annual basis when an HOA's board of governors prepares the yearly operating budget

53. *Id.*

54. *See, e.g.*, *Community Amenities of Covenant Hills*, COVENANT HILLS AT LADERA RANCH, http://www.covenanthills.com/communities.php (last visited Sept. 22, 2012) (marketing homes in a master-planned community in Orange County, California); BEAR VALLEY SPRINGS, http://www.bvsa.org (last visited Sept. 22, 2012) (identifying recreational activities available to residents of a planned community near Tehachapi, California); SEVEN OAKS, http://www.sevenoaksrealestate.com (last visited Sept. 22, 2012) (marketing homes in a master planned community in Bakersfield, California); CTR. FOR CMTY. ASS'N VOLUNTEERS, *supra* note 50, at 18.

55. Davis-Stirling Common Interest Development Act § 1351(k).

56. *See* Saxton, *supra* note 52, at 1448–49.

57. *See* Andrea Boyack, *Community Collateral Damage: A Question of Priorities*, 43 LOY. U. CHI. L.J. 53, 62 (2011).

58. *See id.*

59. *See id.*; *infra* Part III.

60. *See* Perkins, *supra* note 21, at 565.

61. Furman, *supra* note 39, at 754–55.

for the HOA.[62] Unfortunately, a board cannot know how many homeowners, if any, will go into default over the next twelve months when preparing this budget.[63] This uncertainty, coupled with the requirement that the HOA cannot levy more than what is needed to fulfill the functions of the HOA,[64] makes it very difficult to cover the expenses when multiple homeowners begin defaulting on their assessment dues.[65]

HOAs also have the power to levy special assessments.[66] Special assessments occur in addition to regular assessments and are typically reserved for emergency situations in the event that an unbudgeted expenditure arises.[67] During the current foreclosure crisis, many HOAs have been forced to rely on this measure to cover the budget shortfalls caused by defaulting homeowners.[68] HOAs faced with substantial revenue loss due to the foreclosure crisis have three alternatives when it comes to assessments.[69]

First, HOAs can increase the regular assessments to cover the budget deficit.[70] This can prove difficult because the budget must still be distributed among all members of the association, including the defaulting homeowners.[71] In addition, HOAs are required to abide by both the Davis-Stirling Act and their governing documents when increasing assessments.[72] Complying with the former does not often prove too difficult since the statute gives HOAs leeway in the event of an emergency or unforeseen circumstances, requiring only additional documentation.[73] The latter, however, can be a significant barrier because courts have been unwilling to allow HOAs to exceed

62. Davis-Stirling Common Interest Development Act, CAL. CIV. CODE § 1365 (West 2007) (repealed Aug. 17, 2012) (effective Jan. 1, 2014).

63. *See* David C. Swedelson, & Stephanie M. Rohde, *Assessment Lien Enforcement and Collection in a Troubled Economy*, HOALAWBLOG, http://www.hoalawblog.com/Assessment%20Collection%20Troubled%20Economy.pdf (last visited Sept. 21, 2012).

64. Davis-Stirling Common Interest Development Act § 1366.

65. Perkins, *supra* note 21, at 562.

66. Davis-Stirling Common Interest Development Act § 1366.

67. *See* CTR. FOR CMTY. ASS'N VOLUNTEERS, *supra* note 50, at 18 (quoting Clifford J. Treese).

68. Perkins, *supra* note 21, at 572.

69. *Id.* at 571–73.

70. *Id.* at 572.

71. Davis-Stirling Common Interest Development Act § 1365.

72. *Id.* § 1366; Pinkerton, *supra* note 30, at 135.

73. Davis-Stirling Common Interest Development Act § 1366.

the power granted in their governing documents, regardless of need.[74]

Second, HOAs can exercise their power to levy special assessments.[75] This tends to be very unpopular because it is a sudden expense for the innocent members of the association.[76] This option can cause further problems because prospective buyers and their lenders often inquire into whether an HOA has had the need to levy a special assessment, which signals to them that the HOA is having financial trouble and which may discourage them from purchasing or providing financing on the property.[77] This, in turn, will make it difficult for the defaulting members' homes to sell either before or after foreclosure.[78]

Third, HOAs can cut expenses.[79] Ideally, HOAs can achieve this goal by favorably renegotiating contracts with HOA service providers.[80] But it is unlikely that an HOA will be able to negotiate its contracts low enough to cover a budget crisis and maintain the same level of services to its members. Instead, HOAs can cut services altogether in order to keep from increasing assessments.[81] However, there are limits to this action as well. Some services are required under an HOA's governing documents.[82] Even when the association can cut services, this can be a difficult decision, since services and amenities are often the reason the current homeowners chose to buy within an HOA.[83] Another drawback of this solution is that reduction in amenities causes an HOA to be less attractive to

74. Pinkerton, *supra* note 30, at 135 (analyzing the court's decision in *In re* S.A.B.T.C. Townhouse Ass'n, 152 B.R. 1005, 1011 (Bankr. M.D. Fla. 1993)).

75. Perkins, *supra* note 21, at 572.

76. *Id.*

77. Pinkerton, *supra* note 30, at 126; *see also* Boyack, *supra* note 57, at 81 (explaining how the possibility of uncertain assessments affects the decision-making of lenders and investors).

78. *See supra* note 77 and accompanying text.

79. Perkins, *supra* note 21, at 572–73.

80. *See* Daniel Vasquez, *Foreclosure Crisis Forces Some Florida Condos and HOAs to Dump Property Managers or Pay Them Less*, SUN SENTINEL (Feb. 24, 2011, 11:14 AM), http://blogs.sun-sentinel.com/condoblog/2011/02/florida-condos-and-hoas-turning-to-self-management-paying-property-managers-less-to-cut-down-on-expenses.html.

81. Marcie Geffner, *Condo Foreclosures Hurt Others, Too: Homeowner Associations Suffer When Members Can't Pay Their Dues*, NBCNEWS.COM (Aug. 29, 2008, 5:35 PM), http://www.msnbc.msn.com/id/26097473/.

82. *Id.*

83. *See* Perkins, *supra* note 21, at 573.

new buyers.[84] During a foreclosure crisis, attracting new buyers to purchase the homes of defaulting members is an important part of HOA recovery.[85]

Each of an HOA's alternatives for solving its budget crisis is problematic. HOAs struggle to balance the increasing costs and hardships on their homeowners with the commitment they have made to each homeowner. Rarely will all the homeowners in an HOA agree on the course that the HOA should take. Of course, none of the members want their costs to increase or their amenities to decrease, but there may be no alternative when the HOA's income continues to dwindle because of its members' defaults. At least one of these unfortunate solutions will be forced on the innocent homeowners.

2. Association Liens and Foreclosure

A corollary to the power to levy an assessment is the power to enforce payment of the assessment. An HOA can place a lien on the delinquent member's property interest in the amount of the debt and reasonable costs to collect, including attorney's fees.[86] In some states, as soon as assessments become delinquent, the amount due becomes a lien on the property automatically.[87] However, in California, a lien does not exist until the HOA records such at the County Recorder's office.[88] Furthermore, the lien cannot be recorded until after the HOA meets strict notice requirements to the owner.[89]

Once the HOA has a lien on the property, it has the ability to foreclose on that lien.[90] However, in the current market state, this is almost never a viable option because of the prioritization of their lien.[91]

84. Pinkerton, *supra* note 30, at 126.

85. *See* Boyack, *supra* note 57, at 59–60.

86. Davis-Stirling Common Interest Development Act, CAL. CIV. CODE § 1367 (West 2007), (repealed Aug. 17, 2012) (effective Jan. 1, 2014).

87. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(a) (2008); *see infra* Part IV.A.

88. *See* Davis-Stirling Common Interest Development Act § 1367(b).

89. *See id.* § 1367(a).

90. Pinkerton, *supra* note 30, at 136.

91. *See* Furman, *supra* note 39, at 759.

C. Lien Prioritization

A lien's priority determines the order in which the lienholders receive payment for the amount of their liens in the event of a foreclosure.[92] California uses a first-in-time system for lien prioritization with limited exceptions.[93] This system assigns each lien a priority according to its date of creation.[94] The first lien recorded is considered the senior lien and all subsequent liens are junior to it.

Typically, a first mortgage is the most senior lien on a property. In the event of a foreclosure, all junior liens are extinguished.[95] What this means to an HOA is that when a homeowner is in default on his or her mortgage and assessments, the foreclosure of the mortgage—the senior lien—will wipe out the assessment lien, even if the HOA has followed the proper procedure to create such a lien on the property.[96] The foreclosure results in a sale of the property. The amount paid at the sale goes to pay off the individual liens on the property according to seniority. But in the event that there are not enough funds to satisfy each lien, all of the junior liens cease to exist.

Therefore, if the property is worth less than the amount owed on all of the liens senior to the assessment lien, the HOA will see no funds.[97] This means that the arrears that the foreclosed property incurred will have to be absorbed by the HOA. As a result, the current framework of the California HOA not only allows banks to take a free ride, but it encourages them to do so. A bank can delay foreclosure as long it wants at no cost to itself; all the while the HOA maintains and insures the property for the bank.

III. FORECLOSURE DELAYS CREATE ADDITIONAL HARDSHIP ON HOAS

A foreclosure within an HOA is a problem, as it is in any neighborhood.[98] But that problem is exacerbated when a bank delays foreclosure on a defaulted home.[99] The HOA receives no income

92. 5 HARRY D. MILLER ET AL., CAL. REAL ESTATE § 11:99 (3d ed. 2009).
93. CAL. CIV. CODE § 2897 (West 2012).
94. *Id.*
95. *See* MILLER ET AL., *supra* note 92, § 11:99.
96. *See id.*
97. *See* Boyack, *supra* note 57, at 95.
98. Perkins, *supra* note 21, at 574.
99. Furman, *supra* note 39, at 763–64.

from the unit from the moment of default through the foreclosure process and until the bank completes the foreclosure, and it currently has no ability to ever recoup this income.[100] Multiple factors contribute to a lender delaying foreclosure on a property, including government-imposed delays,[101] administrative delays, and strategic delays.[102]

A. Government-Imposed Delays

The general response by the federal and state governments to mass foreclosures has been to encourage lenders to slow down and give homeowners more time.[103] The federal government created multiple programs to serve this purpose as part of economic relief packages, including the HOPE for Homeowners Act,[104] the Helping Families Save Their Home Act,[105] and the Home Affordable Modification Program as part of the Making Home Affordable Initiative.[106] California followed suit with the Perata Mortgage Relief Act.[107] Some of the programs create foreclosure moratoria, mandatory loan modification attempts, and financial counseling services prior to foreclosure.[108] All, ultimately, prolong the foreclosure process.[109] To add insult to injury, few have resulted in homeowners keeping their home.[110]

100. Perkins, *supra* note 21, at 570; *see also infra* Part II.C (discussing the impact of lien prioritization on HOAs).

101. Gary A. Poliakoff & Ryan Poliakoff, *Foreclosures and Non-paying Owners Creating Perfect Storm in Condos, Co-ops and HOAs*, HOME NEWS TRIB., Mar. 3, 2010.

102. Joe Chatham, *The Mortgage Crisis: 2007–2013?*, WESTLAW J. BANK & LENDER LIABILITY, Apr. 12, 2010, at 3, 4.

103. *See* Yianni D. Lagos, *Fixing a Broken System: Reconciling State Foreclosure Law with Economic Realities*, 7 TENN. J.L. & POL'Y 84, 95–96 (2011).

104. 12 U.S.C. § 1715z-23 (2009).

105. 12 U.S.C. § 5201 (2011).

106. 12 U.S.C. § 5219a (2010).

107. *See* CAL. CIV. CODE § 2923.5 (West 2012).

108. *See* Melissa B. Jacoby, *Home Ownership Risk Beyond a Subprime Crisis: The Role of Delinquency Management*, 76 FORDHAM L. REV. 2261, 2274 (2008).

109. *See id.*

110. Chatham, *supra* note 102, at 4 ("According to a report issued by the U.S. Treasury, 'Making Homes Affordable Plan Servicer Performance Through December 2009,' of the 3,356,844 borrowers who are eligible for modification (60 or more days late) with participating lenders, 1,164,507 were offered trial modifications, 902,620 started the trial modifications and only 66,465 were permanently modified. Another 45,056 are pending permanent modification.").

B. Administrative Delays

Government intervention abounds. However, it is likely that the foreclosure delays would occur with or without these programs.[111] Banks simply were not prepared for the astronomical default rates,[112] which was proven when financial institutions began self-imposing moratoria on foreclosures in all states, citing a need to double-check their files.[113] Further foreclosure freezes resulted after the "robot-signer" scandal.[114] Banks admitted to hiring employees to sign foreclosure documents without reading or verifying the documents.[115]

At the heart of the institution's internal struggle is the very practice that created the crisis—securitization.[116] Loan securitization is the process of pooling multiple loans and selling them off to investors.[117] The loans get sold and resold multiple times as part of large packages of loans, and often the formalities of recording these transfers get lost in the shuffle.[118] As a result, lenders have found themselves in possession of defaulted loans that they cannot prove they own, and they therefore struggle when a homeowner challenges a foreclosure action.[119]

111. *See id.*

112. Boyack, *supra* note 57, at 133.

113. Ariana Eunjung Cha et al., *Momentum Builds for Full Moratorium on Foreclosures*, WASH. POST, Oct. 9, 2010, at A01.

114. Shahien Nasiripour, *'Robo-Signer' Foreclosure Scandal May Threaten Fundamental Financial Stability, Government Watchdog Warns*, HUFFINGTON POST (May 25, 2011), http://www.huffingtonpost.com/2010/11/16/robosigners-foreclosures_n_784098.html (explaining that the "robo-signer" scandal arose after "[d]isclosures by big banks that they employed people whose sole job was to essentially rubber-stamp foreclosure documents without reading them or verifying basic facts").

115. *Id.*

116. David R. Greenberg, *Neglected Formalities in the Mortgage Assignment Process and the Resulting Effects on Residential Foreclosures*, 83 TEMP. L. REV. 253, 256–58 (2010); *see also* Peter H. Hamner, *The Credit Crisis and Subprime Litigation: How Fraud Without Motive 'Makes Little Economic Sense'*, 1 U. P.R. BUS. L.J. 103, 117 (2010) (noting that the "originate-to-distribute" method of loan making allowed lenders to immediately sell off loans through securitization, which created little incentive for lenders to ensure creditworthiness and created problems that are at the crux of the foreclosure crisis).

117. Greenberg, *supra* note 116, at 257.

118. *Id.* at 258–59.

119. *Id.* at 259.

Internal discrepancies like these may have provided homeowners a way to create their own delay.[120] Attorneys, consumer empowerment organizations, and bloggers all over the Internet are educating homeowners about the problem of loan securitization and the inability of lenders to produce the note when challenged.[121] Homeowners are encouraged to make these challenges so that they can live for free as long as possible.[122] The end result is that the HOA carries the cost of maintaining and insuring the property, and the homeowner has a free place to live while the lender gets its paperwork in order.

C. Strategic Delays

A lender may choose to delay a foreclosure even if there are no regulations or internal issues standing in its way.[123] After looking at the cost–benefit analysis, lenders often find that delaying foreclosure proceedings is the more economically sound choice.[124] Delaying foreclosures allows lenders to control the number of homes on the market and potentially prevent continued drops in value marketwide,[125] keep the loan on the performing side of the balance sheet,[126] and avoid ownership costs (like paying HOA assessments).[127]

Multiple forces may cause foreclosure delays, but all result in HOAs funding the protection of the lender's future asset.[128] Additionally, each of the causes of delay makes the result even more inequitable because of the culpability of the lender versus the

120. See Stephen Elias, *False Affidavits in Foreclosures: What the Robo-Signing Mess Means for Homeowners*, NOLO, http://www.nolo.com/legal-encyclopedia/false-affidavits-foreclosures-what-robo-34185.html (last visited July 29, 2012).

121. *See, e.g.*, Jon Boyd Barrett, *How to Delay the Foreclosure Process*, SURVIVAL INSIGHT, http://www.survivalinsight.com/prolong-foreclosure-process.html; Elias, *supra* note 120; Angie Moreschi, *Produce the Note "How-To"*, CONSUMER WARNING NETWORK (July 19, 2008), http://www.consumerwarningnetwork.com/2008/06/19/produce-the-note-how-to/; Nick, *How to Delay Foreclosure for as Long as Possible*, FORECLOSURE FISH BLOG (July 22, 2008, 9:36 AM), http://www.foreclosurefish.com/blog/index.php?id=549.

122. *See* Greenberg, *supra* note 116, at 258–59.

123. Boyack, *supra* note 57, at 56 n.2.

124. *Id.* at 113.

125. *See* Chatham, *supra* note 102, at 4.

126. Boyack, *supra* note 57, at 63.

127. Chatham, *supra* note 102, at 3–4.

128. Boyack, *supra* note 57, at 56–57.

innocence of the HOA's nondefaulting members.[129] The government-imposed delays are a direct response to the financial crisis caused in large part by lenders' shortsighted yearnings to maximize profits.[130] The administrative delays are a result of lenders' shortcuts and failure to expend adequate resources to ensure accuracy.[131] The strategic delays stem from lender self-interest.[132]

IV. POTENTIAL SOLUTIONS

A lender is not required to foreclose on a property in any timely manner—if at all.[133] The right to choose when to foreclose is a bargained-for right that the lienholder acquires through contract.[134] It is not the goal of this Note to undermine the sanctity of the lender's right to delay foreclosure. Instead, the lender should be prevented from becoming unjustly enriched as a result of that delay.

Without laws to the contrary, the lender is free to take advantage of the HOA because there is no incentive for the bank to foreclose or pay its fair share of HOA expenses.[135] This leaves the HOA with units in prolonged preforeclosure with little recourse to collect HOA dues from these units.[136] In some states, help for the HOA has come from the legislature[137] or from the judiciary.[138] However, in some states, like California, HOAs have been left to fend for themselves.[139]

129. *See id.* at 56.

130. Mortgage brokers pushed unrealistic loans. Steven Krystofiak, President, Mortg. Broker Ass'n for Responsible Lending, Statement to the Federal Reserve (Aug. 1, 2006), *available at* http://www.federalreserve.gov/secrs/2006/august/20060801/op-1253/op-1253_3_1.pdf.

131. Cha et al., *supra* note 113; *see also* Chatham, *supra* note 102, at 4 (stating that "it is merely a matter of [lenders] not having the financial or administrative wherewithal to absorb so much inventory in so little time.").

132. *Banks Taking Longer to Take Back Homes with High-Balance Loans*, INMAN NEWS (July 11, 2011), http://www.inman.com/news/2011/07/11/banks-taking-longer-take-back-homes-with-high-balance-loans.

133. *See* 1 LAWRENCE R. AHERN, III, THE LAW OF DEBTORS AND CREDITORS § 8:12 (2012) ("Acceleration usually is at the mortgagee's option and does not occur automatically.").

134. *Id.* ("The acceleration clause contained in most mortgages enables the mortgagee to foreclose upon the mortgagor's default.").

135. *See supra* Part II.

136. Boyack, *supra* note 57, at 62–63.

137. *E.g.*, UNIF. COMMON INTEREST OWNERSHIP ACT (2008).

138. Boyack, *supra* note 57, at 115–20.

139. Sale dates cannot be postponed more than one year in California without having to refile notice of default and begin the process again. CAL. CIV. CODE § 2924g(c) (West 2012). To the extent that this provision encourages lenders to complete the foreclosure process within a year, it

A. Statutory Remedies Used Outside of California

Legislative help has come in the form of the Uniform Common Interest Ownership Act (UCIOA) or similar statutory provisions. The UCIOA creates a statutory lien in favor of the HOA for unpaid assessments from the moment of default.[140] In addition, the UCIOA gives this lien priority over all liens except (1) any lien or encumbrance in existence prior to the recording of the HOA declaration; (2) the first mortgage, if recorded prior to the assessment becoming delinquent; and (3) tax or government liens.[141] The UCIOA further provides that six months of assessments have priority over the first mortgage.[142] The lien-priority provision is referred to as a "superlien" provision and means that the HOA will get at least six months of assessments even if the property value has fallen below the value of the first mortgage.[143]

The UCIOA has never received widespread acceptance.[144] Eighteen states and the District of Columbia have adopted the UCIOA's superlein provision or one similar to it.[145] Despite its adoption by other states, the California legislature has rejected a

provides some relief to HOAs. However, there is really no penalty for a lender purposely delaying foreclosure, and thus, there is unlikely any benefit for an HOA in the strategic delay scenario. *See id.*

140. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(a) (2008).

141. *Id.* § 3-116(b).

142. *Id.* § 3-116(c).

143. *See id.*

144. Paula A. Franzese & Steven Siegel, *Trust and Community: The Common Interest Community as Metaphor and Paradox*, 72 MO. L. REV. 1111, 1157 n.125 (2007). Only eight states have adopted the UCIOA. Boyack, *supra* note 57, at 98.

145. ALA. CODE § 35-8A-316 (1991); ALASKA STAT. § 34.08.470 (2010); Colorado Common Interest Ownership Act, COLO. REV. STAT. § 38-33.3-316 (2012); CONN. GEN. STAT. § 47-258 (2009); DEL. CODE ANN. tit. 25, § 81-316 (2009); D.C. CODE § 42-1903.13 (2001); FLA. STAT. § 718.116 (2011); 765 ILL. COMP. STAT. ANN. 605/9 (2009) (requires action by HOA); MD. CODE ANN., REAL PROP. § 11-110 (West 2010) (restricting to four months or $1200 limit); MASS. GEN. LAWS ch. 183A, § 6 (LexisNexis 1996 & Supp. 2002); N.J. STAT. ANN § 46:8B-21 (West 2003 & Supp. 2010); MINN. STAT. ANN. § 515B.3-115(a), (e)(1)–(3), (f), (i) (West 2002 & Supp. 2010), amended by State Agencies—Courts and Common Interest Ownership Act, ch. 116, sec. 16, § 515B.3-115, 2011 Minn. Sess. Law Serv. 41–45 (West); NEV. REV. STAT. § 116.3116(2)(c) (2010), amended by Uniform Laws—Amendments—Common Interest Communities Act, ch. 389, sec. 49, § 116.3116, 2011 Nev. Legis. Serv. 48–50 (West); 68 PA. CONS. STAT. ANN. § 3314 (West 2004); R.I. GEN. LAWS § 34-35.1-3.16 (1956 & Supp. 2010); VT. STAT. ANN. Tit. 27, § 1323 (2006); WASH. REV. CODE ANN. § 64.34.364 (West 2005); W. VA. CODE § 36B-3-116 (2005).

superlien statute in the past, and two California community association attorneys claim that "[i]t would be virtually impossible to lobby and/or convince the legislature or the governor of California to implement a superlien bill."[146] Whether this is true or not, superlien statutes have their limits, and they fail to solve the problem on multiple levels.

First, a guaranteed six months' worth of assessments is better for the HOAs than nothing. But the average foreclosure in California takes sixteen months.[147] UCIOA's strategy leaves HOAs to take a loss on the additional ten months in addition to any arrears the homeowner accrued prior to the lender's filing of notice of default.[148]

Another problem with a six-month lien priority scheme is that it treats all foreclosures equally.[149] There is no accounting for culpability.[150] Although much of this Note has focused on lenders as the most culpable party, there are instances in which this is not the case.[151] A plan that penalizes the lender regardless of the situation does not promote accountability. In some instances, the defaulting homeowner is solvent and has chosen to strategically default and stick the lender with the negative equity.[152]

Beyond being unfair, UCIOA's blanket-rule approach does not discourage foreclosure delays.[153] Once the initial six months lapse, there is no incentive to foreclose.[154] In fact, there is more incentive to delay because the lender will want to recoup the amount that six months will cost.[155] Each additional "free" month will offset those six months.[156]

146. Swedelson & Rohde, *supra* note 63.

147. Jeff Collins, *Calif. Defaults Lowest in 4 Years*, ORANGE COUNTY REG. (July 20, 2011), http://mortgage.ocregister.com/category/dataquick/.

148. *See* UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (1982).

149. *See id.*

150. *See id.*

151. *See* Boyack, *supra* note 57, at 68.

152. *Id.*

153. *See id.* at 103.

154. *See id.*

155. *See id.*

156. *See id.*

B. Judicial Remedies

Many HOAs around the country that encounter budget problems due to delayed foreclosure seek help in the court system. Some opt to try their luck in bankruptcy court, while others develop various litigation strategies.

1. Bankruptcy

Overall, the HOA framework does not make bankruptcy a viable option.[157] An HOA is merely the governing body of its individual members and has no assets of its own.[158] When a bankruptcy court looks at an HOA and there are any solvent members, the court finds the HOA has the ability to create assessments to cover its debts, subsequently denying bankruptcy.[159] The result is the exact outcome the HOA attempts to avoid—additional burdens on the nondefaulting members.

However, an HOA prevailed in a bankruptcy proceeding under a different rationale in Florida. Specifically, *In re Spa at Sunset Isles Condominium Association, Inc.*,[160] the court looked at the situation through the lens of unjust enrichment and held that lenders holding a security interest on a property in an HOA could be surcharged for delinquent assessments when the HOA filed for bankruptcy.[161] The HOA filed for Chapter 11 bankruptcy in an effort to surcharge lenders holding first mortgages on properties within the HOA whose mortgagee was in default on both the mortgage and the HOA assessments.[162] The HOA claimed the lenders were deliberately delaying foreclosing on the property in order to avoid the responsibility of the assessments as legal owners.[163] The court reasoned that the HOA's debt was a result of maintaining, preserving, and repairing the common areas within a condominium project and that therefore, the lenders should pay for the benefit

157. *See id.* at 84–85.
158. *Id.* at 84.
159. *Id.* at 84–85.
160. 454 B.R. 898 (Bankr. S.D. Fla. 2011).
161. Dan Schechter, *Lenders Holding Mortgages on Defaulted Condominium Units May Be Surcharged for Unpaid Dues and Assessments Owed to Bankrupt Condominium Association, Despite State Law to the Contrary*, COM. FIN. NEWSL. (Westlaw), Aug. 22, 2011.
162. *Id*.
163. *Id.*

bestowed on their collateral from the very debt in question.[164] Additionally, the court did not find that the delay was pertinent because the lenders received the benefit as holder of a security interest in the property the HOA was maintaining, preserving, and repairing.[165]

This decision is very interesting because it highlights the unjust enrichment that lenders receive at the expense of the solvent members of an HOA and the particularly difficult situation that an HOA is in when those members can no longer cover the bills for their defaulting members. It is unfortunate that this rationale has thus far found a place only in bankruptcy court because the court's reasoning is equally as valid outside of bankruptcy. The equities are skewed whether or not the HOA finances become dire enough to seek bankruptcy. An HOA should not be required to wait until it is facing bankruptcy before lenders are compelled to pay for the maintenance of its security interest. It is for this reason that California legislators should examine the rationale of the Florida bankruptcy court and create a statutory remedy for HOAs to recover a lender's unjust enrichment.[166]

2. Litigation Strategies

Most of the HOAs that have found refuge in the courts have been located in Florida.[167] There, foreclosure must come before a judge in order to proceed. Because the matter is already before a judge, attorneys for HOAs have developed creative litigation strategies to attempt to recover delinquent assessments by court order.[168] HOAs have found judgments in their favor more frequently at the local trial court where the judges are familiar with the plight of the HOA.[169] However, when lenders appeal, trial court judgments

164. *In re* Spa, 454 B.R. at 909.

165. *Id.*

166. *See infra* Part V.B.

167. Boyack, *supra* note 57, at 116–17.

168. *See* Daniel Vasquez, *Miami-Dade Ruling Shows Banks May Be Fined for Delays in Condo Foreclosure Sales*, SUN SENTINEL (Mar. 2, 2010), http://articles.sun-sentinel.com/2010-03-02/business/fl-bank-sanction-vasquez-0303-20100302_1_foreclosure-sales-south-florida-condo-associations-banks.

169. *E.g.*, Deutsche Bank Nat'l Trust Co. v. Coral Key Condo. Ass'n (at Carolina), Inc., 32 So. 3d 195, 195 (Fla. Dist. Ct. App. 2010) (reversing a trial court decision pursuant to its recent decision in *U.S. Bank Nat'l Ass'n v. Tadmore*, 23 So. 3d 822 (Fla. Dist. Ct. App. 2009), because

have been overturned because they are simply not supported in current law.[170]

In *United States Bank National Association v. Tadmore*,[171] an HOA brought suit to force the first mortgage holder to foreclose.[172] The trial court held, under a theory of equity, that if the lender continued to delay foreclosure, it should pay assessments, because the HOA was unreasonably prejudiced by the bank's deliberate delays in proceeding with the scheduled foreclosure.[173] This ruling was later overturned on appeal, where the court held that a lender cannot be required to pay assessments unless and until it is the legal owner.[174] The appellate court further opined that the trial court could not issue a ruling in equity that was controverted by the law.[175]

One trial court judge may have found a way around the appellate court's ruling by ordering the lender to pay the association's delinquent dues as sanctions for failing to foreclose on court order.[176] Unfortunately for California HOAs, the sanction-imposed payment works only because of judicial foreclosure. In California, lenders are not required to come before a judge in order to begin or proceed with a foreclosure.[177] Therefore, a judge would have no ability to order the foreclosure or impose sanctions.[178]

Nevertheless, it is important to see that some judges have attempted to avoid the inequity that results when HOA finances dwindle because lenders delay foreclosure. Some courts are turning to their equitable powers because no legal remedy currently exists.[179] California legislators should examine this equitable doctrine and

the trial court in both instances held that "it was fair and equitable for the mortgage holder to pay monthly assessments to the Association if there is an extended period of delay in the foreclosure proceeding for no good reason").

170. *See* Boyack, *supra* note 57, at 119.

171. 23 So. 3d 822 (Fla. Dist. Ct. App. 2009).

172. *Id.* at 822.

173. *Id.* at 823.

174. *Id.*

175. *Id.*

176. Vasquez, *supra* note 168.

177. CAL. CIV. CODE §§ 2924–2924k (West 2012).

178. *See* Gomes v. Countrywide Home Loans, Inc., 121 Cal. Rptr. 3d 819, 824 (Ct. App. 2011).

179. *See* Deutsche Bank Nat'l Trust Co. v. Coral Key Condo. Ass'n (at Carolina), Inc., 32 So. 3d 195, 195–96 (Fla. Dist. Ct. App. 2010).

generate a cause of action that will allow HOAs to recover from more culpable parties.

V. CAUSE OF ACTION FOR UNJUST ENRICHMENT

Claims for unjust enrichment currently exist under the equitable doctrine of implied-in-law contracts.[180] The unjust enrichment principle is simple. It requires only the "receipt of a benefit and [the] unjust retention of the benefit at the expense of another."[181] That's it.

Yet, because the principle is so broad, California courts have further restricted this remedy by requiring the plaintiff to show the benefit was conferred through mistake, fraud, or coercion.[182] This is where unjust enrichment becomes difficult and too unreliable to be a viable option for HOAs and their innocent members. Therefore, the legislature must create a cause of action that applies only to situations in which a lender has delayed foreclosing on an HOA property. This specialized cause of action would have the benefit of applying the theory of unjust enrichment without the fear that it would reach unforeseen situations.

A. Applying a Claim of Unjust Enrichment to HOAs and Lenders

It is fairly easy to see how a lender holding a first lien on a property receives a benefit when the security is part of an HOA.[183] First, the framework of the HOA tends to ensure the preservation of the property's value because the HOA maintains the community and funds the amenities.[184] The lender receives the benefit of holding an interest in a property that will be maintained, secured, and controlled, regardless of what its mortgagee does.[185] For this reason, the lender

180. *See* Lectrodryer v. SeoulBank, 91 Cal. Rptr. 2d 881, 883 (Ct. App. 2000).

181. *Id.*

182. *See e.g.*, Enter. Leasing Corp. v. Shugart Corp., Cal. Rptr. 620, 626 (Ct. App. 1991); Dinosaur Dev., Inc. v. White, 265 Cal. Rptr. 525, 528 (Ct. App. 1989); Nibbi Bros., Inc. v. Home Fed. Sav. & Loan Ass'n, 253 Cal. Rptr. 289, 293 (Ct. App. 1988).

183. *See* Boyack, *supra* note 57, at 113–14.

184. *See supra* Part II.B.

185. *See supra* Part II.B.

values the HOA.[186] In a declining real estate market, efforts that protect the value of the security become almost solely a benefit for the first lienholder, because the bank as the first lienholder holds the only valuable interest in the property.[187]

The benefit is always at the expense of another in a lienholder situation.[188] But it only begins to become unjust when the homeowner is in default on both the assessments and the loan and the mortgage lienholder fails to foreclose.[189] This is because this is the point when the HOA and the innocent neighbors take on the cost of maintaining and insuring the property on behalf of the future property owner—the bank.[190]

A bank's unjust enrichment is clearly evident when compared to the cost a lienholder incurs when its security is not part of an HOA.[191] When homeowners in these properties default and abandon the property, the lender usually hires a manager, takes out an insurance policy, and pays for repairs in order to protect its security.[192] None of these expenses are required of a lienholder of an HOA property because the framework of the HOA ensures the same result whether or not the individual unit's assessments are paid.[193] Lenders take advantage of this when they opt to strategically delay foreclosure, putting off liability of ownership, while the other members of the HOA secure the property value for them.[194] This is precisely the unjust enrichment that needs remedying.

186. Lenders include a clause in their loan documents with buyers of HOA properties that requires the borrower to pay assessments. *E.g.*, Fannie Mae/Freddie Mac, Multistate Condominium Rider, Form 3140 (Jan. 2001), *available at* http://www.freddiemac.com/uniform/pdf/3140.pdf. In the event the assessments are unpaid, the lender may pay them and include the amount as debt due on the loan. *Id.*

187. Boyack, *supra* note 57, at 128.

188. A lienholder benefits when the value of the property in which it holds a security interest increases. Because the lienholder does not actually make any improvements or expend any funds during the time in which it holds the lien, any increase in value is a result of another.

189. *See* Boyack, *supra* note 57, at 114.

190. *See id.*

191. *See id.* at 133.

192. *Id.*

193. *See id.* at 114.

194. *Id.*

B. Case Law Falls Short of Guaranteeing HOA Recovery

It would seem to be an easy solution for California HOAs to recover delinquent assessments from lenders in the event of a strategic foreclosure delay by invoking a court's equitable jurisdiction. Unfortunately, as discussed below, current precedent appears to be hit-or-miss for plaintiffs attempting to recover unjust enrichment claims against security holders whose interests are enhanced at the plaintiffs' expense. The challenge, without a statutory remedy for HOAs, becomes proving fraud, mistake, or coercion.

A failure to prove fraud was the plaintiff's shortcoming in *Nimbi Brothers, Inc. v. Home Federal Savings and Loan Association*.[195] There, the plaintiff, Nimbi, was a contractor seeking recovery of unpaid expenditures on a construction project financed by the defendant lender.[196] Nimbi's complaint alleged fraud through misrepresentation, claiming that the lender induced Nimbi to perform work on the property in order to enhance the value of its security, even though the lender knew that the developer was in default on the loan.[197] The lender then took full benefit of the enhancements when it foreclosed on the loan and took possession of the property.[198] Nimbi claimed that the lender assured it that it would be paid for the work it was to undertake.[199] The lender allegedly made this assurance despite having already filed notice of default and having scheduled a foreclosure sale of the property.[200] The California Court of Appeal found this to be a very close question of the equitable principle, but it ultimately held that the lender did not make a misrepresentation of any fact and thus there was no fraud for the purposes of unjust enrichment.[201] As a result, the bank was allowed to repossess the property and sell it with Nimbi's enhancements without any payment to Nimbi.[202]

195. 253 Cal. Rptr. 289 (Ct. App. 1988).
196. *Id.* at 291.
197. *Id.* at 293
198. *Id.*
199. *Id.* at 295.
200. *Id.* at 294–95.
201. *Id.* at 295–96.
202. *See id.*

Another division of the California Court of Appeal came to the opposite conclusion in *Producers Cotton Oil Company v. Amstar Corporation*,[203] decided the same year. In *Producers Cotton*, the court held that when a party has a security interest and knowingly allows necessary expenditures to be made for development of the interest, thereby benefiting from those expenditures, that party may be required to pay the party who financed the expenditures without first obtaining subordination.[204] In *Producers Cotton*, it was only because of a mistake that the party, who paid for the expenditures, failed to first obtain subordination.[205] The mistake was critical for the unjust enrichment theory, but the court's focus was on the knowledge and acquiescence of the beneficiary.[206] Because the party that held the security interest knew a payment was made that caused their security interest to become more valuable, that party was required to reimburse the paying party.[207]

Knowledge was also the theme in *First Nationwide Savings v. Perry*.[208] There, the court looked at whether a recovery for unjust enrichment was available to a senior lienholder that had mistakenly executed a reconveyance on a deed of trust.[209] The property was sold and the plaintiff received none of the proceeds because of the accidental reconveyance.[210] Instead, the proceeds went to a junior lienholder. The plaintiff then attempted to recover from the junior lienholder under the theory that the junior lienholder was unjustly enriched. The court distinguished innocent beneficiaries from "those persons who acquire a benefit with knowledge."[211] Ultimately, the court in *Perry* held that a cause of action for unjust enrichment was available if the plaintiff amended the complaint to include that the junior lienholder's knowledge of the improper reconveyance led to the unjust enrichment.[212]

203. 242 Cal. Rptr. 914 (Ct. App. 1988).
204. *Id.* at 927.
205. *Id.* at 926.
206. *Id.* at 925–26.
207. *Id.* at 927.
208. 15 Cal. Rptr. 2d 173, 180 (Ct. App. 1992).
209. *Id.* at 175–76.
210. *Id.*
211. *Id.* at 177.
212. *Id.* at 181.

Based on this precedent, an HOA is not precluded from proceeding on a theory of unjust enrichment. But a statutory remedy is necessary to provide the assurances necessary for a comprehensive solution. If HOAs are forced to attempt to fit their claims into the current precedent, their lawsuits are likely to result in the same unpredictable recoveries. Although this might help an HOA here or there, it will not provide the kind of certainty that is required to ultimately solve the problem.

C. The Optimal Solution for California

Providing HOAs with a cause of action against lenders in the case of foreclosure delay will provide an equitable solution to the current problem. Modeling the cause of action after the theory of unjust enrichment will ensure that HOAs are compensated by the appropriate party and can hold lenders accountable for the liabilities of their assets. Because unjust enrichment is an equitable remedy, the focus will be fairness rather than technicalities.

This cause of action will allow all the factors to be taken into account, including the actual benefit that the lender receives from the particular HOA and the culpability of the parties. This is when the type of HOA will play a role. In the HOAs that provide divisible services, such as the HOA that provides cable to its residents, the costs for those services should be deducted. This case-by-case analysis will also resolve the situation in which other, perhaps more culpable, parties exist and can be forced to pay.[213] Lenders can have confidence in this system because it will prevent HOAs from tacking on penalties and manipulating costs in order to get large financial institutions to fund their communities.[214]

It may seem that a case-by-case analysis will only serve to prolong the process even further; however, a clearly defined cause of action should promote settlement and communication among HOAs and their defaulting member's lender. In drafting this remedy, California legislators should track the Davis-Stirling Act and require

213. *See, e.g.*, *supra* note 152 and accompanying text (describing homeowners who have the funds to make their payments but choose to default in order to avoid further equity loss).

214. *See* Boyack, *supra* note 57, at 138–39 ("[L]enders might validly complain that an association might manipulate costs in order to obtain coverage of community expense from lenders' deep pockets.").

alternative dispute resolution (ADR) as a first line of defense.[215] HOAs would follow the same policies currently used in recovery of delinquent assessments. ADR can work in these situations once lenders know there is legal merit to the HOA's claim. If properly implemented, this remedy will align with California's ideals and protect all parties.

Legislators are often discouraged from taking action for fear of drying up the credit market for properties in an HOA.[216] However, this solution will not discourage lenders from financing HOA properties because it does not create indefinite liability for them. Instead, through equitable principles, it allows lenders a defense against any situation that was not in their control and against costs that exceed their fair share. Moreover, lenders can easily protect themselves from ever seeing a claim by requiring mortgagees to impound HOA assessments as they do with taxes and insurance.[217] The similarity of assessments to taxes[218] and insurance[219] makes this a sensible solution.

VI. CONCLUSION

Until this point, banks have been able to take a free ride at the expense of HOAs. This has placed an inequitable burden on HOAs and the innocent homeowners who compose them. However, banks are not the only entity to blame. California legislators need to address the imbalance while taking this into account. A statutory remedy modeled after the equitable doctrine of unjust enrichment does just that.

215. Davis-Stirling Common Interest Development Act, CAL. CIV. CODE §§ 1367.4, 1369.520 (West 2012) (repealed Aug. 17, 2012) (effective Jan. 1, 2014).

216. Furman, *supra* note 39, at 773–74.

217. Lenders often require homeowners to make a payment each month that covers one-twelfth of their annual or semiannual tax and insurance cost. This portion of the payment is placed in an escrow account so that the lender is assured the funds will be available when these payments become due. *See* Boyack, *supra* note 57, at 129.

218. *See id.* at 73.

219. HOA assessments typically cover insurance on the property, and this is the bulk of the HOA expense. *See* Olear, *supra* note 49. Homeowners within an HOA typically only purchase a personal insurance policy to cover personal property; therefore, the lender need not require a homeowner in an HOA to impound insurance. Lenders could easily justify substituting assessments for insurance impounds.