



*Trustee's
Sales
&
Bankruptcy*

**MULCAHY
Community
Association
Cheat Sheet®**

**BRINGING ANSWERS
TO COMMUNITY
ASSOCIATIONS**

This publication discusses significant points of law as they apply to community associations and is not intended to offer specific legal advice or responses to individual circumstances or problems.

MULCAHY LAW FIRM, P.C.

3001 East Camelback Road
Suite 130

Phoenix, Arizona 85016

Phone: 602.241.1093

Toll Free: 877.206.7164

Facsimile: 602.264.4663

E-mail:

bmulcahy@mulcahylaw.net
krosenbeck@mulcahylaw.net
www.mulcahylawfirm.net

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TRUSTEE'S SALE

If an owner becomes delinquent with his mortgage or deed of trust company, the mortgage or deed of trust company may initiate foreclosure proceedings on the owner's property by noticing a Trustee's Sale.

Secure the association's interests: A lien places the Trustee on notice of the association's interests, so the association will receive notice of the Trustee's sale and notice of excess proceeds generated at the Trustee's Sale, if any.

Generally, the **Notice of Trustee's Sale** will include the following information: 1) the Trustee of the sale, sale location and a contact information for additional information; 2) description and address of the property subject to the Trustee's Sale; 3) name of the beneficiary - e.g. mortgage company or deed of trust; 4) the recording number of the mortgage or deed of trust subject to foreclosure; 5) the principal balance owed; 6) the Trust or - e.g. the owner of the lot; and 6) the date of the Trustee's Sale.

A Notice of Trustee's Sale will be recorded with the county recorder's office and posted at the property. The beneficiary (mortgage or deed of trust company) will assign a Trustee to manage the affairs of the Trustee's Sale. The Trustee may be contacted for updated information regarding the status and results of the sale.

Events that may occur regarding a Trustee's Sale:

Postponement of a Trustee's Sale: If the owner enters into a mutually agreeable payment arrangement to pay off the delinquencies or if the owner files for bankruptcy the Trustee's Sale may be postponed.

Cancellation: If an owner pays off the mortgage, brings the delinquent balance current or refinances the property, the Trustee's Sale may be canceled. If the owner refinances, the association may be able to be paid through the closing.

Revert back to the beneficiary: If no one bids for the property at the Trustee's Sale, the property will revert back to the mortgage or deed of trust company. Accordingly, the owner will lose title/ownership of the unit/lot and the mortgage or deed of trust company shall become the new owner. A Trustee's Deed will be recorded showing transfer of ownership to the beneficiary.

Sale: The property may revert back to the beneficiary or the property may be sold to a third party. If the property is sold to a third party excess proceeds may be generated or the bid/purchase amount may be so low that no excess proceeds are generated. A Trustee's deed is recorded showing transfer of ownership to the third party purchaser for both types of sale.

AFTER THE TRUSTEE'S SALE

New Owner: Trustee's Sales are a unique sale of property in which the purchaser (either the beneficiary or a third party) takes title of the property *free and clear* of junior lien holders. The association lien is inferior to the First Deed of Trust/First Mortgage; thus, if the First Deed of Trust/First Mortgage is the foreclosing party, the association's lien will be wiped out through the Trustee's Sale. The new owner will only be liable to the association for amounts due and owing *as of the date of the Trustee's Sale*. However, if the foreclosing party is the Second Deed of Trust/Second Mortgage, the association's lien will remain pending against the lot/unit.

Former Owner: If excess proceeds are not generated, the former owner (e.g. owner that lost the property at the Trustee's Sale) remains *personally liable* to the association for past due amounts (unless a bankruptcy is involved). The association may pursue the owner personally for breach of contract; however, our firm recommends that the association run a credit check so as to determine whether the owner is collectible. In addition, if the lot/unit was the owner's residence, the association may also need to run an address search to find the new mailing address for the former owner.

Events that require close monitoring:

1. The association may obtain information that the owner(s) filed for bankruptcy, transferred ownership (sale) or intends to sell the property.

2. If the property is sold at the Trustee's Sale and excess proceeds are generated, the association will need to quickly send a request for excess proceeds *directly* to the Trustee. (State law provides that the Trustee will be discharged of liability by paying amounts owed the association from the proceeds in good faith. State law also provides that the association shall be paid first in line after the first deed of trust/first mortgage/and tax liens are paid off. Therefore, the association has a very strong probability of being paid by the Trustee with little cost to the association.)

AFTER THE TRUSTEE'S SALE *CONTINUED*

3.If the property is sold at the Trustee's Sale and excess proceeds are generated, but are deposited with the County Treasurer's Office, the association will need to file a timely Answer/Application for Release of Excess Proceeds in the case. If this occurs and an attorney was not monitoring the sale, our firm recommends that your association consult with an attorney.

BANKRUPTCY

When a homeowner files a bankruptcy (and lists an association as a creditor in the bankruptcy), there is an automatic stay in place, which prohibits the association from proceeding forward with collection against the owner or face strict and costly penalties. The association may proceed forward after the bankruptcy is dismissed, a lift of stay is granted to the association or the bankruptcy is terminated. Therefore, when the association receives notice that a homeowner has filed a bankruptcy the file should be clearly flagged as a bankruptcy file, so that no actions are taken in violation of the stay.

There are two types of bankruptcies, Chapter 7 and Chapter 13. The notice of bankruptcy will identify the type of bankruptcy and the date of filing. The master mailing list and bankruptcy schedules will set forth whether the association is a listed creditor in the bankruptcy.

A Chapter 7 Bankruptcy is generally, but not always, a no asset bankruptcy. If the homeowner has no assets, the notice of bankruptcy will state that a creditor should not file a proof of claim unless a notice to do so is received. If the homeowner owes delinquent assessments, the association should file a Notice of Appearance to assure that the association receives all notices from the Court regarding the bankruptcy. Unless the association receives notice to file a Proof of Claim, generally, the association will only need to file a Notice of Appearance and periodically monitor the status of the case.

If the debtor (owner) receives a DISCHARGE of his/her Chapter 7 Bankruptcy, the debtor is no longer personally liable to the association for any pre-petition amounts owed to the association (any amounts owed prior to the date the debtor/owner filed for bankruptcy). The association should adjust the association's accounting ledger to reflect that the owner is no longer liable for the pre-petition amounts. However, if the debtor is still an owner within the association, the association is still a secured creditor of the debtor; therefore, the association still has a valid lien against the debtor's lot/unit (note:lien is only valid for 3 years from the date the debt became due and owing). Accordingly, if the debtor sells/refinances his/her lot/unit in the future the association may be paid in full (for the pre and post-petition amounts) through the proceeds.

A Chapter 13 Bankruptcy is called a "wage earners" bankruptcy due to the fact that the party filing has a regular income and has some assets from which to pay creditors. If a homeowner files a Chapter 13, the association should file a Notice of Appearance and a Proof of Claim in the case. The Proof of Claim should include the pre-petition debt and attorney fees incurred and anticipated in the bankruptcy.

In every Chapter 13, the debtor files a proposed plan in which to pay creditors back the pre-petition debt. Secured claims have priority over unsecured claims and are generally paid in full.

As long as the homeowner still owns the property (i.e. has not lost it at a Trustee's Sale during the term of the bankruptcy), the association is a secured creditor. After the debtor's plan is approved by the Court, the association will receive payments from the bankruptcy trustee for the amount of its claim (or the amount of the claim approved in the order confirming the plan). Payments received from the trustee should be applied towards pre-bankruptcy debt.

Responsibility for Post-bankruptcy Assessments: A homeowner is responsible for all assessments, late fees and other charges, including bankruptcy related attorneys' fees after the date of filing. If the homeowner is not staying current on his/her assessments, the association's attorney should send a letter to the homeowner's bankruptcy attorney regarding the post-bankruptcy delinquent assessments. However, the association cannot initiate collection or threaten to cut off services, due to a homeowner's post-bankruptcy delinquent account. The automatic stay precludes such actions.

Lift of Stay: If the owner is not paying post-petition assessments and not responding to post-petition demand letters, the association has the opportunity to file a motion to the Court requesting a relief of stay. This is costly and most debtors will object and the motion may not be granted by the Bankruptcy Court. However, if granted, the bankruptcy stay will not be in effect against the association and the association may proceed forward with collection, including foreclosure. If the owner fails to pay his/her mortgage, the mortgage company will likely file a motion for the lift of bankruptcy stay. If granted, the mortgage company will be able to proceed forward with foreclosure through a Trustee's Sale.

Date of Filing is the date that triggers the automatic stay and precludes any further collection action against the homeowner for unpaid assessments.

Date of Discharge Chapter 7: The date the Court grants the debtor a personal discharge of all debt owed as of the date filed for bankruptcy protection. Chapter 13: The date the Court grants the debtor a discharge of all debt owed and not paid pursuant to the Bankruptcy Plan, as of the date filed for bankruptcy protection.

Date of Termination or Closing of Case is the date that the bankruptcy case has been closed or terminated and the automatic stay is no longer in effect.

Property Sold During Bankruptcy Term:

ALL AMOUNTS ARE DUE AND OWING! A payoff should include pre-petition debt and post-petition debt due to the association. It is very important to be sure that when providing a payoff, both pre and post-petition accounting ledgers, if separated, are taken into consideration in which to base the payoff.

Dismissal of Bankruptcy:

In some cases a bankruptcy will be dismissed. This is usually due to the homeowner's failure to pay fees to the Court, file a plan or fund a plan. When a case is dismissed, it's as if it were never filed and the association is able to resume collections on the homeowner.