



Do Banks Have To Pay Debts of Former Owners?

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A recent article published in the Arizona Republic and authored by a local attorney suggested that some communities have documents that require banks to pay debts of former owners or that a simple amendment to a community association's governing documents could be adopted to require bank owners to pay the prior owner's assessment delinquency. This has caused confusion and concern. Let us clarify.

To preface, associations have two avenues of collection: the association's lien and the owner's personal obligation to pay. An association can sue to foreclose its assessment lien and sell the property, or it can sue the owner personally for the unpaid debt. Associations often get paid by virtue of the lien on resales, or if there are excess proceeds after trustee's sales. The "personal" liability is based on contract and the debt accrues from the time an owner becomes an owner.

It is possible that governing documents of a particular association require a bank owner to pay the delinquency on the date of the sale but, in our experience, these provisions are so rare (and perhaps violate state law anyway), that the implication in the article that this is common is inappropriate.

It is also not fair to characterize the bank's liability as a simple amendment issue, as the article appears to suggest. CC&R provisions related to the assessment lien and personal obligation, as well as a specific document's definition of the term "owner," are complex and often intertwined with many other provisions. In addition, an amendment to alter a bank owner's liability immediately upon ownership is untested and therefore risky.

Under state law, an association's assessment lien is extinguished when a first position lender (first mortgage) sells property pursuant to the terms of the recorded deed of trust, also known as a trustee's sale. Therefore, the new owner, usually the first lender in this economy, takes the property free and clear of any junior liens, including an association's assessment lien. Any amendment to the CC&Rs to change the lien priority and the effect of a trustee's sale would violate the statutes and have no effect.

With the standard language of most CC&Rs, the personal obligation to pay assessments is limited to those assessments and other charges that accrued during a homeowner's period of ownership. In fact, most CC&Rs provide language that specifically states that the personal obligation for past charges does not

pass to successors in title of the homeowner unless expressly assumed by such successors. The reality is that a bank would not normally be willing to expressly assume such debt. There is no upside to the bank in that regard.

Regardless of the CC&Rs, common law principles would dictate that a person or entity is not obligated for the debt of another unless that debt is expressly assumed. If an association wished to change this by amendment, it should do so understanding that it is an aggressive and untested amendment that would not go without risk.

Perhaps there is a way to amend an association's governing documents to require payment of an amount equal to a previous unpaid balance upon a change in ownership. However, such an amendment requires careful attention and detailed legal analysis on a case-by-case basis. In addition, contrary to the article's assertion, this is also untested and certainly not common, if it exists at all.

Unfortunately, for the vast majority of associations that have banks or lenders as owners due to the "foreclosure economy" we are in, there is no legal argument available to make banks pay the delinquency that existed on the date the bank takes ownership and an amendment to change this fact would be time consuming, expensive, and would likely not be enforceable by the association even if it were adopted.