

Pitfalls for Community Associations When an Owner Files Bankruptcy

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By **Zach Shelomith** | July 17, 2019



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According to recent statistics, there are 342,000 community associations (including homeowners' associations and condominium associations) in the United States. Approximately 69 million Americans—21% of the United States population—live in community associations. The state with the most community associations is Florida, with over 47,900 associations. Last year, over 750,000 bankruptcy cases were filed in the United States. Therefore, it is only natural that a significant number of owners of properties in community associations are filing bankruptcy. When that happens, the collision of community association law and bankruptcy law can create unpleasant pitfalls for associations.

It is important for these associations to have counsel that recognize these dangers, who is well-versed in both community association law and bankruptcy law. Associations enjoy certain privileges under the U.S. Bankruptcy Code, but there are several instances where their rights can be waived if they do not participate in the bankruptcy case.

When an owner files bankruptcy, notice must be provided to the association. Once that notice is received, it is incumbent upon the association to immediately send the notice to its attorney. Bankruptcy involves a quagmire of deadlines, and parties can find out that they waived their rights by not acting in a timely fashion. How an association is treated in a bankruptcy filed by an owner is largely dependent on what type of bankruptcy was filed. The most common types of bankruptcy cases filed by individuals are Chapter 7 (liquidation) and Chapter 13 (reorganization).

Chapter 7

Chapter 7 is usually the more favorable type of bankruptcy for an association. Both Chapter 718 (governing condominium associations) and Chapter 720 (governing homeowners' associations) of the Florida Statutes provide associations with liens on the owner's property to secure the payment of assessments. Generally, these liens relate back to the date on which the original declaration of the community was recorded (with exceptions for first mortgages of record).

In Chapter 7, liens generally survive the bankruptcy. While the in personam liability associated with the pre-bankruptcy assessments would be included in a Chapter 7 discharge, the Bankruptcy Code provides that post-bankruptcy assessments are nondischargeable. Furthermore, associations can foreclose on those liens that survive a Chapter 7 bankruptcy, once the bankruptcy automatic stay is terminated.

Chapter 13

Chapter 13 presents additional challenges for an association. With regard to pre-bankruptcy assessments, an owner may be able to "strip" the pre-bankruptcy lien on assessments, if the owner can prove that the value of the property is less than the amount owed to the first mortgage lender. Otherwise, an owner will likely be able to repay those pre-bankruptcy assessments over a period of time up to five years. An owner that is current in pre-bankruptcy assessments may opt to continue paying ongoing assessments "outside" of the Chapter 13 plan.

Upon receiving notice of the owner's intentions in a Chapter 13 bankruptcy, an association must act quickly to respond. If an owner intends to "strip" the pre-bankruptcy lien, an association has a specific period of time to respond and contest the owner's valuation or the determination of the amount owed to the first mortgage lender. Furthermore, when an owner expresses an intention to repay pre-bankruptcy assessments over a period of time, the association must ensure that the proposed amounts are correct, or else find itself stuck with the amount as calculated by the owner, even if incorrect.

One of the special provisions favorable to associations is that even if the association's pre-bankruptcy lien is "stripped" in a Chapter 13 bankruptcy, it does not impact a subsequent owner's in personam liability for unpaid assessments. Subsequent owners are jointly and severally liable with current owners for unpaid assessments. While the current owner's in personam liability may be discharged and lien rights may be "stripped," a subsequent owner will still be liable for those unpaid assessments. And with that liability, when there is a subsequent owner, the association can then foreclose on that obligation.

Similarly, with respect to post-bankruptcy assessments in Chapter 13, if an association disagrees with the owner's calculation of the correct monthly amount, depending on the circumstances, the association could be bound by the owner's calculation, even if it is incorrect, by sitting on its rights. One interpretation of the various bankruptcy rules is that if the association is being paid inside of the owner's Chapter 13 plan, the association must file a notice of payment change with the Bankruptcy Court every time there is a change in the monthly assessment amount, within 21 days of the payment change, or else it will have waived the right to seek that increased amount.

Furthermore, unlike Chapter 7, in Chapter 13, the in personam liability associated with post-bankruptcy assessments, which arose prior to the completion of the Chapter 13 plan are dischargeable. However, if unpaid, the association would still maintain its lien on the owner's property. Associations must nevertheless be careful when the owner files a pleading in the Chapter 13 case deeming the owner current, as the association will be bound if properly served and if the amount of the post-bankruptcy assessments are incorrect.

Finally, associations may also have the right to charge the owner for post-bankruptcy interest, legal fees and costs, in the event that there is equity in the property. An owner who decides to be particularly litigious during the bankruptcy proceeding may be liable for the association's attorney fees under the Bankruptcy Code.

These are just some of the pitfalls involved for associations when an owner files bankruptcy. The most important points are to not ignore an owner's bankruptcy notices and make sure to act quickly to avoid the waiver of any rights that an association may have.

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