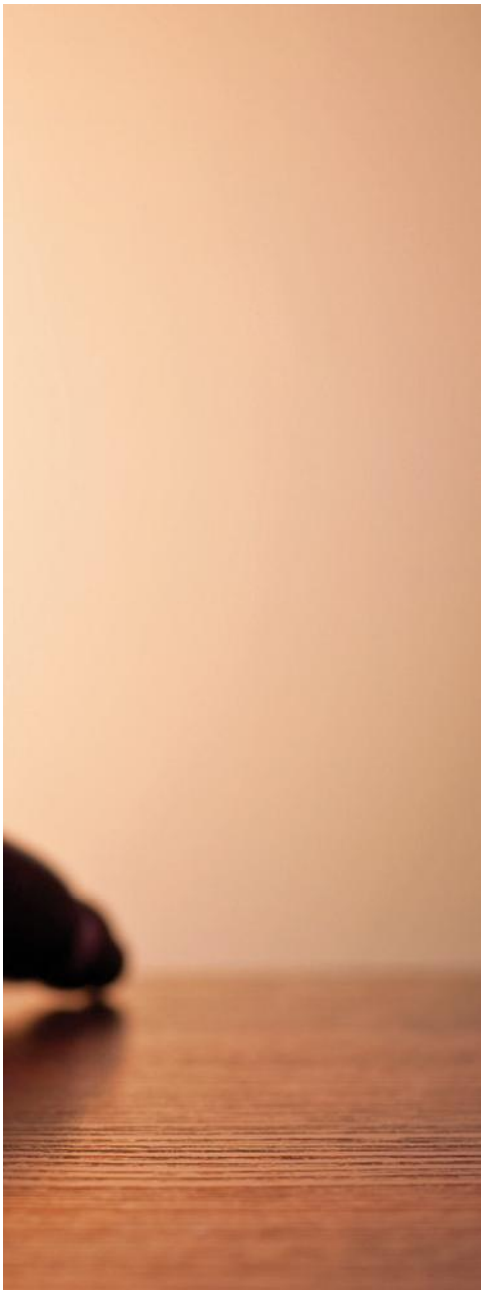
Lien Stripping

ASSOCIATIONS NEED TO KNOW THEIR RIGHTS

BY JEFFREY S. BERLOWITZ

As the housing market in Florida continues to recover from the foreclosure crisis, community associations are facing significant challenges with unit owners who file for personal bankruptcy and utilize what is known as the "lien stripping" provisions of the bankruptcy code to avoid pre-bankruptcy assessments that are due to their associations. If approved by the bankruptcy court, bankruptcy laws enable debtors in bankruptcy to wipe away second mortgages, lines of credit, and association liens tied to



JEFFREY S. BERLOWITZ, SIEGFRIED, RIVERA, HYMAN, LERNER, DE LA TORRE, MARS & SOBEL, P.A.

Jeffrey S. Berlowitz is a shareholder with the law firm of Siegfried, Rivera, Hyman, Lerner, De La Torre, Mars & Sobel, P.A., which maintains offices in Coral Gables, Fort Lauderdale, and West Palm Beach and focuses on all aspects of community association matters, construction law, real estate, and corporate law. Berlowitz focuses on bankruptcy, creditor's rights, reorganizations and workouts, and commercial litigation, and he has represented secured creditors in bankruptcy cases in many jurisdictions throughout the United States. Visit **www.srhl-law.com**, call toll-free at (800) 737-1390, or e-mail JBerlowitz@srhl-law.com.

their real property if they are able to prove to the court that they owe more to their first mortgage lender than what their home is worth as of the day they filed for bankruptcy relief.

Sometimes called a personal reorganization bankruptcy, a Chapter 13 bankruptcy is an individual repayment program that is typically utilized by individuals who have fallen behind in their mortgage payments and seek to save their homestead property over a three- to five-year period of time via a court-approved repayment plan. In doing so, the debtors must use their disposable income to catch up on their mortgage arrears while at the same time pay their regular monthly mortgage payment going forward, pay outstanding IRS obligations, if any, and pay a portion of their unsecured obligations (i.e., credit card debt or medical bills), depending on the scope of the debt and income. Those who qualify for Chapter 13 must propose a detailed repayment plan that is subject to review and objection by the Chapter 13 Trustee assigned to administer the case as well as by the creditors (including an association) and must ultimately be approved by the court.

With regard to associations, most owners who file for Chapter 13 are striving to save their home from foreclosure. However, what is becoming more prevalent with bankruptcy filers who reside in community associations is the taking advantage of a debtor-friendly component of the bankruptcy laws affording a debtor the right to "strip off" second mortgages, lines of credit, and association liens in the event that the debtor evidences to the court that the value of their unit is less than the amount due on their first mortgage. If successful, then the unit owner may receive the benefit of a complete avoidance of an association's lien claim in the amount that existed as of the date of the bankruptcy filing; ultimately a remarkable benefit to a debtor and a potentially harsh outcome to the community association.

In order to gain the benefit of the lien stripping laws and the avoidance of the owner's obligations to the association in the amount outstanding as of the day of the bankruptcy filing, the owner must complete their Chapter 13 bankruptcy plan by remitting all payments due under the plan to the bankruptcy trustee administering the case and receive a Chapter 13 discharge. If the owner's Chapter 13 case is dismissed for any reason or if the case is converted to a Chapter 7 liquidation (usually because the owner could no longer afford the Chapter 13 plan payments), then the association's lien will not be stripped off

but will be reinstated against the unit. Importantly, and as some consolation to the association, the owner remains liable to the association for all assessments that come due after the bankruptcy filing, even if a lien stripping action is in place. In other words, if the owner is maintaining the unit in either Chapter 7 or 13, then the owner is liable for all assessments that accrue against the unit after the bankruptcy filing date (please note that lien stripping is available to Chapter 7 debtors, but lien stripping actions are much more active in the Chapter 13 setting).

Associations should be well advised that an owner's intentions to lien strip an association claim does not mean that the association cannot challenge or object to the owner's effort to avoid the association's lien. My colleagues and I have assisted associations in overcoming lien stripping efforts by debtor owners notwithstanding the debtor-friendly law supporting lien stripping. This is accomplished by countering the owner's value of their home with an appraisal procured by the association demonstrating that the value of the unit at the time of the bankruptcy filing was greater than the amount due under the owner's first mortgage. Simply stated, this is an "all-or-nothing" deal: If the bankruptcy court determines that the unit maintains even just a single dollar of equity, then the owner will be required to cure all arrears due to the association over the life of the bankruptcy plan. Should the court find that the unit is underwater and lacks equity, then the owner will be in a position to carry out the bankruptcy plan to strip off the amount due to the association as of the day in which the bankruptcy case was filed. Given the risk associated with going before the bankruptcy court in this all-or-nothing lien stripping venture, wherein the bankruptcy judge will make a finding on the unit's value that will inure entirely to the benefit of either the association or the debtor/owner, often the parties will amicably resolve the matter wherein the association agrees to accept a portion of the arrears paid through the bankruptcy plan by the debtor/owner, as opposed to having the association's lien avoided entirely. However, should the matter proceed to a valuation hearing before the bankruptcy judge, no matter the findings of the court, an owner remains liable to the association for all regular monthly maintenance assessments as well as any special assessment that come due after the day the bankruptcy case was filed.

ASSOCIATIONS SHOULD APPRISE THEMSELVES OF THEIR RIGHTS AS A CREDITOR IN THE BANKRUPTCY CASE AND UNDERSTAND THAT THE FILING OF BANKRUPTCY BY A UNIT OWNER DOES NOT AUTOMATICALLY RESULT IN A LOSS TO THE ASSOCIATION.

Additionally, and as a related event connected to the craze of the foreclosure crisis in south Florida over the last several years, associations are finding that investors (a.k.a. "third-party buyers") are positioning themselves to purchase units in foreclosure. Florida Statutes governing associations provide that a "subsequent owner" is liable to the association for the prior owner's outstanding maintenance obligations. Notwithstanding, these third-party buyers who purchase a unit out of foreclosure that was formerly owned by an individual who filed for bankruptcy relief have creatively argued that they should get the benefit of the prior owner's bankruptcy discharge or, in certain circumstances, the prior owner's avoidance of the association's lien via the lien stripping action and, therefore, are not liable to the association as the subsequent owner for the prior owner's liabilities that were released through the bankruptcy case.

Those arguments have failed. Recent court decisions favor associations that lose certain of their lien rights against bankrupt owners and then attempt to collect the past-due assessments from the subsequent buyers of the properties. In a case that was decided by one of the local bankruptcy judges in the Southern District of Florida earlier this year, the court determined that even if an owner strips off a condominium association lien because the unit lacks equity and that individual is ultimately released from their pre-bankruptcy personal obligations to the association, the subsequent owner will not receive the benefit of the prior owner's lien strip and will remain liable to the association for the prior owner's unpaid assessments that were due at the time title to the unit transferred to the subsequent owner. In other words, no matter what a unit owner in

bankruptcy accomplishes in their bankruptcy case with respect to their liability for association assessments, nothing can impact a subsequent owner's personal liability for the unpaid assessments and nothing in the prior owner's bankruptcy impacts the association's right to pursue payment from that subsequent owner.

Similarly, in a case in which I represented a community association, a successful third-party purchaser at the prior owner's foreclosure sale argued in state court that it was not liable for the prior owner's unpaid assessments because the prior owner filed bankruptcy and received a personal discharge from his monetary obligations to the association. The new owner asked the court to give it the benefit of the prior owner's bankruptcy discharge and the resulting avoidance of the prior owner's personal liability to the association for unpaid assessments. I successfully demonstrated to the court that the bankruptcy discharge had no legal bearing on the statute assigning liability for past unpaid assessments to the new subsequent property owner. The court concurred and issued a summary judgment in favor of the association and ruled that the subsequent purchaser does not receive the benefit of the prior owner's bankruptcy discharge.

The lien stripping provisions of the bankruptcy code have definitely taken a financial toll on many community associations throughout Florida. Thankfully for the associations, these recent rulings by a state circuit court judge and a Southern District of Florida bankruptcy judge should provide some clarity that the courts are not going to exacerbate the damage that lien stripping brings upon an association by affording to the subsequent buyers the benefit of the prior owner's accomplishments in bankruptcy court.

For community associations, it has become imperative that they not shy away from actions taken by an owner in a bankruptcy case seeking to avoid an association lien. To the contrary, associations should apprise themselves of their rights as a creditor in the bankruptcy case and understand that the filing of bankruptcy by a unit owner does not automatically result in a loss to the association. Associations have rights in bankruptcy court, and they should seek the advice of experienced counsel in asserting those rights. ■