

The HOA Mini Report is a quarterly newsletter providing news of legal developments of interest to Homeowners Associations throughout Eastern Washington. If you have any comments or suggestions, would prefer to receive this report by email, or would prefer not to receive this newsletter in the future, please contact me at [nick@gnbergh.com](mailto:nick@gnbergh.com).

This issue of the HOA Mini report covers:

1. *Capital Reserves*. Recent amendments to the Washington Homeowners' Associations Act authorize HOAs to collect reserves to cover significant capital expenses, beginning in 2012.
2. *Foreclosures and HOA Assessments*. Novel legal techniques to minimize loss of HOA dues during bank foreclosures.
3. *Maintaining HOA Corporate Status*. Avoid involuntary dissolution of your HOA corporation by filing required paperwork.

**1 Capital Reserves.** HOAs are often required to maintain roads, storm water run-off systems and other utilities and facilities within the development. The costs of maintaining and replacing this common area infrastructure can be significant, particularly when, as is usually the case, the HOA dues structure requires regular assessments to cover only basic operating costs and special assessments to cover extraordinary expenses. Unless reserves are collected to cover extraordinary expenses, the resulting special assessments can be huge; affected homeowners may refuse to authorize the expense or be unable to pay the assessment.

Recent amendments to the Washington Homeowners' Associations Act, effective January 1, 2012, require certain HOAs to prepare reserve studies and authorize HOAs to establish reserve accounts to fund major maintenance, repair, and replacement of common elements.

HOA's are exempt if there are 10 or fewer homes in the association; the cost of the reserve study exceeds 5 percent of the HOA's annual budget; or the HOA does not possess "significant assets." An HOA has significant assets if the current replacement value of the major reserve components is 75 percent or more of the HOA's gross budget, excluding reserve account funds.

The initial reserve study must be prepared by a reserve study professional based on a visual site inspection. The study must be updated annually, using professional assistance every third year based on a visual site inspection. If no reserve study is prepared for three years, a vote of 35 percent of the HOA membership may demand that a reserve study be conducted in the next budget year. If the demand is ignored, the members may file suit to require the study and are entitled to recover their attorney's fees.

HOAs are encouraged, but not required, to establish reserve accounts, supplemental to the annual operating budget, to fund major maintenance, repair, and replacement of common elements. HOAs must disclose information to owners regarding reserve accounts and reserve studies with the summary of the annual budget.

The deadline for beginning compliance with this new law is fast approaching. If you would like a copy of the new law, drop me a line at the email address above, and I would be happy to send it to you.

**2. Foreclosure.** Bank foreclosures are increasingly causing problems for HOAs by interfering with the collection of dues necessary to operate and maintain common areas. Homeowners in financial straits usually stop paying their HOA assessments before they stop paying their mortgages. When assessments go unpaid the burden falls on the other homeowners in the association. Moreover, HOA documents almost invariably provide that first mortgage loans are superior in priority to HOA assessments. This allows banks to refuse to pay assessments falling due prior to and during the bank's foreclosure.

To make matters even worse, sometimes banks delay foreclosing because of problems with their mortgage paperwork, because they don't want the property in their inventory, because they don't want to repair the property or because they don't want to pay assessments until they can resell the property.

Standard practice for HOA's is to file liens for delinquent assessments, to advise foreclosing banks of delinquent assessments during a foreclosure, and to demand payment of assessments falling due after completion of a bank's foreclosure. Banks often refuse to pay any pre-foreclosure delinquent assessments and may attempt to delay payment of post-foreclosure assessments until the property is sold. HOAs are often reluctant to foreclose on delinquent assessments because the bank's foreclosure will eliminate the HOA's lien claim. The net effect of this is to squeeze HOA finances and force other homeowners to pick up the shortfall in assessments for protracted periods.

Recently, several novel techniques to deal with this downward spiral have been developed in Florida. The first, dubbed a "reverse foreclosure," may work in situations where a bank has begun a foreclosure but is delaying completing the process. The HOA forecloses on its own lien for the unpaid assessments and obtains title to the property. Even though the HOA can't sell the property because the bank's lien is in the way, the HOA (now the owner of the property) can ask the court to enter immediate judgment in the bank's foreclosure, waive public sale and redemption rights, thereby forcing the bank to take title to the home and become responsible for paying assessments.

A variation on the reverse foreclosure may be available where the bank has delayed its foreclosure for an unreasonable period. The HOA, after foreclosing on the original homeowner, asks the court to determine that the bank is unfairly delaying its own foreclosure and for an order compelling the bank to proceed with its foreclosure or lose its mortgage. In several of the cases utilizing this variation, the bank has simply failed to defend and allowed an order to be entered eliminating its mortgage.

A second tactic, called the "mortgage terminator" can allow the HOA to foreclose its assessment lien and obtain full title to the property in cases where the property has very little value, often because it has been abandoned and needs extensive repairs. The effectiveness of this tactic depends not on any action taken by a judge, but rather on the willingness of the bank to make a business decision to simply walk away from the property and its mortgage, and avoid the cost of foreclosing and repairing the property. If the tactic is successful, the HOA may be able to resell the unrepaired property for enough to cover unpaid assessments and foreclosure costs, while at the same time eliminating a blight in the neighborhood.

These strategies may be available in Washington, given proper circumstances.

**3. Maintaining Corporate Status.** Every year some HOAs fail to file required paperwork, causing the Secretary of State to administratively dissolve their corporations. Often this happens because the person originally chosen to serve as registered agent for the HOA moves away, or fails to realize that action must be taken every year to maintain HOA corporate status. It is fairly easy to have the corporation reinstated if corrective action is taken within three years.

The consequences of loss of corporate status can be severe. If a corporation no longer exists, it cannot file actions to enforce covenants or collect assessments, and if this persists for a long time, the covenants may become unenforceable. The corporation remains liable for its actions for several years after it is dissolved, and may have judgment entered against it without its knowledge if its registered agent is no longer present. Title to common area property owned by the HOA may become clouded. Resolving any of these issues could be difficult and expensive.

Fortunately, maintaining corporate status is neither difficult nor expensive, and professional assistance is readily available. Many law firms will act as registered agent and several companies are also available to perform this service. Taking advantage of this professional service will ensure that your corporate paperwork does not fall through the cracks, and that your HOA receives notice of any actions that may be filed against it. Please feel free to contact me at the email address above if you would like more information on maintaining corporate status.

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This newsletter is not a substitute for legal advice. Please consult with your legal counsel for specific advice and information.

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