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MEMORANDUM

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DATE: February 28, 2008

TO: Managers and Board Members

FROM: James H. Hazlewood, Esq.
Javier B. Delgado, Esq.

RE: Some Solutions for Your Association's Collections Challenges in This Down Economy

We are writing this memorandum as a tool for Community Managers and Board members alike. First, even though it may be obvious, we want to remind you that the housing market and the overall economy have taken a turn for the worse. As your community is an Association of home and unit owners, the troubled housing market has a financial consequence for all of us.

Historically, in better markets, many of our Association clients did not work too hard nor did they spend too much money to collect delinquent assessments. Delinquency rates were relatively low and most often delinquent owners paid delinquent accounts when the property was sold or re-financed. Gone are the days of frequent sales and refinances. Today's market is different and those delinquent owners must be reminded of their obligation to your Association in different ways.

Please understand this first and most important point: your Association is experiencing the impact of market woes and other economic conditions. The delinquency rate in your community has little or nothing to do with you or management – it has everything to do with market forces. There are obviously some things that you and your Association can do to react to these market influences. Hopefully this memorandum will help you understand those choices.

The big question for all of you is how can you change your collection strategies and how can you rework your collection tools to respond to the market forces? Ironically, the simplest and best advice we can give in this market is to **be aggressive and be consistent**. Ironically, these are the general models for success even when economic conditions are better. In this memorandum, we hope to give you some helpful tips in being more aggressive and in being consistent with collections. In addition, we hope to dispel some of the myths about other collection models that may seem attractive to you in this market. Please understand that this memorandum is for informational purposes only and is not specific legal advice for your Association. There are aspects of our helpful tips that may be document specific – in other words, we can only best tailor our advice to your community if we have incorporated references to your Association's governing documents. But many of these tips and principles can be helpful for all.

Tip #1 – Don't Use Foreclosure as Your Only Collection Method

The Association's assessment lien is a powerful thing. The threat of foreclosure is a great tool in the collections tool box. However, as you are aware the legislature changed the rules with regard to foreclosure – Associations must now wait one year or until the owner's debt reaches \$1,200 before filing an assessment lien foreclosure lawsuit. For many associations waiting for that one year or \$1200 threshold to occur could be costly.

An owner owes assessment debt personally as well as it being secured by the lien on the property. Therefore, it can be more efficient and cost effective to file a Justice Court lawsuit to collect assessments against the owner personally. A judgment against an owner for delinquent assessments can be collected in many ways. Wage and bank garnishment are possibilities. These lawsuits can be filed long before the one year/\$1200 threshold. We find that Associations that use the personal money judgment route first are always more successful than waiting to hit the foreclosure thresholds.

Tip #2 – Use Foreclosure When Necessary

The threat of foreclosure is a great tool, but many Associations are afraid to make that decision. In this market, if a personal money judgment is unsuccessful or if the delinquency is already at the legal threshold, foreclosure is the best collection option. Do not hesitate to consider this option when the facts and the legal threshold are met. Rarely do our clients become the successful bidders at their own foreclosure sheriff's sale, although it is occurring more often as equity

levels have dropped, making bidders less interested at such sales. Most often, the threat of foreclosure or the Association's act of filing the lawsuit is enough to encourage the owner to pay the outstanding debt or negotiate a payment schedule. Again, if the legalities and the facts warrant considering foreclosure, it is always our advice for an Association to consider this collection tool.

Tip #3 – A Notice of Trustee Sale Should not Stop nor Delay Your Collection Activity

Lender/bank trustee sales (foreclosure) are obviously a problem for homeowners in this market. But there are many trustee sale notices that are recorded that do not result in a sale. This means that many owners who find themselves in a situation with a delinquency on their first mortgage find a way work it out with the lender/bank and keep the property. Many Associations have incorrectly decided to wait out trustee sale notices to see if the owner loses the property. This is generally not a wise decision. There certainly is some risk in moving forward to collect assessments against an owner that may one day lose the property, but there are ways to collect against a delinquent owner either before the sale date or even after the sale has been completed. The trustee sale (first mortgage) does legally extinguish the Association's lien for assessments, but that does not necessarily mean that the debt is uncollectible. The owner's personal obligation is not extinguished (absent a bankruptcy discharge).

Tip #4 – Banks are Owners Too

If the owner does lose the house to a trustee sale and the bank takes ownership, the bank is an owner and owes the assessments. Do not be afraid of enforcing the documents and pursuing collection against banks. If the bank does not pay voluntarily, treat them like any other delinquent homeowner. They tend to want to behave like they do in up economies, when resales happen quickly and assessments are just paid out of the next escrow/sale. Also, if the bank owns because of foreclosing on its first mortgage, the property is "free and clear", and the threat of lien foreclosure by the Association is a real threat.

Tip #5 – Tighten Up Initial Deadlines and Be Aggressive

In years past, collections happened more frequently upon a sale or a refinance. Now, your Association's collection policy that establishes a series of courtesy letters and deadlines may give the owner too much time. If the documents do not prohibit shorter deadlines, perhaps the Board should consider changing its collection deadlines so that collection activity (recording liens, attorney action, etc.) can begin sooner. This kind of aggressive collection practice will be helpful in pursuing owners. The sooner the Association can begin serious collections

activity the more likely the Association (and its attorneys) will be successful. In this market, time may be your Association's biggest enemy. Owners invariably want to pay, but the larger you allow the balance to get, the harder it is for them to pay.

Tip #6 – There is No Such Thing as “Free” Collections

Because of the cost of collections, many Associations and Board members like you have asked for other options to help with the expense of attorneys' fees and costs. There are other law firms or collection agencies that advertise a “no cost” way of collection owner assessments. But there really is no such thing as “no cost.”

The collection agencies generally ask you to give them a percentage of what they collect. This means that if an owner owes \$300 in assessments, the agency will collect the \$300 (perhaps) and take \$100. This method may or may not be effective in collecting money, but because of a Board's duty to collect assessments, the Board may be in breach of that duty by not collecting all the assessments, i.e. by giving up principal. This means that all of the other assessment paying owners have to shoulder the expense of those owners who partially pay. The collection efforts may not cost the Association anything, but what is collected costs everyone else. Moreover, in our many years of experience, (1) collection agencies have not been successful for associations in Arizona, and (2) they are only useful for “former owner” situations, where the debt is not growing and getting part of the principal may be a valid business decision.

Then, there are law firms that advertise no cost collections as they collect their fees “from owners” directly. While this may be an attractive option as it reduces the “up front” costs, this system is flawed in several ways. First, when comparing pricing, an owner that receives and pays his assessments (plus the fees) upon receiving the first attorney demand letter pays the assessment and almost \$300 in attorneys' fees (based on what we know of such arrangements) to such firms. The delinquency, which is often small at first, can easily be eclipsed by the cost. In this situation, as a delinquent owner may be asked to pay an attorney fee that is three times the normal fees for such a letter.¹ The “no fee” system is actually incredibly costly for homeowners. Even though these owners are delinquent, they are still your neighbors and the Board's desire to reduce collection costs should not be borne by the backs of the owners – especially not at three times

¹ Our firm charges \$125 for our initial demand letter. Ultimately, our firm is 93% successful in collecting our attorneys' fees for our Association clients. In addition, there are more than 50% of owners that pay their delinquent assessments after that first demand letter.

the normal rate. In the “free” system, we have all too often watched as Boards complain that “free” collections do little more than cause delinquency rates to increase, because these law firms have the incentive to run up their own fees and collect nothing for you, their client Associations. If the result is nothing collected, the “free” ride has resulted in your being months behind in legitimate collection efforts.

Finally, read your attorney’ fees agreement and rate information carefully. The law and the rules that regulate lawyers require that you as the client are free to choose any lawyer you wish. But in many of these “free” collection agreements, you as the client must agree to a termination clause that allows the lawyer to send you a huge bill when you fire that firm. There is a lawsuit pending in Maricopa County Superior Court in which one such firm has filed suit against its former clients for this reason. Reading the “free” collections agreement is important and understanding how your attorney/client relationship works is critical in these challenging collections times.

Again, there is no such thing as “free” collections as these programs ultimately cost you and your homeowners more money that they should. Law firms such as ours get paid for collections on an ongoing basis because of our track record of success and our experience, just as you would pay any contractor.

Conclusion of the Matter

We are aware that this is a challenging time for your Association. But please make sure that you focus your frustration on the true culprit: market forces beyond your control. Circumstances are the cause, but we are hopeful that our memorandum has given you some good ideas about how to confront those circumstances. If you are a Board member, please ask your management company for assistance or contact our office to discuss ideas about tackling your Association’s delinquency issues.