

BANKRUPTCY OF OWNERS AND EFFECTIVE ASSOCIATION ASSESSMENT COLLECTIONS

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Bankruptcies of Owners are Challenging for Associations

Collection issues are particularly challenging to owner associations when an owner files for bankruptcy.

Owners can file 3 different ways for bankruptcy under federal law

- Chapter 7 (liquidations)
- Chapter 11 (for companies only – for a plan or payment over time)
- Chapter 13 (a plan for payment over time)

Most owners file a Chapter 7 (liquidation). Some owners file a Chapter 13 (a plan for repayment over time).

This article reviews the effects of bankruptcy filings by owners and effective collection options for owner associations when an owner files a Chapter 7 or a Chapter 13 bankruptcy.

Bankruptcy filing by an owner stops all pending collection efforts

Once an owner files bankruptcy, an "automatic stay" or injunction is deemed issued, to stop all collection efforts. All collection lawsuits and efforts against the owner must stop (be stayed).

Chapter 7 Bankruptcies

A Chapter 7 bankruptcy is liquidation. It is utilized by owners when the owner has little or no equity or other assets. Any 'non-exempt' asset or property with equity or value is sold by a bankruptcy trustee and the proceeds are used to pay creditors.

Most owners who file Chapter 7's do not have any 'non-exempt assets' and/or have little or no equity in their home. So, there is nothing to liquidate. In these 'no asset' cases, the owner may 'surrender' their home to their lender. The lender can then proceed to foreclose on the owner, to obtain title to the property. Then, the owner association is required to write off or discharge the pre-petition assessments due (the petition being the filing date of bankruptcy by the owner). Post-petition assessments remain a personal obligation of the owner. The first lien lender forecloses, the owner remains liable to the Association for assessments; yet, post-petition assessments cannot be pursued by the owners association until the bankruptcy is closed or the owner association gets permission from the bankruptcy court (known as "relief from automatic

stay”). Even then, these post-petition assessments, are typically difficult to collect. As a practical matter, post-petition assessments, in a 'no asset' Chapter 7, are typically written off.

If an owner has filed a Chapter 7 and surrenders or vacates occupancy of the home, the owner association is required to write off or discharge the pre-petition assessments.

If an owner has filed a Chapter 7 but wants to keep the home, the owner will receive a 'discharge' from the bankruptcy court, if they complete their bankruptcy or take it to its conclusion. With a discharge, the owner is no longer personally obligated to pay the pre-petition assessments. However, those pre-petition assessments remain secured by the owner association's lien. The owner is also personally obligated to pay post-petition assessments. Yet, post-petition assessment cannot be pursued by the owners association, until the bankruptcy is concluded or the owner association gets permission from bankruptcy court (known as relief from the automatic stay).

When an owner who has filed a Chapter 7 has equity in a home and is not planning to keep the home, the home is liquidated (sold) by the bankruptcy trustee and the owner association would be paid in full (pre and post-petition assessments). This sounds good, but rarely occurs.

Chapter 13 Bankruptcies and Assessment Collections

In a Chapter 13, the owner files a plan (for paying creditors over time). The plan should cover repayment of pre-petition assessments (with interest) over an extended period of time, usually 3 years. If the plan does not address paying pre-petition assessments, the association can object to the plan. The plan is subject to approval by the bankruptcy court.

In the plan even before it is approved, the owner begins making monthly payments to the Chapter 13 Trustee. That trustee then distributes the funds according to a plan, once approved by the bankruptcy court. One of the tests or requirements of a plan, and the approval required to be obtained from the bankruptcy court, is that the amount of the debts to be paid must be more than what unsecured creditors would have received under a Chapter 7 filing by the owner.

During the repayment period of the plan, the owner association is prevented from requiring payment directly from the owner for assessments incurred before the bankruptcy filing ("pre-petition assessments"). If the plan is not adequate, the owner association can object to the plan, and seek to have the case dismissed or relief from the automatic stay granted so that collection can resume.

Owners who file Chapter 13's are also required to pay assessments that accrue after the owner filed for bankruptcy. These post-petition assessments are a personal obligation and cannot be discharged by the bankruptcy, since the bankruptcy only relates to the debts the owner had on the date they filed. Yet, to pursue post-petition assessments, relief from the bankruptcy must be

obtained, or the association can proceed if the case is closed or the Chapter 13 bankruptcy is dismissed.

Owner Association Liens and Bankruptcy of an Owner

Owner association liens are not affected by an owner's bankruptcy and remain in place against the property, if the owner keeps the property. If the owner surrenders the property, and then the first lien lender forecloses or abandons possession of the property, the owner association's lien (except the 'super lien') is lost.

Changes in Bankruptcy Law under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

Congress made changes to bankruptcy laws in 2005, making bankruptcies slightly less favorable to owners, and with slight better results for owner associations. The changes made post-petition assessments non-dischargeable, unless the property is abandoned. Owners filing for bankruptcy are required to meet a "means" test (a test that compares monthly qualified expenses to income and other required factors).

Effective Collection from Owners in Bankruptcy

Bankruptcies of owners and their effect on owner associations are technical and confusing. Yet, we know, from collection experience, it is the 'squeaky wheel gets the oil.'

This all leads to the conclusion that owner associations must be proactive and aggressive in collecting assessments, including when an owner is in bankruptcy. When an owner files bankruptcy, the owner association should be aware of the issues and technicalities reviewed above.

For the best collection results, owner associations and management should consult with knowledgeable and aggressive owner association attorneys.