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Lenders' Rights Under Threat in Nevada: the Nevada Supreme Court Rules That Homeowners Association Liens Can Extinguish First Deeds of Trust

Article By:

Jacob D. Bundick

In a September 2014 ruling, the Nevada Supreme Court held that a homeowners association's (HOA) non-judicial foreclosure sale can extinguish a mortgage lender's previously-recorded first deed of trust on a property if that foreclosure is to recover assessments categorized as super priority amounts (or nine months of regular assessments, plus any amounts required for abatement) as set forth in Nevada Revised Statute (NRS) 116.3116. SFR Invest. *Pool I, LLC v. U.S. Bank, N.A. et al.*, 334 P.3d 408 (Nev. Sept. 18, 2014). Using ambiguity in NRS 116 and the recent SFR Invest ruling, HOAs have been proceeding with foreclosures of assessment liens, selling properties at auction for amounts typically between $3,000 and $25,000 total, often to third party purchasers / investors. The winning bidder at the foreclosure sales are filing quiet title actions, claiming to own the properties free and clear of all other liens, including lenders' previously-recorded first deeds of trust on the property. If the HOA lien is foreclosed upon, Nevada law provides that any action for a deficiency judgment against the borrower must be commenced within six months of the initial foreclosure sale. Therefore, any lender who has lent money secured by a deed of trust on real property in a community association is at risk of losing its security interest if the HOA forecloses on a lien. In addition, if the lender does not take prompt action, it could also lose its right to pursue a deficiency against the borrower. NRS 40.4639 (providing junior lien holders must seek action on note within six months of a foreclosure sale).

There are a number of bases on which lenders can defend a claim by the HOA or third party purchasers that the HOA lien extinguished a first priority deed of trust.

- If the secured loan is an FHA loan, Federal Courts have held that Nevada law cannot be interpreted to extinguish the deed of trust. In *Washington & Sandhill Homeowners Assoc. v. Bank of Am. N.A. et al.*, No. 13-cv-01845-GMN-GWF (D. Nev. Sept. 25, 2014), an HOA, relying on its super-priority lien, foreclosed on a property that was subject to a mortgage insured by the federal Department of Housing and Urban Development (HUD) pursuant to its Single Family Mortgage Insurance Program (SFMI Program). The federal district court found that federal law, not state law, governs federally insured mortgages and that state law cannot prevent HUD from acquiring title to an insured property pursuant to the terms of the SFMI Program. It thus held that the HOA's foreclosure pursuant to NRS 116.3116 was preempted and invalid. The HOA appealed this ruling to the Ninth Circuit Court of Appeals.

- HOAs often fail to follow Nevada's procedural rules regarding serving the notice of default to the lender, allowing the lender opportunity to cure. If the lender does not receive proper notice, a claim for wrongful foreclosure could invalidate the HOA's foreclosure sale.

- HOAs often refuse to provide lenders with any payoff quote for super-priority amounts, even when the lender makes a specific request. As a result, lender's due process rights are being denied when HOAs proceed with foreclosure.

- Further, HOAs' CC&Rs typically contain a mortgage savings clause that provides that no HOA assessment shall take priority over a first deed of trust. Lenders are filing breach of contract claims against the HOA for failing to honor this clause.

Even if an HOA foreclosure has not yet occurred, lenders should take immediate action to protect their interests in any first deed of trust.

Lenders must proceed with caution in Nevada and act promptly to preserve their rights against an HOA claiming delinquent assessments. The firm's Las Vegas office is uniquely prepared to assist lenders in auditing their loan portfolios and addressing issues that arise on loans secured by real property in Nevada.

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