

SUBJECT: Revising foreclosure procedures for property owners' associations

COMMITTEE: Business and Industry — committee substitute recommended

VOTE: 9 ayes — Brimer, Dukes, Corte, J. Davis, Elkins, George, Giddings, Solomons, Woolley

0 nays

SENATE VOTE: On final passage, April 2 — voice vote

WITNESSES: For — Jude Wiggins, Cypress Creek United Civic Associations and Rolling Fork Owners Committee; Jim Windsor, Lakewood Forest Fund

Against — None

On — Geneva Kirk Brooks, American Veterans in Domestic Defense and Property Rights Foundation

BACKGROUND: State law provides little authority to regulate land use and development in unincorporated areas outside cities. In some small rural counties with no incorporated cities, the county may provide services such as garbage collection or maintenance of parks and recreation areas. Larger counties with many residents in unincorporated areas, such as Harris County, may rely on volunteer fire departments and sheriff's or constable's offices to provide emergency services. In many cases, homeowners associations — typically nonprofit groups governed by representatives of subdivision owners — provide street lighting, garbage and recycling services, maintenance of common areas, and other community improvements.

Inside the city of Houston, which lacks a zoning ordinance, homeowners associations may develop and enforce limited land-use regulation through deed restrictions and other covenants. Homeowners associations typically require property owners to pay assessments and other fees to provide for public services and other improvements.

Nationwide, more than 40 million people live in areas regulated by more than 205,000 condominium, cooperative, and homeowners associations.

Under Art. 16, sec. 50 of the Texas Constitution, residence homesteads can be subject to foreclosure for failure to pay taxes, mortgages, and liens for repairs and renovation of the property. The Texas Supreme Court held in *Inwood North Homeowners' Association, Inc., v. Harris*, 736 S.W. 632 (Texas 1987) that the homestead law does not protect homeowners against foreclosure for failure to pay assessments.

In 1993, the 73rd Legislature enacted the Uniform Condominium Act (Property Code, chapter 82) to regulate the creation and management of this type of real estate, in which portions are designated for separate ownership or occupancy and the rest of the property is designated for common ownership. Property Code, sec. 82.0113 allows the condominium association to assess a lien for unpaid assessments and to foreclose a homestead to collect those liens. This section also gives the homestead owner the right to redeem the condominium unit within 90 days by paying the delinquent assessment and other expenses associated with the foreclosure.

Texas Constitution, Art. 8, sec. 13 creates a right of redemption by former owners of residence homesteads sold for unpaid taxes. Tax Code, sec. 32.06(i) provides that an owner, or the holder of the first lien, of a property foreclosed and sold for the repayment of taxes can redeem the property within one year after the date the property is sold by paying the purchaser the tax-sale purchase price, plus costs, and interest accrued from the judgment to the date of redemption, or 118 percent of the amount of the judgment, whichever is less.

DIGEST:

CSSB 507 would enact the Texas Residential Property Owners Protection Act. It would define a property owners' association, regular assessment, and restrictions; require recording of a management certificate; provide for notice and other procedures for enforcement actions, including foreclosures; and establish a right of redemption after foreclosure. It would not apply to condominium associations governed by Property Code, chapter 82.

Definitions. CSSB 507 would define a property owners' association as an incorporated or unincorporated association that:

- ! is the designated representative of property owners in a residential subdivision;
- ! has a membership primarily consisting of property owners covered by the subdivision's dedicatory instrument — restrictions, covenants, bylaws, and other rules and regulations; and
- ! manages or regulates the residential subdivision for the benefit of the property owners.

The bill would apply to any residential property owners' association, whether its dedicatory instrument designated it as a homeowners association, community association, or similar designation.

Regular assessments would be defined as any assessment, charge, fee, or dues that property owners pay to the association on a scheduled basis. Special assessments would be defined as assessments, charges, fees, or dues paid for a construction or reconstruction project, unexpected repairs, other capital expenses, maintenance and improvement of common areas, or other purposes stated in the association's articles of incorporation or dedicatory instrument.

The bill would define restrictions as restrictive covenants contained or incorporated in a properly recorded map, plat, replat, declaration, or other instrument filed with real property records or map or plat records.

Management certificates. CSSB 507 would require a property owners' association to record a management certificate in each county where the subdivision was located. The management certificate would have to include the names of the subdivision and association, the recording information of the subdivision and the declaration, mailing address of the association or its manager, and any other appropriate information.

Records. Association records and books, including financial records, would have to be available to property owners as required by the Texas Non-Profit Act (Art. 1396-2.23, V.T.C.S.). However, the bill would exclude attorney's records and files from this open records requirement.

Notice requirement. CSSB 507 would require a notice to a property owner before the property owners' association could suspend the owner's right to

use a common area; file suit, other than to collect a regular or special assessment or foreclose a lien; charge for property damages; or levy a fine for a violation of restrictions or bylaws.

The notice would have to describe the alleged violation or property damage, state an amount due for the violation, and inform the property owner of the right to remedy the violation, unless the property owner had been given notice and reasonable opportunity to correct a similar violation within the past 12 months. Property owners would have to be informed of their right to request a hearing within 30 days after receiving the notice.

Hearing procedures. CSSB 507 would allow a property owner to submit a written request for a hearing before a committee appointed by the property owners' association's board or before the full board. The hearing would have to be held within 30 days of when the board received the request for the hearing, and both the board and the property owner would have to be allowed to request a postponement of up to 10 days. Additional postponements could be granted by an agreement of both parties. The board could make an audio recording of the hearing.

The hearing process would not apply if the property owners' association filed suit seeking a temporary restraining order, temporary injunctive relief, or foreclosure. The property owner or the property owners' association could file a motion to compel mediation. The parties also could use an alternative dispute-resolution service.

The property owners' association could suspend a property owner's right to use a common area temporarily without a hearing for a violation that occurred in the common area and that posed a significant and immediate risk to the property owner or others.

Attorney's fees. CSSB 507 would allow the property owners' association to collect reasonable attorney's fees only if the owner received a notice of the attorney's fees and costs that would be charged if the delinquency or violation continued. A property owner would not be liable for any attorney's fees and charges incurred by the property owners' association if those fees were expenses before the hearing or if the property owner did not request a hearing. All attorney's fees, charges, and other money collected from the

property owner would have to be deposited in a special account at the association's financial institution, and the property owner would have the right to review invoices for attorney's fees and other costs related to the property owner's case.

The bill would limit the amount of attorney's fees included in an assessment lien to the greater amount of one-third of all actual costs and assessments, excluding attorney's fees, plus interest and court costs, or \$2,500. The bill would not prevent the property owners' association from collecting excess attorney's fees through other legal actions.

Limits on foreclosure. CSSB 507 would prohibit foreclosures of liens consisting solely of fines assessed by the association or of attorney's fees.

Notice of foreclosure. A property owners' association that conducted a foreclosure sale would have to send the property owner a notice by certified mail within 30 days of the foreclosure sale informing the owner of the right to redeem the property. The information also would have to be recorded in the county's real estate records. The bill would apply the notice requirement to any sheriff's or constable's sale conducted as part of a judgment obtained by the property owners' association.

Right of redemption after foreclosure. The property owners' association or any other person buying property at a foreclosure sale would have to initiate a forcible entry and detainer action — a summary legal action to take possession of property — against the original property owner.

The property owner could redeem the foreclosed property within 90 days of being served with a citation in a forcible entry and detainer action or within two years of the foreclosure sale, whichever came first. A person buying the property at a foreclosure sale could not transfer the property, except to the original property owner, during the redemption period. The property owner could redeem the property purchased by the property owners' association at the foreclosure sale by paying the association:

- ! all money due at the time of the foreclosure;
- ! interest from date of the foreclosure to the date of redemption on delinquency assessments, at the rate set in the dedicatory instrument or

- 10 percent, if an amount was not stated;
- ! costs of foreclosing the liens, including reasonable attorney's fees;
- ! any assessment levied against the property after the foreclosure sale;
- ! reasonable costs, including mortgage payments or repair or maintenance costs; and
- ! the purchase price paid, less any amounts due to the association for the original charges.

A property owner redeeming the property from another person, other than the property owners' association, who bought the property would have to pay the assessments due to the association under the first provision and would have to pay the purchaser:

- ! assessments levied against the property since the foreclosure sale that the purchaser had paid;
- ! the purchase price paid at the foreclosure sale;
- ! the amount of the deed recording fee;
- ! any ad valorem taxes, penalties, or interest on the property paid by the purchaser;
- ! taxable costs incurred under the proceeding; and
- ! a 25 percent redemption premium based on the other costs.

The buyer would have to execute and deliver a deed to the original owner transferring the property back to the original owner. The bill would provide for legal action against the buyer for failing to comply with this provision. If the redeeming property owner failed to record the deed or an affidavit stating that the owner had redeemed the property, the property owner's right to redeem the property would expire.

The property owners' association could apply any rent or income toward the amount owed the association if it bought the property. If another person bought the property, all rents and other income from the foreclosure date until the redemption date would be credited to the purchaser's taxable costs incurred under the foreclosure, with any excess amount being credited to the original owner. The property owners' association would have to provide an affidavit that the association's taxable costs for the foreclosure proceeding had been paid before a deed could be issued to the purchaser. The property

would be subject to any existing liens and encumbrances on the property before foreclosure.

Any partial payments made by the owner to the property owners' association before the redemption period expired would have to be refunded to the property owner. The redemption period could be extended by 10 days if the property owner sent a written request to redeem the property, by certified mail, return requested, on or before the last day of the original redemption period.

Either the property owners' association or a third-party purchaser would have to record a affidavit stating that the original owner did not redeem the property and another affidavit containing a legal description of the property.

CSSB 507 would grant similar redemption rights to a property owner whose property was sold at a sheriff's or constable's sale to satisfy a judgment won by the property owners' association.

Additional powers of property owners' associations. CSSB 507 would allow associations to:

- ! impose fines for property owners who littered within a subdivision;
- ! prohibit property owners from keeping animals whose noise disturbed other property owners;
- ! impose fines for keeping animals prohibited in the deed restrictions; and
- ! remove or authorize the removal of a noisy animal or one not permitted by the deed restrictions.

The bill would take effect January 1, 2002.

SUPPORTERS
SAY:

CSSB 507 would establish overdue recognition of homeowners associations in state law and would provide a balanced approach to protect the rights of individual property owners and of homeowners associations.

Much attention has been paid to the unfortunate situation in which Wenonah Blevins, an 82-year-old widow living in Harris County, had her \$150,000 home foreclosed and sold for \$5,000 because she failed to pay \$814.50 in homeowner's fees to the Champions Community Improvement Association.

However, this bill, which is similar to legislation filed last session, was filed before that incident and is intended to prevent such problems from arising.

CSSB 507 would address a shortcoming in existing law identified in the Blevins case by providing a fair and equitable procedure for homeowners to redeem their property after a foreclosure sale. This procedure would follow the precedents set for redemption procedures for people whose property is foreclosed to satisfy liens for unpaid property taxes or for condominium owners after foreclosures for unpaid condominium assessments.

Although homeowners associations are operated privately, they often function as *de facto* governments of planned communities. These associations assess fees, provide services, and mandate membership. However, no state agency regulates them, and they are subject to very few statutory restrictions. Some associations have been secretive, abusive, and uncooperative with property owners. The only recourse an owner has now is to hire a private lawyer.

Homeowners associations play a vital role in providing needed services and protecting individual property owners' investments in their homes, especially in unincorporated areas that lack zoning ordinances or deed restrictions. For example, the Lakewood Forest Homeowners Association in Harris County serves 2,600 homes and has an overall population larger than dozens, if not hundreds, of Texas cities. Like government entities, these associations must be able to raise money to pay for public services and improvements, and they need mechanisms to enforce the collection of those assessments.

Some homeowners have experienced problems with foreclosure proceedings by associations for unpaid fines. CSSB 507 would prohibit foreclosures based solely on fines or associated attorney's fees. It would prohibit foreclosure unless the dedicatory instrument granted the association that authority and would require the association to send written notice to the owner and provide an opportunity for a hearing before the association could begin foreclosure proceedings. The owner of a foreclosed home would have 90 days from being served an order of forcible entry and detainer, or two years from the date of the foreclosure sale, to redeem the property.

Foreclosure would remain a rare and extreme remedy under CSSB 507. Homeowners associations are reluctant to act against their neighbors and are willing to work informally with homeowners who cannot pay assessments because of illness, divorce, or other personal reasons.

Homeowners associations should have generally the same protections spelled out for government entities foreclosing for unpaid taxes, mortgage companies collecting for unpaid mortgages, or condominium associations seeking payment for assessments. These entities can provide notices through certified mail and are not required to contact the property owner in person about the deficiency. None of these entities must reimburse the property owner for the difference of the price paid at a foreclosure sale and the fair market value. Prices paid for foreclosed properties are discounted heavily to account for the risk of acquiring a property subject to redemption rights and other liens and of acquiring property sold on an “as-is” basis.

Homeowners sometimes are subjected to extensive attorney’s fees, fines, and other charges with little notice. CSSB 507 would require the association to send written notice of a violation to the owner. It would give the owner an opportunity for a hearing before the board and would require a “cure” period for a violation. It also would prevent accrual of attorney’s fees until the conclusion of a hearing or expiration of the 30-day period in which an owner could request a hearing. These provisions would protect homeowners from the rash actions of an association.

CSSB 507 would establish a due-process procedure that would fall somewhere between a neighborhood chat and a full-blown legal proceeding in the judicial system. It would provide for a notice and an opportunity for a hearing on any alleged violation. It also would encourage the use of mediation and alternative dispute resolution.

Assessments levied by these associations are contractual obligations that an owner accepts when buying a house in a particular community. Foreclosure is the best protection for the association and the other homeowners to maintain the community. The Federal Housing Authority, Veterans Administration, and Department of Housing and Urban Development will not lend money to buy a home unless the association has lien and foreclosure power.

OPPONENTS
SAY:

CSSB 507 would not offer sufficient protection to homeowners who found themselves in the same situation as Mrs. Blevins. Foreclosure of a person's home is one of the most serious actions that can be taken against that person. Owners who had fallen into arrears for as little as several hundred dollars still could lose their homes.

Homeowners associations should not be granted foreclosure powers without a constitutional amendment approved by voters. Even without the threat of foreclosure, honest homeowners will pay fees owed if given enough time.

Homeowners associations should have to provide personal notice to a property owner before foreclosure and should have to be financially responsible for the difference between the foreclosure price and the value of the property. If this safeguard had been in place in Mrs. Blevins' case, the Champions Community Improvement Association would have been less willing to foreclose on a \$150,000 house over an \$800 debt. As an alternative to foreclosure, associations could be authorized to garnish wages or to rescind certain rights. They also have the option of injunctive relief or fines instead of foreclosing.

If associations are going to act as political subdivisions, they should be accountable to the state. Associations now have no oversight by any agency. Board members can act against owners' wishes without fear of reprisal. CSSB 507 would not specify that arbitrary rules enacted by an association could be challenged and are not enforceable. Such a provision would protect owners against an association's capricious acts.

NOTES:

The committee substitute added a provision that would limit the amount of attorney's fees a property owners' association could include in the lien. It would give a property owner 90 days after being served an order of forcible entry and detainer or two years from the date of the foreclosure sale, rather than 90 days from when the property owners' association mailed a notice of the foreclosure sale, to redeem the property. The substitute also added the provisions that would authorize an association to impose fines for littering and for keeping noisy or restricted animals in the subdivision and to remove prohibited animals.

During the 76th Legislature in 1999, the Senate passed SB 699 by Carona, which would have established rights and obligations for property owners living in areas where property owners' associations had mandatory membership and would have established procedures for liens, foreclosures, and voting procedures. SB 699 died on the House General State Calendar in the final days of the session.