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Hopkins • Tschetter • Sulzer
Attorneys and Counselors at Law

HOA COMMUNICATOR

SELLING ASSOCIATION LIENS

Why Investors Want To Pay Off A Homeowner's Debt To An Association

Foreclosures are continuing to impact communities and managers. Clients have recently received numerous phone calls from investors wanting to purchase an HOA lien on a homeowner. This can be a good way for an Association to collect on a past due debt, but there are some potential risks associated with the sale. This article will briefly touch on why investors want to purchase liens, and what an Association and manager can do to protect themselves in the transaction.

In previous articles, we discussed the superlien rights that an Association has over the first mortgage against a property. Investors are often interested in Association liens, not for the superlien, but for the Associations lien that is in excess of the superlien. This presents the opportunity for the Association to recover money beyond the six months that may be due on the superlien.

Before we get to the sale of the Lien, here is a very brief overview of the foreclosure sale process. Understanding the basics of this process is helpful in understanding the reasons for investors' willingness to pay money for a homeowner's debt to the HOA.

When a property in your Association goes into foreclosure, often times it is the first mortgage holder that is doing the foreclosure.

The typical foreclosure process in Colorado will take approximately 6 months to complete. If an owner has substantial equity in the property, there are investors who will attempt to purchase the property when it goes to sale at the Public Trustee Auction. Typically, at the Public Trustee Auction, the bank will place a bid on the house for the amount of money it is owed plus fees.

Example- Henry Homeowner's House is worth $300,000. If the Bank is owed $200,000 on the mortgage and for fees associated with the foreclosure, then the Bank will bid $200,000 at the auction, even though the House is worth $300,000. Therefore, the

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THE LITIGATION TOOLBOX:

HOW TO BE A WITNESS

As many of our loyal readers have noticed, we offer specialized segments to the HOA Communicator on important topics, such as Fair Housing. With this edition, we proudly offer a new segment called, the "Litigation Toolbox." Look for this column in future Newsletters. In this specialized segment, we will share our personal experiences with HOA-related litigation, in hopes of providing our readers with certain tools to take to court. It is the firm's devout philosophy that litigation should be avoided whenever possible. However, the reality is that it often can't. As our readers well know, Homeowners Associations often find themselves in all kinds of conflicts that sometimes end up in court. Whether it be an action that an Association has to initiate to enforce a rule or something where the Association must defend itself, litigation is looming out there. With that in mind, we desire to educate our readers on what it truly means to go to court.

In this first installment, we want to emphasize the importance of being a witness in a court case. Court actions can range from small matters in County Court to protracted battles

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Homeowner has $100,000 in equity in this property. That is very appealing to investors.

Because there is substantial equity in the property there are investors bidding for the property. There are two investors Abbey and Ben. Abby outbids Ben, with a winning bid of $225,000. The Public Trustee will issue a certificate of purchase. Henry is still the homeowner, but Abby is on her way to owning the property. After the sale of the property, before Abby becomes the owner, the junior lien holders have redemption rights. This means that the junior lien holder could pay the amount owed at the sale, Abby would get her money back, and the junior lien holder would end up with the ownership of the property. If there are no junior liens or no junior liens redeemed, then Abby will end up being the owner.

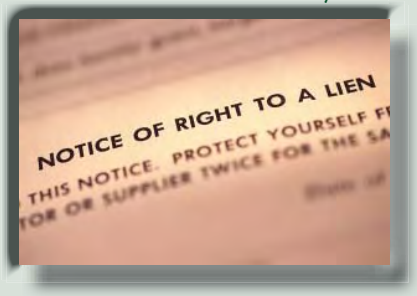
So in our example, let us say the HOA dues are $100 a month, and that Henry owes the Association $1,600. Tthe HOA has a superlien of $600, and a subordinate lien of $1000.

The $1000 is subordinate to the mortgage on the bank. It is a junior lien. Because it is a junior lien, there is a redemption right. The HOA could decide to pay off Abby's $225,000 bid and end up with Henry's House, and end up with a property that has $75,000 in equity.

An association rarely wants to buy homes. Investors realize this, and if there is equity here, Ben may purchase the Associations lien and redeem the lien with the Public Trustee on behalf of the Association. If Ben redeems the lien, then he ends up owning the property, and Abby just gets her money back that she spent at the sale. Abby may want to buy the Associations lien to protect her $75,000 equity purchase. Paying $1,000 to the HOA to protect your $75,000 is a good hedge.

The tricky part for communities and managers is the sale of the lien. Some investors will offer below the total owed to the Association and some will offer a premium. This will depend on whether the foreclosure sale has occurred yet, and how aggressive the investors want to get. The example given is an extreme example for a demonstration. Often times the margins and the equity are a lot smaller. An investor will not want to take a large risk by purchasing an HOA lien before the investor knows how much equity is going to be at stake. The investors only know for sure the amount of equity in the property when the property is sold at the public trustee sale.

Some investors will request that Managers contact them first about the sale of the lien, or make a promise to the investor that they will sell the Association's lien to that investor. The manager must be very careful here about what promises and representations are made to the investor. If a manger promises a sale to Abby before the sale, and then sells the lien to Ben, because he offers double the amount of the lien, Abby will very likely sue to enforce that promise. By selling to Ben, Abby missed out on the $75,000 in potential gains. Yes, Abby gets her money back when Ben redeems the property, but Abby loses out on the possible gain.



Guidance for Associations:

➪ Associations and Managers can sell liens, but they should have a clear cut policy on what range the association will be willing to sell and who they would be willing to sell to. A very conservative approach is to only sell the lien for face value and only sell it to the Certificate of Purchase holder.

➪ Be careful of what investors are told. Stick with the policy, whether it is the Association only sells to the holder of the certificate of purchase, or the lien is sold on a first come, first serve basis.

➪ Consult with legal counsel. Make sure to involve your attorney in determining what sales policy the Association is comfortable with, and what sort of form will be used to transfer the ownership of the lien to an investor. This article is a brief overview of a tricky topic, so for more details, talk to your attorney.

Selling a lien can be a good opportunity for an Association to collect on a past due debt that has not been recovered. However, Associations and Managers just need to be cautious and stick with a policy when communicating with investors.

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THE LITIGATION TOOLBOX: HOW TO BE A WITNESS Continued From Page 1

in state or federal District Court. The one commonality among almost all court cases is that there are witnesses. Someone has to testify. For Associations, this can mean a community manager and/or a board member. What does it mean to testify? What do I have to do to get ready to testify? What should I be ready for when I actually take the stand? Understanding your role as a witness will make life a lot easier if you are called upon to testify in court.

In any court action, each side presents a case. This means facts are presented and arguments are made. Normally, this process cannot take place without witnesses. Being a witness means one simple thing: you have to take the stand and offer testimony to a judge, or, in some cases, a jury of your peers. Imagine this: first, you raise your right hand, get sworn in, and take an oath. That's pretty official stuff. You are swearing to tell the whole truth and nothing but the truth. That suggests no half-truths are allowed. That alone is intimidating. Next, you sit in a tiny box with an uncomfortable chair and a little door that swings closed on you. Can you feel your pulse increase and your legs stiffen? Then, you get to talk to a complete stranger (unless you know the judge or jury). By now, your adrenal glands should be pumping at full force. This business of being a witness is serious stuff, even for those who have done it before.

In common HOA cases, witnesses for the Association often testify about the Association's covenants, certain events that have taken place within the community, community policies, and how the Association documents its actions. Community managers often testify about homeowners' ledgers and community rules. Board members are called to testify about all types of situations. No matter who the witness is, the objective is always the same. You are to tell a story of some kind. This means you must tell it accurately and in a manner that is understandable. Many trial attorneys profess that facts win cases. There is much truth to this logic, but who presents the facts? Witnesses do. Thus, witnesses have to be ready to present the facts they know about. Where a covenant or other rule is at issue, it means knowing the rule and how the Association enforces that rule. Where a ledger is at issue, it means knowing the format of the ledger and the details of the particular ledger relevant to the case. No matter what a witness is talking about, it is communication. It means talking about events, explaining a piece of evidence, and getting your listener to understand what you have to say. Documents and other forms of evidence, such as photographs, often do not automatically come into evidence. Witnesses lay the foundation for such evidence to come into the court record and give the facts. Facts tell the story. For instance, Homeowner Hank is a mechanic and parks his work truck on the street. This violates your community's covenant against commercial vehicles on the street. Hank won't move the truck or pay the fines. The Association sues to enforce. A community manager or board member will be called upon in court to discuss the covenant at issue and the evidence that demonstrates the violation. Such a witness will have to know the source of the violation, dates of the violation, frequency, and how the Association enforces the rule at issue. This requires preparation. Going into court cold is never a good idea.

Witnesses need to be prepared. Be familiar with what documents or other evidence you will testify about. Go over that evidence. **Trial lawyer secret:** here's a little secret about preparing for your testimony. It may be your first time testifying, but for the judge, he or she hears all kinds of cases on a weekly basis. Frankly, it can get pretty boring. Unfortunately, witnesses can add to that. Preparation should be designed to make a witness likable, credible, and interesting. That is easier said than done. Covenants, ledgers, and similar documents are only so intriguing. Knowing the document or a piece of evidence that you will be asked to talk about makes you likable and credible. How can you be interesting in this little box you have been put in? Let your personality come out. Smile when appropriate! Don't be afraid to make eye contact with the judge. If you ever end up in front of a jury, smile and look at all the jurors from time to time. Another valuable tip: when talking about a particular event, talk about it in

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the present tense. Witnesses typically talk in the past tense about things that happened prior to court. Talking about an event as if it is happening now really perks the listener up. (E.g. "Well, I am sitting at this board meeting when Homeowner Hank says to us that he does not have to follow the rules", as opposed to "I was at the board meeting when Hank told us . . .") Present tense takes the judge or juror to the event. It paints the canvas of the story and is more interesting.

As mentioned above, being a witness can be intimidating. If you have never testified, it can help to visit the courtroom beforehand and get familiar with the surroundings. If your attorney does not take you through some of your testimony, ask him or her to do that. Going over the documents, the chronology of events, and the main facts makes you that much more credible and confident. You want to be confident because all kinds of things happen on the stand.

As described above, the first thing that happens for most folks on the stand is stress. The heart rate increases, blood pressure goes up, and the mind races. This can affect your memory. It is also normal to physically tense up. After minutes on the stand, that can lead to major stiffness, and even pain. **Trial lawyer secret:** Breathe! Biofeedback studies of witnesses, and even lawyers, show major increases in heart rate and blood pressure during a court case. The same studies show that simple, relaxed breathing immediately lowers the heart rate and blood pressure. So, practice breathing as you go over your testimony and remember to breathe during trial. Being overly tense can make you less believable and less interesting.

Be as relaxed as you can because unexpected things do happen as you testify. The other side gets to ask you questions after your lawyers asks you questions. This is cross examination. Cross examination is exciting on T.V., but when you are the victim of it, the experience can be anything but pleasant. You may know what your lawyer will ask you but you can't be certain of what the other side will ask you. If the homeowner or other party has a lawyer, the lawyer gets to grill you about the testimony you gave on direct examination. If the other side is pro se, meaning she has no counsel, she still gets to ask you questions. Sometimes, this can be more frustrating that having an attorney in your face. Pro se litigants tend to attack and make statements, instead of asking questions. At least lawyers tend to ask questions. Either way, be ready to be put on the defensive. Many people forget that our court system is designed to let each side tell their story, argue their case, and try to rebut the other side's case. The key is to know your story and stay focused.

The goal of the person conducting the cross examination is to further tell her side's story and tear down your story. This is called impeachment. You can avoid impeachment by good preparation and knowing the evidence you will testify to. Still, lawyers love to put words in witnesses' mouths and ask tricky questions. How do you protect yourself against that? There are ways to ensure you testify well, even under the microscope of cross examination. First and foremost, don't joust with the opposing attorney or party. Stay calm. **Trial lawyer secret:** Insensitive attorneys make the mistake of thinking that hammering on a witness conveys that the witness has done or said something wrong. The reality is that this tactic usually just hurts the cross-examining attorney's credibility. So, stay calm. If you do, you look credible and the cross examiner does not. Next, stay focused on the facts as you know them. Just tell the truth. It is hard to trip up the truth. That said, attorneys do like to pigeon-hole testimony; meaning, to twist the truth and pin the witness down. For example, an attorney may ask you on cross examination whether the sky was blue, hoping to pin you down with a simple yes answer, when it may not be simply "yes." Sometimes, yes or no answers are required, but it is perfectly permissible to clarify a "yes" or "no." (e.g. "yes, the sky was blue but

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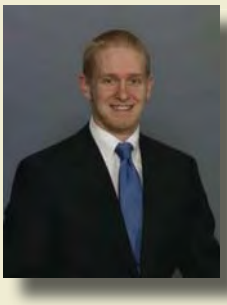
there were some clouds forming in the sky.") Always stay focused on the facts and listen closely to the question asked. Only answer that question. It is human nature to try to anticipate the next question. Answering the question posed can only build your credibility as long as you get out what you need. Finally, always stay professional. If you know the facts and maintain credibility, you will do just fine on cross examination.

Being a witness is no slight task. As a witness, you are the voice for your community in the midst of a legal battle. As such, you want to present as well as you can. Being prepared is the key. Preparation builds confidence and confidence makes you more interesting and secures your credibility.

HTS RISING STAR

HTS attorney Pete Muccio has been recognized as a Super Lawyer Colorado Rising Star. The Rising Star designation is awarded to the top up-and-coming



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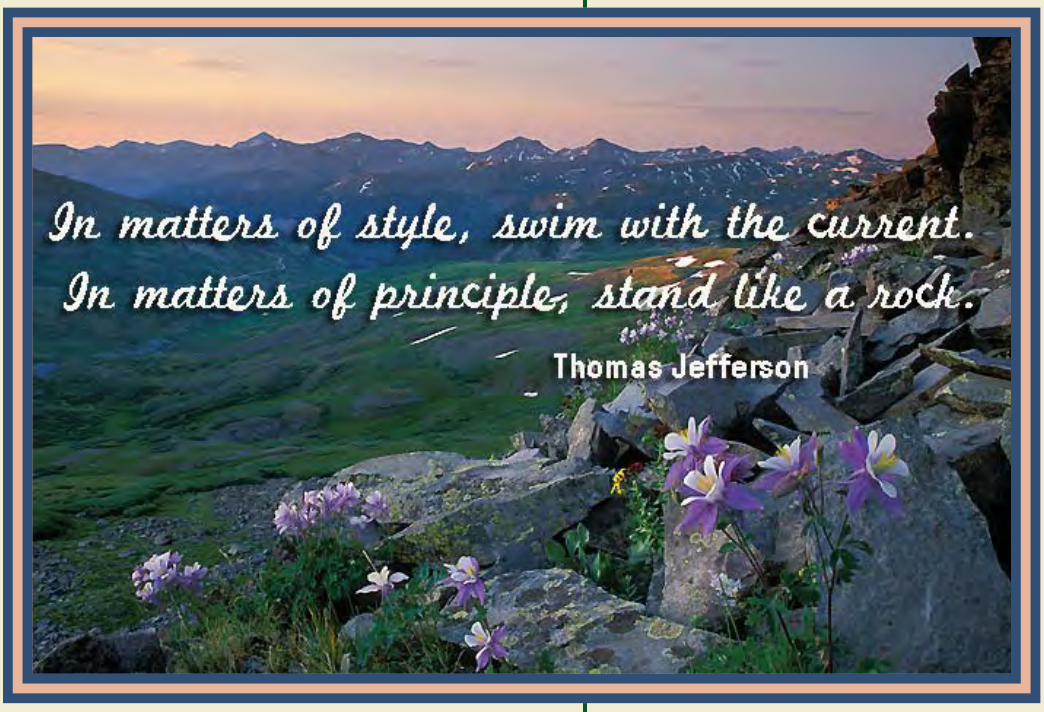
be either 40 years old or younger or in practice for ten years or less

have first-hand knowledge of the attorney.

Law & Politics magazine oversees and conducts the rigorous selection process. Each candidate is chosen based on 12 indicators of peer recognition and professional achievement. Next, the attorney-led research team reviews the credentials of potential "Rising Stars" and assigns points based on a set of defined evaluation criteria. After the scores are tallied, only 2.5 percent of the best up-and-coming attorneys in Colorado remain. Hopkins Tschetter Sulzer congratulates Pete for the distinction of being named a Rising Star by Law and Politics Magazine.



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