HAWAII FINANCIAL SERVICES ASSOCIATION

c/o Marvin S.C. Dang, Attorney-at-Law
P.O. Box 4109
Honolulu, Hawaii 96812-4109
Telephone No.: (808) 521-8521
Fax No.: (808) 521-8522

March 27, 2013

Senator Clayton Hee, Chair
and members of the Senate Committee on Judiciary and Labor
Hawaii State Capitol
Honolulu, Hawaii 96813

Re: **House Bill 21, HD 2, SD 1 (Condominiums)**
Hearing Date/Time: Wednesday, March 27, 2013, 10:50 a.m.

I am Marvin Dang, the attorney for the **Hawaii Financial Services Association** ("HFSA"). The HFSA is a trade association for Hawaii's consumer credit industry. Its members include Hawaii financial services loan companies (which make mortgage loans and other loans, and which are regulated by the Hawaii Commissioner of Financial Institutions), mortgage lenders, and financial institutions.

The HFSA **offers comments on this Bill**.

The purposes of this Bill are to: (1) permit the board of directors of a condominium association to collect a six-month special assessment from the mortgagee or other purchaser of a unit with a recorded lien for delinquent common assessments; and to (2) specify how excess rental income received by a condominium association shall be paid to existing lien holders.

Over the past 2 years, the law regarding lien priority of delinquent condominium association fees (i.e. special assessment) has been changing annually. The priority is detailed in Hawaii Revised Statutes Sec. 514B-146. Just last year, the lien priority was changed to 6 months and there was no dollar cap under Act 182. Before that, under Act 48 in 2011, the lien priority was 12 months and the cap was $7,200.00. Previously, the lien priority was 6 months with a cap of $3,600.00.

During the entire period of these changes, and going back to Act 39 in 2000, the one consistency was that if the mortgage lender acquires the delinquent unit through a foreclosure, the special assessment would be paid by the person who later buys the unit from the lender. This Bill would now require that the mortgage lender be liable to pay the special assessment if the lender acquires the unit at foreclosure. If this Bill passes, this would be the third consecutive year of change involving condominium association lien priority.

This Bill separately makes it clear that if a condominium association acquires title to an apartment after a foreclosure, and if that association is able to later rent out that apartment, once the association receives from the rental income all the specified obligations owed to the association for that apartment, then any "excess rental income" will be disbursed to existing lien holders (e.g. a mortgagee). This "excess rental income" provision makes sense.

Thank you for considering our comments.

Marvin S. C. Dang

MARVIN S.C. DANG
Attorney for Hawaii Financial Services Association

(MSCD/hfsa)

10:50 a.m. March 27, 2013 Room 016

HB21 HD2 SD1

Comments

Chairman Hee, Vice Chair Shimabukuro, and members of the committee.

I support HB21 as ORIGINALLY drafted. I am opposed to HB21 HD2 SD1, section K. Either the word "association" should be changed to "purchaser", or the entire paragraph should be struck. I would prefer the latter. It will further delay the lender's foreclosure.

For example: Given that a lender purchased a 30 year, $300,000 mortgage at a rate of 3% and that the borrower defaults 5 years later. The lender has already collected $75,000 ($42,607.82 in interest and 32684.49 on the principle). If the property in now valued at $200,000, the mortgage is upside-down. If the lender initiates foreclosure and the borrower has no desire to go through the process, the unit will become vacant and fall into disrepair, except for the common elements. Until recently, the lender was satisfied to retain the property, with the association maintaining the common elements at no cost to the lender, until market values improved. (This proved costly to the lender when years of neglect had to be rectified.)

If the association forecloses with the intent of rehabilitating the unit in order to rent it, several things could happen.

1) After the association brings the property into rentable condition, the lender could execute foreclosure. There is no provision for the association to recoup the costs if the lender then forecloses and takes the unit.
2) If the association takes the unit subject to the remaining mortgage and the mortgage is upside-down, the lender enjoys not only free maintenance of the common elements but also the unit itself at no cost. The lender simply sits on the property until values improve.

This is the situation that this and other legislation has attempted to address, with the goal of putting a paying owner in the unit.

Now, if the association is going to be tasked to be the landlord for the lender, and assume all the liabilities of that responsibility, the impetus for the lender to execute foreclosure is further reduced. Why would the lender, now with a positive cash flow on a unit that is undervalued, want to foreclose?

The lenders will say they are not in the business of rental investments. Associations should not be tasked by law to be landlords for a lender.

Thank you for your service and attention to this matter.

Ted Walkey, PCAM and condominium owner

hee2 - Kathleen

From: mailinglist@capitol.hawaii.gov
Sent: Tuesday, March 26, 2013 11:16 AM
To: JDLTestimony
Cc: epei@hawaiiba.org
Subject: Submitted testimony for HB21 on Mar 27, 2013 10:50AM

HB21
Submitted on: 3/26/2013
Testimony for JDL on Mar 27, 2013 10:50AM in Conference Room 016

Submitted By	Organization	Testifier Position	Present at Hearing
Edward Pei	Hawaii Bankers Association	Comments Only	Yes

Comments: HB21, HD2, SD1 allows a condominium association to specially assess to a mortagee purchasing a unit through the foreclosure process up to six months of unpaid common assessments. The Hawaii Bankers Association does not object to this provision, even though it requires the mortagee to accelerate payment to the association.

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

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HAWAII CHAPTER
community
ASSOCIATIONS INSTITUTE

P.O. Box 976
Honolulu, Hawaii 96808

March 25, 2013

Honorable Clayton Hee
Honorable Maile S.L. Shimabukuro
Judiciary and Labor
415 South Beretania Street
Honolulu, Hawaii 96813

Re: HB 21 HD2 SD1/COMMENTS

Dear Chair Hee, Vice-Chair Shimabukuro and Committee Members:

I Chair the CAI Legislative Action Committee. CAI has the following comments on HB 21 HD2 SD1.

If the Committee chooses to pass a bill based on HB21 HD2 SD1, CAI requests amendments because the obligation to pay "excess rental income" to others would put associations in legal jeopardy. The association would be liable to suit for paying the wrong claimant. The analogous problem faced by counties following real property tax foreclosures is addressed in H.R.S. Section 246-63. In that case:

> If the officer is in doubt as to the person or persons entitled to the balance of the fund the officer may refuse to distribute the surplus and any claimant may sue the officer or the officer's successor in office in the circuit court in the circuit within which the property sold was situated. The officer may require the claimants to interplead, in which event the officer shall state the names of all claimants known to the officer, and shall cause them to be made parties to the action.

CAI respectfully requests that the Committee consider amended language (page 10, line 17) such as:

(k) After any judicial or non-judicial foreclosure proceeding in which the association acquires title to the unit, any excess rental income received by the association from the unit shall be paid to existing lien holders based on the priority of lien, and not on a pro rata basis; **provided that one of the existing lienholders shall first obtain a final judgment, from the circuit court where the unit is located, that determines the lien priorities.**

Community Associations Institute

Philip Nerney

Philip Nerney

Steve Glanstein
P. O. Box 29213
Honolulu, HI 96820-1613

March 26, 2013

Honorable Senator Clayton Hee, Chair
Honorable Senator Maile S.L. Shimabukuro, Vice Chair
Senate Committee on Judiciary and Labor
Hawaii State Capitol, Conference Room 016
415 South Beretania Street
Honolulu, HI 96813

RE: Testimony regarding HB21 HD2 SD1; Suggested Amendments; Hearing Date: March 27, 2013 10:50 a.m.; sent via Internet only.

Aloha Chair Hee, Vice-Chair Shimabukuro, and Committee members,

Thank you for the opportunity to present testimony and comments on HB21 HD2 SD1.

I recommend that HB21 HD2 SD1 be replaced entirely with the original HB21.

The original bill simply protected condominium owners by providing priority to condominium assessments over the first mortgage, similar to leasehold land or city property tax.

The bill has since morphed into(a) a 6 month maintenance fee recovery against an innocent purchaser of a unit in foreclosure or the mortgagee and (b) a lender bailout if a homeowners' association risks purchasing a foreclosed unit, renovating, it, and renting it out (page 10, lines 13ff) to recover lost maintenance fees.

These changes have been made notwithstanding overwhelming testimony in House and Senate Committees in support of and requesting the original bill.

Since it appears unlikely that the House and Senate will in fact return to the original HB21, please consider an alternative modest proposal to help Hawaii's condominium consumers.

1. Change the 6 month priority in page 9, line 13 from "6 months" to "6 years" to be consistent with the 6 year limitation on page 1, lines 15-18 and page 2, lines 3-12.

2. Remove the foreclosure liability of the innocent purchaser of a unit in page 8, line 6 to read the "mortgagee" (Strikeout "or other purchaser of a unit").

3. Remove the lender bailout subsection on page 10, line 13 through page 11, line 12.

4. If the lender bailout lender subsection must remain (page 10, line 13 - page 11, lines 12), protect the condominium community from liability for paying excess rent to the wrong mortgagee. Suggested wording is to insert after "pro rata basis" on page 10, lines 17, "; provided, that one of the existing lienholders shall first obtain a final judgment, from the circuit court where the unit is located, that determines the lien priorities and appropriate payee for purposes of payment."

The current statute HRS §514B-146 provides a 6 year limitation on the right of an association to foreclose its lien on a delinquent unit (page 1, lines 15-18 and page 2, lines 3-12).

The lending institution should also be responsible for the same period of delinquency instead of the 6 months that has been entirely inadequate for the condominium community.

The nonprofit condominium community should not be an ATM machine for lenders, real estate salesmen, foreclosure attorneys, or realtors, nor should it be forced to take foreclosure risks that adversely affect their fellow owners.

Please consider the needs of the 1,715 condominium associations (constituting 159,501 owners and their families) and perfect this bill to protect our Hawaii condominium owners.

Should you wish to discuss further, your call is most welcome. My phone number is 423-6766. Thank you for the opportunity to present information on this subject.

Sincerely,

Steve Glanstein

Digitally signed by Steve Glanstein
DN: cn=Steve Glanstein, o, ou, email=Steveghi@Gmail.com, c=US
Location: Honolulu, HI
Date: 2013.03.26 16:28:48 -10'00'

Steve Glanstein
Professional Registered Parliamentarian
SG:tbs/ATTACHMENT
D:\$P\Legislative2013\HB21\Letter4.wpd

hee2 - Kathleen

From: mailinglist@capitol.hawaii.gov
Sent: Monday, March 25, 2013 11:23 PM
To: JDLTestimony
Cc: carpenterd@hawaiiantel.net
Subject: Submitted testimony for HB21 on Mar 27, 2013 10:50AM

HB21
Submitted on: 3/25/2013
Testimony for JDL on Mar 27, 2013 10:50AM in Conference Room 016

Submitted By	Organization	Testifier Position	Present at Hearing
Dante K. Carpenter	Individual	Comments Only	No

Comments: Chair Sen. Clayton Hee, VC Sen. Maile Shimabukuro & Members: Aloha Kakou. My name is Dante K. Carpenter, President of Country Club Village, Phase 2, AOAO. Tho condo consists of 2-21 story apartment buildings with 469 units. This Assoc. is in strong support of HB21 or HB21, HD1, Relating to Condominiums. The intent of HB21 repeals the prioritization of liens for unpaid mortgages over subsequently recorded liens for unpaid condo association fees. AOAO's are empowered to require unit owners to comport with and pay fair assessments on a timely basis in accordance with HRS Chapter 514B. The AOAO must assure equal participation by all unit owners, but, must pay for those individuals who renege on their obligations to pay their fair share on timely basis. This forces the AOAO's to increase assessments to other owners to pay all current bills to keep good credit standings. Present mortgage payment obligations are to a large degree "controlled by loan institutions" who may foreclose or unnecessarily delay foreclosure process to suit convenient business conditions for many, many months, or more often to several years! HB21 attempts to address the relationship between the AOAO and mortgage holders. There will be no adverse effects on the rights of homeowners, the real intended beneficiaries of these reforms; i. e., the majority consumers! More importantly, this bill will encourage banks and servicing agents to act more responsibly and effectively to reduce potential liabilities of both owner(s) and non-profit AOAO's. Mahalo for your consideration of either HB21 or HB21, HD1. DKC

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

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SENATE COMMITTEE ON JUDICIARY AND LABOR

KAHA LANI AOAO
4460 Nehe Road
Lihue. Hawaii
(808) 822-9331

TESTIMONY OF NICHOLAS BLONDER
RE **HOUSE BILL 21**,
RELATING TO CONDOMINIUMS

TO: **Senate Committee on Judiciary and Labor**
Chair: Hon. Clayton Hee
Vice-Chair: Hon. Maile S. L. Shimabukuro
and Committee Members

Hearing Date: March 27, 2013 @ 10:50 a.m.

Introduction

Hawaii's condominium associations (HOAs) are caught in a legal limbo that prevents them from collecting delinquent maintenance fees when a unit becomes "underwater" and is foreclosed by a mortgage holder. HB 21[1] will level the playing field by amending HRS §514B-146[2] to give HOA liens priority over mortgages. I strongly support the enactment of HB 21, *as originally introduced*.

This testimony reflects my views as Vice-President of the board of directors of the AOAO at Kaha Lani, a 74-unit condominium property located in Lihue, Kauai.

This testimony will explain why (1) HOAs should have priority over mortgage holders (pp. 1—6), and (2) the opponents' claims, about purported adverse effects of HB 21 on the secondary mortgage and real estate markets, are unfounded (pp. 6-14).

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[1] Unless otherwise indicated, references to HB 21 in this testimony are to the bill as originally drafted and introduced by Rep. Evans.

[2] Unless otherwise indicated, all statutory references are to the Hawaii Revised Statutes.

Background

HB 21 is intended to address a direct consequence of the "Great Recession," which began in 2008. Before the economic downturn, foreclosures of condominium loans were rare. A default was usually due to temporary adverse circumstances intrinsic to an individual owner (e.g., loss of employment or divorce). Existing law has always given HOAs a basic lien right to secure payment of assessments, but it was seldom necessary to actually foreclose a lien.

In most cases the property had equity, so the owner had an incentive to cure the default. If the financial adversity was quickly remedied, the loan would be reinstated. If the problem was intractable, the property would be sold, enabling the owner to preserve most of his or her equity.

When the real estate bubble burst in 2008 there was a steep drop—often as much as 50%—in residential property values. A property owner is said to be "underwater" when the fair market value of his or her property falls below its mortgage balance. In many cases, the underwater owners have simply abandoned their property and stopped making payments. As a result, Hawaii condominiums are caught in a wave of slow-moving foreclosures.[3] Before the mortgage crisis, nonjudicial foreclosures might only have taken a few months. But in the post-recession economic environment, foreclosures now can take years, during which time the HOAs are unable to collect assessment fees.[4]

(Continued)

[3] The delay inherent in the foreclosure process has been increased by recent legislation limiting the availability of nonjudicial foreclosures. (Acts 48 [2011] and 182 [2012].) This legislation has dramatically increased the amount of time it takes to complete a foreclosure. Support of HB 21 is not inconsistent with the foreclosure relief legislation. It is mentioned here only to explain that the HOAs' predicament has been exacerbated by the combination of (i) the substantial additional delay in the foreclosure process caused by the remedial legislation, and (ii) the unintended loophole (explained below) in the condo foreclosure law which enables banks to ignore, without adverse consequences, the cost of maintaining a portion of their security.

[4] At Kaha Lani, two units have been delinquent since February, 2009, with no resolution in sight.

Existing Law Is Out-of-Date and Unfairly Limits HOAs' Ability to Recover Delinquent Maintenance Fees

Existing law provides that HOAs may perfect a basic lien for unpaid assessment fees. The heart of the present controversy is the law's provision that HOAs' lien rights are subordinate to any mortgage that was recorded before the delinquent assessment lien. The HOA may foreclose on its lien; but when the owner has no equity, this remedy would accomplish no more than to place the HOA in the shoes of the underwater owner.[5] Under these circumstances, the HOA's lien rights usually are worthless.

The bank's security interest, on the other hand, is subject only to liens for taxes. No matter how long it may take for the bank to complete the foreclosure process or consent to a short sale, the HOA is precluded, by the bank's lien priority, from recovering from its statutory security any of the costs attributable to the delinquent unit's share of the property's common elements maintenance costs.

The HOA may also record a "special assessment" lien that is enforceable only against the next owner of the property.[6] (§514B-146(g).) This would come into play if (1) a foreclosing bank takes title to the property and sells to a new owner, or (2) there is a short sale. In either case, the new owner is only responsible for up to six months of delinquent HOA fees. (§514B-146(h).) *Even if the HOA were to eventually receive the full six months of fees, this arbitrarily limited amount often will not come close to covering the HOA's aggregate loss, which likely will represent several years' worth of unpaid maintenance fees.*

Please note that the six-month maximum duration of the special assessment has remained in the law unchanged since 2000. Before 2008, the time necessary to complete a foreclosure was normally measured in months. But since 2008, the average time to complete a Hawaii foreclosure is now measured in *years*. There is no valid reason why the HOAs' recovery of unpaid assessments—through a lien against the unit—should be limited to

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[5] House CPC amended HB 21, in harmony with HB 25, to facilitate an HOA's foreclosing its own lien and renting the unit out to recoup unpaid fees. However, for most HOAs this is an investment strategy whose risks far outweigh its possible return.

[6] This is Hawaii's version of the so-called "super lien," which is discussed in greater detail below. HB 21 SD1 would convert the this "special assessment" to a "true" super lien. However, this change is more form than substance; in virtually all situations it will not materially improve the amount of HOAs' recovery.

any arbitrary period of time. From the HOAs' standpoint, the six-month limitation on lien duration is functionally obsolete.

The unfairness to the HOA is self-evident: the mortgage holder receives the full benefit of the HOA's continuing maintenance, for years, of the common elements, without having responsibility for the corresponding costs.[7] The condominium lien law must be amended to take into account the new landscape of the real estate market. HB 21 accomplishes a reasonable adjustment of the stakeholders' interests. Simply put, a defaulted unit should be fully available as security to make the HOA whole with respect to unpaid maintenance fees.

The Law Should Reflect the True Nature of the HOAs' and the Banks' Respective Interests

HOAs Perform Functions Similar to Those of Public Agencies

The HOA maintains the property's common elements (building exteriors, landscaping, parking lots, recreational amenities, etc.). In this respect, the HOA's role is analogous to that of local government, which maintains public buildings, streets, parks, fields, schools and libraries, and public safety institutions such as fire protection and police.[8]

In order to preserve local governments' ability to fund its necessary functions, the law provides that liens for property taxes and related fees have priority over virtually all other encumbrances, including mortgages. The HOAs' maintenance fees are analogous to property taxes and therefore should similarly have priority over mortgages, regardless of when the mortgage was recorded.[9]

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[7] Existing law states that the loss caused by a default in assessment fee payments shall be borne by the non-defaulting owners. (§514B-146(b).) This provision may have made sense when foreclosures were rare and comparatively swift; but it likely was not intended to require the performing owners to absorb a substantial shortfall caused by the banks' ability to ignore these costs for years.

[8] An appellate court recently observed: "Courts have recognized a homeowners association functions as a quasi-governmental entity, paralleling the powers and duties of a municipal government." (*Silk* v. *Feldman*, 208 Cal.App.4th 547, 553 (2012.)

[9] It is commonly known that virtually all condominium units are subject to a monthly assessment that enables the HOA to maintain the property's common elements. The condominium project's founding documents, which are in the public record, normally contain CCRs that include the unit owners' responsibility to pay the assessment fees. It is

Banks Are de facto *Owners*

The modern mortgage is a *virtual partnership* between the lender-bank and the borrower-buyer. The bank usually provides the bulk of the funds necessary to close the buyer's purchase. The buyer is the equitable owner of the unit, and the bank receives a mortgage as security for repayment of the loan. These parties—not the HOA--should bear all risks of loss associated with a mortgage secured by the unit.

After a unit becomes underwater, the bank will have substantial control of the property. It can only be sold through a short sale, which requires the consent of the mortgagee bank. However, under existing law, the bank has no responsibility to pay the HOA fees accruing during the pendency of the foreclosure. Moreover, as explained above, the defaulting owner has little practical incentive to keep the HOA dues current.

If a bank were to complete a foreclosure and become fee owner of a unit, HOA fees likely would be its largest recurring expense of ownership. It has been suggested by many knowledgeable observers that, under these circumstances, banks are "slow-walking" the foreclosure process to avoid responsibility for HOA fees while waiting for market conditions to improve.

From the HOA's viewpoint, however, this is not a two-way street. The bank can ignore the fees which are legally chargeable only against the departed owner-mortgagor.[10] But the HOA remains obligated to continue to currently maintain *all* of the common elements.[11]

It is acknowledged that a mortgage holder is not the fee owner and, therefore, should not have *personal liability* for fees that accrue during the foreclosure period. For this reason, HB 21 only treats the property as *security* for HOA fees.

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reasonable to assume that all institutional lenders are fully aware of their borrowers' ongoing liability *before* closing escrow on a new loan.

[10] The HOA could seek a civil judgment against the delinquent homeowner. However, this remedy entails substantial legal expenses to obtain a judgment which, in most cases, will not be collectible.

[11] If a homeowner has not paid his or her property taxes, the municipal government could not withhold maintenance of the public road in front of the delinquent owner's property. The road must be maintained for the benefit of the entire community. HOAs operate under the same principle, but without the municipalities' secure source of funding.

Moral Hazard

At some point the HOA will have to either (1) increase its monthly fees or (2) impose multiple special assessments on the non-delinquent owners to restore lost revenue. These financial burdens invoke the spectre of "moral hazard." The owners who have been honoring their obligations also end up *subsidizing* the banks' losses. As now written and applied, §514B-146 *compels* this result. A fee increase or special assessment under these circumstances amounts to a partial bailout of the banks. The HOA and the other owners are innocent bystanders; they are not parties to the banks' bad loans. They should not have to share or absorb *any* portion of the banks' mortgage losses. If HB 21 is not passed with the full HOA-priority lien intact, the non-delinquent owners will be forced to *indefinitely* continue bailing out the negligent banks.

Fannie Mae Guidelines Are Not Inconsistent With HB 21

The Hawaii Bankers Association (HBA) and the Mortgage Bankers Association of Hawaii (MBAH) submitted written testimony opposing HB 21. Their testimony emphasized possible "unintended consequences" if the bill were to be passed in its original form. The principal basis for their opposition to HB 21 was the claim that it would harm the local market for condominium loans. The bankers asserted that Fannie Mae and Freddie Mac's underwriting criteria may make it more difficult for originating lenders to sell their loans in the secondary mortgage market.[12] HBA and MBAH both identified Fannie Mae as a prominent secondary market for Hawaiian mortgages.

There are serious problems with the bank lobby's argument.

The Six-Month Limit Is Only a Guideline

The keystone of the banks' argument is the purported six-month limit on HOA-priority liens, which are sometimes called "super liens." Fannie Mae's documentation has for many years referred to a six-month limit. However, this limitation is found within an extensive, diverse list of

[12] Fannie Mae and Freddie Mac are also known as Government Sponsored Enterprises, or GSEs.

guidelines that lenders are instructed to use when evaluating a condominium unit as security for a mortgage. Fannie Mae's "Selling Guide," a compendium of lender guidelines, is 1,200+ pages long. The six-month limit is just one among many factors that lenders are advised to consider. Moreover, as explained below, *Fannie Mae recently amended this guideline to accommodate HOA-priority liens with a duration longer than six months.*

The Six-Month Limit Is Obsolete in Hawaii

Please note that the six-month standard originated in 2000, long before the Great Recession and the ongoing foreclosure crisis. When this guideline was adopted, it took *months*, not *years*, to complete a foreclosure. In that context, it was reasonable to limit the HOA-priority lien to six months because, within that approximate time frame, the foreclosure would usually be completed and a new fee-paying owner would be taking over the unit. But while the Hawaiian real estate market has changed radically, the original durational limit for the lien has never been adjusted to be reasonably consistent with the amount of time normally required to complete a contemporary foreclosure.

As described below, Hawaii's HOAs are suffering from the *actual* "unintended consequences" of the outdated super lien statute. The super lien was originally intended to make HOAs substantially whole if a unit went into foreclosure—and six months of fees were usually adequate to cover all or most of the HOA's loss. Instead, the law's unintended effect has been doubly harmful: (1) it limits HOAs' eventual recovery to only a small fraction of the accrued obligation, and (2) makes it substantially more difficult for a new, current, fee-paying owner to acquire the delinquent unit. The latter consequence is a direct result of the banks' "right" to arbitrarily hold a unit in foreclosure limbo indefinitely without regard to the accruing unpaid maintenance fees.

Bank foreclosures at Kaha Lani are averaging more than three years from start to finish. As noted above, Kaha Lani has two units that have been, and remain, in foreclosure since February, 2009. Consequently, no maintenance fees have been paid to the AOAO on either of these units for 48 months. Our corporate property manager, which handles several condominium properties, has confirmed that Kaha Lani's experience is representative of conditions found in the other properties it manages. The special assessment lien (§514B-146 (h)) offsets only a fraction of the actual loss suffered by the AOAO due to nonpayment of maintenance fees. At Kaha Lani, for example, the recovery rate after completed foreclosures *is less than 12%*. In

our case, the super lien is not very "super"; it delivers too little, too late. These are tangible, adverse consequences, and could not possibly have been the legislature's intent.

A significant cause of the delay is recent foreclosure reform (Acts 48 [2011] and 182 [2012]).[13] However, the delay is not attributable only to the reform laws and the sheer quantity of foreclosures. It is generally accepted that the banks are manipulating the pace of foreclosures for their own financial advantage. Under existing law, after six months of delinquencies have accrued, the secured-party banks have *no incentive* (as far as maintenance fees are concerned) to expedite a foreclosure.

The out-of-date six-month limit has become almost fully detached from today's marketplace reality. The Hawaiian version of the super lien, with its six-month limit, does not come close to offsetting the substantial losses being suffered by HOAs. In this era of volatile financial markets, there is no credible reason why the HOAs' lien for unpaid maintenance fees should be limited to any arbitrary duration. The proper standard is one that enables an HOA to be made whole, that is, to recover all of its unpaid fees.

Florida Unilaterally Increased the Duration of Its Super Lien

In 2010, Florida, one of the largest mortgage markets in the country, broke ranks and increased the duration of its super lien from six to 12 months (Florida Statutes, §718.116(b) 1 a). This increase of the limit apparently has had no material adverse effect (i.e., "unintended consequences") on the closing of new Florida condominium loans or their transfer to the secondary mortgage market.

(Continued)

[13] This testimony should *not* be interpreted as criticism of the reform legislation, which was intended to address multiple issues and represented a good-faith effort to aid homeowners confronting flawed foreclosure procedures. HB 21 only addresses the relationship between the HOAs and the mortgage holders. It will have no adverse effect on the rights of the homeowners who were the reforms' intended beneficiaries. Moreover, HB 21 would encourage the banks and servicers to act more efficiently and responsibly, thus reducing the potential liabilities of owners of underwater units.

The Banks Have Offered No Credible Evidence to Support Their Dire Predictions If the HOA-Priority Lien Period Is Increased

In testimony before the House Judiciary Committee, the HBA wrote that it had spoken with an unnamed Fannie Mae employee who purportedly said the six-month rule still controlled. However, in the same paragraph, the HBA alludes to an inconsistency, between Fannie Mae policy and documentation, which had been referred, without resolution, to Fannie Mae's legal department. The legislature should not accept vague conclusionary statements, and sweeping generalizations based on those statements, as the basis for maintaining an unfair status quo.

Fannie Mae Has Changed Its Guidelines to Accommodate Longer Duration for HOA-Priority Liens

The GSEs do not operate in a vacuum. They likely are well aware of the extreme delays that have become epidemic in Hawaii's foreclosure process and should be reluctant to punish consumers (i.e., sellers and new borrowers) for states' efforts (such as HB 21) to improve the HOAs' solvency. As apparently occurred in Florida, it seems reasonably likely the GSEs relaxed enforcement of their guidelines to accommodate much-needed relief for the state's HOAs. After all, financially secure HOAs are vital to the health of the local condominium market.

The foregoing view is confirmed by Fannie Mae's recent amendment of its Selling Guide. Previous editions of the Selling Guide limited eligibility to loans subject to HOA-priority liens that were capped at six months. In late 2012, however, the guide was amended to allow HOA-priority liens to be

> the ***greater*** of six months of regular common expense assessments, ***or the maximum amount permitted under applicable state law, to have limited priority over Fannie Mae's mortgage lien*** if the condo . . . project is located in a jurisdiction that has enacted
>
> - the Uniform Condo Act
> - the Uniform Common Interest Ownership Act; or
> - other similar statutes that provide for regular common expense assessments, as reflected by the project's operating budget, to have such priority over mortgage liens.

(Selling Guide, Section B4-2.1-06, January 17, 2013, at page 607; emphasis added.)

This sea change guideline amendment was originally released on August 21, 2012, in Selling Guide Announcement SEL-2012-07, at page 5:

> Fannie Mae is revising the *Selling Guide* to allow the greater of six months of regular expense (homeowners' association) assessments or the maximum amount permitted under applicable state law to have limited priority over Fannie Mae's mortgage lien.

According to John S. Forlines, Fannie Mae's Chief Credit Officer:

> The change was driven by the fact that some states had *requirements* that more than 6 months of assessments were priority to our first lien. Prior to the Selling Guide change our guidelines were in conflict with these state laws. Obviously, we prefer a shorter period of time but we could *not require our lender customers to be in conflict with the state laws*.

(Email dated 2/20/13); emphasis added.) As a practical matter, this revised Fannie Mae guideline *invites* state governments to amend their condominium laws and thus tailor HOA-priority lien statutes to more reasonably address local financial and market realities. The Hawaii Condominium Law (§514B-1 et. seq.) is based on concepts from both of the above-referenced sets of uniform laws. HB 21 falls within the scope of the revised guideline.

The Hawaii condominium market is a lucrative source of business for the mortgage industry. Even if Fannie Mae's guideline had not been revised, it is likely that, as in Florida, banks would have been able to continue making condominium loans. The Committee should be skeptical of the industry's speculative negative predictions. Moreover, the recent modification of Fannie Mae's guidelines suggests that the banking lobby's argument may have inadvertently misstated current underwriting standards.

The foregoing discussion has focused on the inadequate, fixed six-month duration of the HOA-priority lien. HB 21, on the other hand, does not provide for a durational limitation on the HOA's basic lien for unpaid assessments because none is necessary. Please bear in mind that HB 21's maximum effect would do no more than restore to the HOAs funds they previously expended in good faith to *maintain the banks' security*.

"Unintended Circumstances" Regarding Loan **Servicers** *Is Another Unwarranted Scare Tactic*

The opponents also claim loan servicer guidelines would prevent the sale of mortgages to the secondary market if the original version of HB 21 becomes law. They suggest that limitations within the servicing agreements (between mortgage holders and servicing entities) will prevent loans from moving to the secondary market. This is yet another financial industry smokescreen intended to distract lawmakers from evaluating HB 21 on its substantive merits.

Loan "servicing" is a component of the underlying mortgage. It is the process by which the originating bank or a GSE collects loan payments from the borrowers and performs a variety of ministerial tasks. Loan servicing is a fee-based enterprise governed by the terms of the servicer's contractual relationship with the originating bank or GSE. The servicers' profitability depends on their ability to efficiently and effectively perform their obligations under the servicing agreement.

HB 21's opponents are ingeniously attempting to inject wholly extrinsic risk factors as a justification for retaining existing law and requiring HOAs to continue subsidizing maintenance of the banks' security. For example, the HBA said it's "clear from the guidelines that lenders will not want to make loans to sell to Fannie Mae because the servicer...will bear the brunt of the loss" if there's a delinquency. However, that is where the risk belongs--*HOAs should not have to shoulder the lenders' or the servicers' risks of loss.*

The banks and GSEs on the one hand, and the servicers on the other, are powerful, sophisticated business entities that are fully capable of negotiating among *themselves* the allocation of *financial risks*, including the possibility of an HOA-priority lien default. Whether or not a loan servicer may be obligated to clear delinquent assessments is irrelevant to the question of whether the HOAs have to continue bearing losses for which they never assumed the risk. There is no justification for attacking HB 21 with contrived fallout from what is nothing more than part of the modern mortgage industry's basic operating model.

As explained above, Fannie Mae has expressly endorsed the principle that states should be, and now are, allowed to establish HOA-priority lien rules that reasonably shift the risk of loss from innocent condominium owners to the security held by lenders who made the loans. *Prior* to July 1, 2012, Fannie Mae's Single Family Servicing Guide provided:

> If the [condominium] project is located in a state...that provides for up to six months of delinquent regular condo assessments to have priority over the mortgage lien, Fannie Mae will reimburse the servicer for up to six months of such advances.

(Servicing Guide, March 14, 2012, Part III, §202.) Tellingly, this guideline was originally adopted in 2003, *before* the current foreclosure crisis.

Fannie Mae recently announced a revision of the foregoing section, which provides:

> For properties located in states providing for assessment liens over a previously-recorded document, services must...determine the amount to be paid in order to clear the HOA's claim of lien and preserve the priority of [Fannie Mae's] mortgage lien. The amount is generally the lowest of:
>
> - the actual delinquent assessment balance and allowed costs,
> - the maximum amount due from the foreclosing first mortgage entity based on the provisions in the project's declaration, or
> - the *maximum amount due from a foreclosing first mortgage entity under the relevant state statute*.
>
> The servicer must pay that amount immediately following, but not later than 30 days after, the foreclosure sale date or acceptance of a deed-in-lieu of foreclosure.

(Servicing Guide Announcement SVC-2012-05, April 11, 2012; effective July 1, 2012; emphasis added.)

As with the previously-described modification of the Selling Guide, Fannie Mae is again acknowledging, this time in the context of loan servicing, that a state may establish laws providing for an HOA-priority lien greater in length than six months.

The obvious conclusion to be drawn from Fannie Mae's guideline revisions is that lenders and servicers should work out the allocation of risk among themselves. And that risk obviously includes the possibility that an HOA lien liability may be greater than six months. The lenders should not be permitted to hide behind out-of-date state lien laws to unfairly shift some of their losses onto innocent third parties (HOAs and their unit owners).

Foreclose and Rent

In testimony before the CPC Committee, the HBA recommended that HOAs achieve relief by foreclosing their own liens on delinquent units (which are already subject to a pending mortgage foreclosure) and renting them out to offset the uncollected maintenance fees. The HBA offered the following analysis:

> [I]f this bill [HB 21] were to become law, there is little incentive for an association to act prudently knowing that eventually the entirety of the delinquent assessments will be paid.

The HBA appears to be arguing that the prudent course for an HOA is to *ignore* the obvious benefit of HB 21 (i.e., full payment of delinquencies) and, instead, begin investing in underwater units.

HB 25, pending in the current session, would amend the foreclosure law to facilitate nonjudicial foreclosures by an HOA. There may be some circumstances in which the possible benefits of foreclose-and-rent may outweigh the many risks.[14] And the choices available to an HOA should not be limited. On February 13th, the CPC Committee recommended that HB 21 be "Passed, with amendments." The amendment incorporated some details of a foreclose-and-rent remedy into HB 21. It clarifies how to determine an HOA's net income from renting a foreclosed unit and provides that excess rent, as defined, shall be distributed to the other lienholders.

The Judiciary Committee retained the foreclose-and-rent provisions in HB 21 HD1, but deleted the changes in the original bill that established priority, for the HOAs' basic lien, over mortgages. Foreclose-and-rent is a risky investment strategy which may occasionally benefit an HOA. It does not assure the necessary relief that would be provided by an effective basic HOA-priority lien.

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[14] My earlier CPC Committee testimony detailed many of the risks inherent in this approach. Chief among them were (i) substantial acquisition costs (including legal fees) (ii) possibly substantial refurbishment expenses, and, most significantly, (iii) the *still-pending foreclosure* of the first mortgage. As a practical matter, the HOA would be stepping into the shoes of the underwater unit owner. The HOA's *provisional* ownership could be terminated at almost any time if the first mortgage holder decides to complete its foreclosure. If that happens, all of the HOA's unrecovered investment in the unit will be lost.

The Realtors' Opposition Is Misplaced

The gist of the Realtors' objections is that HB 21 may make it harder for buyers to qualify for loans and thus reduce sales and home values. The Realtors, however, are ignoring the obvious: continuation of the unjustified allocation of accrued losses to HOAs and the performing owners will inevitably cause HOAs to significantly raise monthly fees and/or impose serial special assessments (as we are having to do at Kaha Lani). If HB 21 is not enacted, the Realtors should be concerned that the continuing wave of delinquencies will cause owner fees to soar, making it that much harder for buyers to qualify for new loans.

Any agent will tell you the first question asked by a prospective condo buyer always is "What are the monthly fees?" The heightened risk of increased levies will discourage buyers. Moreover, these known liabilities associated with unit ownership are circumstances which real estate agents are legally duty-bound to disclose to prospective buyers.

On the other hand, HB 21 allocates these costs where they properly belong, to the security for the mortgage holders who, as secured parties, have enjoyed the full benefit of the HOAs' maintenance efforts—while *paying nothing* for those services. By making the HOAs whole, the original version of HB 21 would enhance the financial health of this important segment of the real estate market. In the long run, the Realtors' interests will be better served by laws which help—rather than hinder—HOAs' ability to maintain their properties' common elements.

Conclusion

Under existing law, foreclosing banks receive the full benefit of the HOAs' maintenance of the banks' security, but have no responsibility for the unit's proportionate share of the corresponding costs. If given priority over the banks, the HOA's basic statutory lien rights would enable them to be made whole. HB 21, as originally drafted, accomplishes this by updating §514B-146 to (1) reflect the post-recession realities of the condominium market and (2) rescind the banks' unfair priority over HOA liens for delinquent maintenance fees.

The mortgage industry is using speculative and inaccurate scare tactics to discourage support for HB 21. However, nothing in the mortgage industry's submissions eclipses the fair result that would be implemented by HB 21. Moreover, Fannie Mae's suitability guidelines have recently been amended to accommodate legislation such as HB 21. Contrary to the

industry's prediction of dire consequences to the local mortgage market, HB 21 has much to offer:

1. It would remedy the HOAs' long-standing problem with uncollectible maintenance fees for foreclosed underwater units.

2. It would fairly compensate the HOAs for maintaining the defaulting units' shares the properties' common elements.

3. It would cause the banks to become more forthcoming and cooperative in agreeing to and performing on short sales which, in turn, would sooner get new, paying owners into the delinquent units.

4. It would address the banks' moral-hazard problem by relieving the nondefaulting unit owners from the burden of partially bailing out of the banks' losses from bad loans.

I strongly support the enactment of HB 21, *as originally introduced*. Please contact me at (415) 381-4340 (cell) or ngblonder@yahoo.com if the Committee has any questions about this testimony.

Dated: March 26, 2013.

Respectfully submitted,

/s/ Nicholas Blonder
Nicholas Blonder
4460 Nehe Road, #324
Lihue, Hawaii 96766

Arlette S. Harada
888 Mililani Street, 2nd Floor
Honolulu, Hawaii 96813
(808) 523-0702

March 25, 2013

SENATE COMMITTEE ON JUDICIARY AND LABOR

REGARDING HOUSE BILL 21, HD 2, SD1

Hearing Date:		WEDNESDAY, March 27, 2013
Time	:	10:50 a.m.
Place	:	Conference Room 016

Chair Hee, Vice Chair Shimabukuro, and Members of the Committee,

I am Arlette Harada, an attorney representing condominium associations in collection matters. I have handled judicial and non-judicial foreclosures for associations for the past 16 years. I write in opposition to proposed subparagraph (k) of Hawaii Revised Statutes 514B-146 as stated in HB 21, HD2, SD1.

Subparagraph (k) would require that an association that has taken the risks involved with foreclosing on a unit, pay any proceeds over the amounts defined in the bill as amounts to recover the Association's expenses and the maintenance fees and costs, to the other lienholders, including senior lienholders such as the mortgagees who are ahead of the Association in priority.

When an Association forecloses, we are foreclosing on the Association's interest and any junior liens. The senior liens, including the real property taxes, lease rents, mortgages of records and federal tax liens of record are not extinguished by the Association's foreclosure. They continue to be able to assert their rights to foreclosure, tax sales or actions to terminate the lease. Therefore, the people bidding at the Association's foreclosure auctions are bidding for the benefit they can derive from the unit either by clearing title and paying the senior liens or, and this is more likely, buying the unit to rent out until one of the senior lienholders takes action on its interest. The high bid less the amounts owed to the Association and any lienholders junior to the Association represents the owner's equity in the property.

The Association may not force a senior lienholder to foreclose its interest but neither does the senior lienholder have a right to take the proceeds of sale from the

prior owner (after payment of the Association's lien and any liens junior to the Association) or take the rental proceeds from an Association who purchases at foreclosure. I believe that forcing an Association to pay a lender the rents received after the Association becomes the owner is an unconstitutional taking of property without due process of law. As the new owner of the unit, the Association has a right to derive the benefits of the rental, including the amounts over and above the unpaid assessments and costs of collection.

The lenders have the ability to conduct their own foreclosures and there have been many, many instances where we have completed a non-judicial foreclosure only to have the lender appoint a commissioner within a month or two. In these cases, the Association gains nothing from the very expensive process of foreclosing. For every instance where an association has recovered enough to cover the arrears owed by the prior owner and the expenses of foreclosure, there are many more cases where the Association has not received enough to even cover the expense of publication of the foreclosure notice. There also have been many instances where, only after the Association performed repairs on a unit and had a tenant placed in the unit, the lender moved forward with its foreclosure and had a commissioner appointed who took the rents. The Association recovered very little of what it was owed. The Association should be able to recover some of these losses through the foreclosures that result in rental for a period sufficient to "recover" the costs incurred.

The lenders have the ability to foreclose and should be required to conduct their own foreclosure rather than take the owner's equity or the Association's rents. Lenders resell units after they foreclose and there has not been any sharing of the profits from those sales with the associations. In the meantime, the Associations provide services to the unit and keep the common areas maintained to the benefit of the lenders who are foreclosing or trying to resell foreclosed properties.

Furthermore, a specific problem with subparagraph (k) is the requirement that the rents be applied first the unpaid assessments constituting the Association's lien which would leave legal fees and costs and other costs associated with putting a unit into rentable condition to be paid last. This provision would directly conflict with HRS 667-92(f) and 667-100 which recognize the Association's ability to obtain a deficiency judgment and the application of proceeds of the sale in a certain priority. The provisions of subparagraph (k) would reverse the priority during the period that the unit is rented by the Association.

In closing, I ask that you reject Subparagraph (k) of HB21, HD2, SD1. The rest of

the proposed changes to HRS 514B-146 are reasonable and intended to remove the differentiation between the purchase of a lender foreclosed unit by the lender and by a third party. However, HB21, HD2, SD1 only addresses condominium associations covered by HRS 514B and not planned communities covered by HRS 421J.

Please contact me at 523-0702 if you have any questions. Thank you for this opportunity to testify.

Very truly yours,

Arlette S. Harada

Ashwork/Testimony/2013 Testimony HB21, HD2, SD1 (03 25 13)

hee2 - Kathleen

From: mailinglist@capitol.hawaii.gov
Sent: Tuesday, March 26, 2013 8:38 AM
To: JDLTestimony
Cc: howecb@hawaii.rr.com
Subject: Submitted testimony for HB21 on Mar 27, 2013 10:50AM

HB21
Submitted on: 3/26/2013
Testimony for JDL on Mar 27, 2013 10:50AM in Conference Room 016

Submitted By	Organization	Testifier Position	Present at Hearing
Bruce Howe	Individual	Oppose	Yes

Comments: HB 21 as originally proposed was clearly beneficial to community associations in providing lien priority to collect delinquent accounts. As currently drafted, it is unfair in requiring them to become collection agents for lenders after the original delinquency is satisfied. This not only creates potentiakl liability but places them in an inferior position to any other purchaser at the foreclosure sale. An unrelated purchaser at the foreclosure sale would have no such obligation to any other claimant. Associations should be treated similarly if they are to receive equal protection and equal treatment under the law. For these reasons, I oppose HB21 in its current form.

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

Do not reply to this email. This inbox is not monitored. For assistance please email webmaster@capitol.hawaii.gov

Jane Sugimura
98-340 Koauka Loop, #112
Aiea, Hawaii 96701

March 26, 2013

Sen. Clayton Hee, Chair
Sen. Maile Shimabukuro, Vice-Chair
Senate Committee on Judiciary and Labor

Re: HB21, HD2 SD1 Relating to Condominiums
Hearing: Wednesday, March 27, 2013, 10:50 a.m., Conf. Rm. #106

Chair Hee, Vice-Chair Shimabukuro and Members of the Committee:

I am Jane Sugimura, President of the Hawaii Council of Associations of Apartment Owners (HCAAO), but this testimony is made in my individual capacity as a board member of over 20 years of 2 condominium projects in the Pearlridge area.

This bill as amended will help condominium associations recover on their maintenance fee delinquencies by clarifying their rights to collect rent from units that they acquire through foreclosure (see amendments beginning at line 13 on page 10 to line 12 on page 11 of HB21 HD2 SD1).

Both of the associations that I serve as a Board member have acquired units in foreclosure and I have personal knowledge of the foreclosure process by which my associations acquired title to the units and the process used by both associations in renting the units and applying all rent income first to the current maintenance fee for the unit, then to any costs associated with the rental, e.g., cleaning and repairs of the unit, leasing commissions, and applying any excess to the maintenance fee delinquency associated with that unit.

Prior to the recent changes in the mortgage foreclosure laws, the condominium associations were seldom in a position where they could benefit from acquiring a unit in foreclosure. Associations typically paid a nominal amount (i.e., $1 – several thousands of dollars) but not in excess of their lien against the foreclosed unit. The reason why associations were able to acquire title in foreclosure for such nominal amounts was due to the fact that the interest they acquired was subject to the lender's priority interest in the property. This meant that as and when the lender filed its own foreclosure action and a commissioner was appointed in that foreclosure action, the association lost its rights to collect the rental income from the unit because of the lender's superior rights under its mortgage to recover any income generated by its collateral. Associations, however, were entitled to receive payments from the Commissioner for the current maintenance fees on the unit.

Testimony in Support of HB21 HD2 SD1 Re Condominiums

As a result of the recent changes in the mortgage foreclosure laws, associations are allowed to use the shorter non-judicial procedures to foreclose on their maintenance fee delinquencies; whereas, most mortgage lenders are required to use the time-consuming judicial procedures to foreclose on their mortgages and due to the court's backlog of cases, it takes longer for a lender to complete its foreclosure. This means that the associations are able to acquire their interest in a defaulting unit relatively quickly and then use the rental income from those units to pay the current maintenance fees, all leasing expenses and then applying any excess to the lien placed on the unit in respect of the delinquent maintenance fees. This benefits the association because the rental income increases its cash flow to pay for common expenses for all members, it is beneficial for the defaulting unit owner since any excess proceeds are used to reduce the amount of his or her lien on the unit and it benefits the lender because now the association is maintaining its collateral while it is required by new federal and state laws and regulations to remediate its mortgage with the defaulting mortgagor unit owners.

In both of the associations where I serve on the board, we have units, which we acquired in 2008 where the original maintenance fee delinquencies are almost paid and there has been discussion and debate as to who is entitled to the excess proceeds once the maintenance fee delinquency has been paid. Since the interest of the association is subject to the prior lien of the first mortgagee, it is my opinion (and there are many board members that I have talked to who agree with me) that any excess (i.e., rental income after payment of the (i) current maintenance fee, (ii) costs to repair, clean and maintain the unit, (iii) leasing commissions, and (iv) any administrative costs, should go to lender who has a superior lien on the unit. HB21 HD 2 DS1 addresses that concern and clearly balances the rights of the association, the unit owner and the lender with respect to how rental proceeds from a defaulting condominium unit should be equitably allocated among the interested parties.

Because I believe that HB21 HD2 SD1 resolves these issues in an equitable manner, I ask that you pass this bill out in its current form without any further amendments.

Thank you for allowing me to testify on this bill.

Jane Sugimura

Jane Sugimura

888 Mililani Street, 2nd Floor
Honolulu, Hawaii 96813-2918
March 26, 2013

SENATE COMMITTEE ON JUDICIARY AND LABOR
REGARDING HOUSE BILL 21, HD2, SD1

Hearing Date: WEDNESDAY, March 27, 2013
Time : 10:50 a.m.
Place : Conference Room 016

Chair Hee, Vice Chair Shimabukuro, and Members of the Committee,

My name is John Morris and I am testifying in favor, with comments on HB 21, HD2, SD1. As originally drafted, this bill provided condominiums and other homeowner associations with a lien for delinquencies that had an absolute priority over the lien of any mortgage. In other words, just like real property taxes, the association's claim for delinquent maintenance fees would always have been ahead of the lender's claim for unpaid amounts on a mortgage. That would have meant that in any foreclosure of a mortgage, once a unit was auctioned, the proceeds would be applied to real property taxes, then the association's lien, and then to the amounts due on the mortgage.

The SD1 now gives the association only a six-month priority over any mortgage, which is essentially what the current law provides for associations. In other words, under the SD1, like real property taxes, the association's claim for delinquencies will be ahead of the claim of any mortgage lender but only for up to 6 months of unpaid maintenance fees. That would have meant that in any foreclosure of a mortgage, once a unit was auctioned, the proceeds would be applied to real property taxes, then the association's lien, for a maximum amount of six months, and then to the amounts due on the mortgage.

The current law, which the SD1 proposes to delete, is essentially the same, with one important exception. Currently, the law states that, if a third-party purchaser buys a unit in foreclosure, the association can make a claim for six months of delinquent, unpaid maintenance fees at that time. Nevertheless, the current law states that an association can never make a claim directly against a mortgage lender.

For example, if the mortgage lender buys a unit in a foreclosure, the association cannot make a claim directly against the mortgage lender for the six months of delinquent maintenance fees. Instead, under the current law the association will have

to wait until the mortgage lender sells the unit to a third-party, at which point the association can claim six months of maintenance fees from the third-party purchaser.

The change proposed by the SD1 makes sense because Hawaii law will then be consistent with the uniform laws and most of the laws found in other states. The uniform laws and most of the other laws are essentially the same as the changes outlined in the SD1.

In addition, however, the Uniform Common Interest Ownership Act ("UCIOA"), as amended in 2008, does include one important addition: it also allows the association to claim reasonable attorney's fees in addition to 6 months of delinquent maintenance fees (See Section 3-116 of UCIOA). In other words, the association's priority over a mortgage is not only six months of delinquent maintenance fees but also reasonable attorney's fees incurred by the association collecting its delinquency. Since UCIOA has adopted this provision, the Hawaii legislature could certainly consider that provision as an addition to the SD1.

Finally, since the association's absolute priority lien in the original version of HB 21 has been eliminated, subsection (k) of HB 21, HD2, SD1 should also be eliminated. Subsection (k) provides that if the association: (i) collects rent while renting out a delinquent owner's unit; and (ii) eventually reaches the point where it is collecting more rent than it is owed in delinquent assessments, the surplus amount should go to the lender. That provision may have made sense when the association was being granted an absolute priority lien over the lender by the original version of HB 21. Under those circumstances, if the lender would end up paying the association for the unit owner's delinquency, the lender should receive some benefit from that obligation.

Under HB 21, HD2, SD1 as written, however, the provision no longer makes sense. There is no reason an association should pay surplus rent to the lender if the association is not receiving the benefit of an absolute priority lien over the lender. Instead, since the SD1 eliminates the absolute priority lien – in effect, returning to the same "every man for himself" scenario that currently exists under the law – the association should be able to retain any rent it collects.

Otherwise, if the committee decides to keep the requirement that the association must pay surplus rental proceeds to the lender, the lender should also be required to pay any surplus proceeds it realizes from its collection procedures to the association. That would only be fair if the association has to provide the same collection service to the lender.

Please contact me at 523-0702 if you have any questions. Thank you for this opportunity to testify.

Very truly yours,

John A. Morris

JAM:alt\\G:\C\2013 Testimony HB 21, HD2, SD1 (03.26.13)