

# SB2662

Measure Title: RELATING TO CONDOMINIUMS.

Report Title: Condominium; Association Foreclosure; Priority

Description: Ensures that any surplus proceeds from an association foreclosure be paid to junior creditors and the former owner of the condominium instead of first being paid to the first mortgage holder.

Companion:

Package: None

Current Referral: CPH, JDL

Introducer(s): BAKER, INOUYE, Kidani

# 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

February 1, 2016

Senator Rosalyn H. Baker, Chair

Senator Michelle N. Kidani, Vice Chair

and members of the Senate Committee on Commerce, Consumer Protection & Health

Hawaii State Capitol

Honolulu, Hawaii 96813

Re: **S.B. 2662 (Condominiums)**

**Hearing Date/Time: Monday, February 1, 2016, 9:00 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 **opposes** this Bill as drafted.

The stated purpose of this Bill is to ensure that any surplus proceeds from an association foreclosure be paid to junior creditors and the former owner of the condominium instead of first being paid to the first mortgage holder.

Here are our concerns:

1. The title of this Bill (“Condominiums”) is too narrow for the subject of this Bill. The statute in this Bill is HRS §667-100 which is for an “association” foreclosure. An “association” is defined in HRS §667-1 by referring to both HRS §421J-2 (planned community associations) and HRS §514B-3 (condominium). Because this Bill encompasses more than just “condominiums”, it is defective as drafted.

2. This Bill refers only to non-judicial foreclosures initiated by an association. It doesn’t address priorities for judicial foreclosures initiated by an association. The statute for judicial foreclosures is:

§667-3 Proceeds, how applied. Mortgage and other creditors shall be entitled to payment according to the priority of their liens, and not pro rata; and judgments of foreclosure that are conducted in compliance with this part shall operate to extinguish the liens of subsequent mortgages and liens of the same property, without forcing prior mortgagees or lienors to their right of recovery. The surplus after payment of the mortgage foreclosed, shall be applied pro tanto to the next junior mortgage or lien, and so on to the payment, wholly or in part, of mortgages and liens junior to the one assessed.

The priorities for non-judicial foreclosures in this Bill are treated differently from the priorities for judicial foreclosures under HRS §667-3. We believe that for both non-judicial foreclosures and judicial foreclosures, the priorities should be the same, i.e. the senior mortgage should have the right to be paid off before the association and junior creditors. Both HRS §667-100 and HRS §667-3 need to be amended. However, the title of this Bill is much too narrow to allow that.

3. We incorporate by reference the various concerns raised in the testimonies of the Mortgage Bankers Association of Hawaii and the Hawaii Bankers Association.

Accordingly, we ask that your Committee “hold” this Bill and not pass it. Thank you for considering our testimony.

*Marvin S. C. Dang*

MARVIN S.C. DANG

Attorney for Hawaii Financial Services Association

Presentation To  
Senate Committee on Commerce, Consumer Protection, and Health  
February 1, 2016 at 9:00 AM  
State Capitol Conference Room 229

**Testimony in Opposition to Senate Bill 2662**

TO: The Honorable Rosalyn H. Baker, Chair  
The Honorable Michelle N. Kidani, Vice Chair  
Members of the Committee

My name is Edward Pei and I am the Executive Director of the Hawaii Bankers Association (HBA). HBA is the trade association representing eleven FDIC insured depository institutions with branch offices in the State of Hawaii.

The stated intent of this bill is to “ensure a fair distribution of funds when an association forecloses on a condominium”. However, the priority for the distribution of surplus proceeds from the sale of the unit hardly seems fair, if the first mortgage creditor is not paid until all other creditors are paid, including the defaulting former owner of the property. While it is accurate that “the first mortgage holder retains a lien on the property and all of the associated remedies”, all junior creditors have essentially the same remedies. So, the fair way to distribute surplus proceeds should really be based in the order of priority as a matter of law.

We also feel that the measure lacks sufficient definition of various terms, including “surplus of proceeds” and “junior creditor”. We incorporate by reference the various concerns raised in the testimony of the Mortgage Bankers Association of Hawaii. Accordingly, we ask that your Committee “hold” this Bill and not pass it out.

Thank you for the opportunity to submit this testimony and please let us know if we can provide further information.



Edward Y. W. Pei  
(808) 524-5161



Testimony to the Senate Committee on Commerce, Consumer Protection & Health  
February 1, 2016

Testimony in Opposition to SB 2662, Relating to Condominiums

To: The Honorable Rosalyn Baker, Chair  
The Honorable Michelle Kidani, Vice-Chair  
Members of the Committee

My name is Stefanie Sakamoto, and I am testifying on behalf of the Hawaii Credit Union League, the local trade association for 63 Hawaii credit unions, representing over 800,000 credit union members across the state. We are opposed to SB 2662, Relating to Condominiums.

Approximately 50 of Hawaii's credit unions currently offer mortgages and other forms of credit to their members.

The first sentence of this bill reads "...it is important to ensure a fair distribution of funds when an association foreclosures on a condominium." The bill goes on to state that "junior creditors" and the borrower are the recipients of the proceeds of the foreclosure before the first mortgage creditor. This is unfair.

Credit unions are not-for-profit financial cooperatives which are member-owned. If a credit union cannot collect a debt which it is owed, the credit union members as a whole suffer the loss.

Thus, we oppose SB 2662, and concur with the concerns raised by the Mortgage Bankers Association of Hawaii.

Thank you for the opportunity to provide comments.



*Mortgage Bankers Association of Hawaii*  
*P.O. Box 4129, Honolulu, Hawaii 96812*

January 29, 2016

The Honorable Rosalyn H. Baker, Chair,  
The Honorable Michelle N. Kidani, Vice Chair, and  
Members of the Commerce, Consumer Protection and Health Committee  
State Capitol, Room 229  
Honolulu, Hawaii 96813

Re: Senate Bill 2662 Relating to Condominiums

**Chair Baker, Vice Chair Kidani, and Members of the Committee:**

I am Linda Nakamura, representing the Mortgage Bankers Association of Hawaii ("MBAH"). The MBAH is a voluntary organization of individuals involved in the real estate lending industry in Hawaii. Our membership consists of employees of banks, savings institutions, mortgage bankers, mortgage brokers, financial institutions, and companies whose business depends upon the ongoing health of the financial services industry of Hawaii. The members of the MBAH originate and service or support the origination and servicing of the vast majority of residential and commercial real estate mortgage loans in Hawaii. When, and if, the MBAH testifies on legislation, it is related only to mortgage lending and servicing.

The MBAH opposes Senate Bill 2662. The MBAH is unsure of the intent of the bill. The bill is ambiguous in its definition of a junior creditor. Is a junior creditor a creditor junior to the first mortgage or is a junior creditor junior to the condominium association's lien?

The bill states that it is important to ensure a fair distribution of funds. However, is it fair that a creditor of an unsecured credit who becomes a secured junior creditor by way of placing a judgment lien against the condominium unit will be paid before a first mortgage creditor and the borrower? Any junior creditor with a lien against the condominium unit will have the same collection remedies as the 1<sup>st</sup> mortgage creditor. The MBAH does not see this as fair.

Once the condominium unit owner no longer owns the unit, prior liens are not likely to be paid and therefore foreclosed upon. As a matter of efficiency and economy, as well as fairness, upon the completion of the condominium association foreclosure sale, holders of liens of record, including first mortgages, should be paid in order of priority except for the lien in favor of the condominium association for six months of regular common area assessments.

Thank you for the opportunity to present this testimony.

LINDA NAKAMURA  
Mortgage Bankers Association of Hawaii



January 29, 2016

VIA WEB TRANSMITTAL

Hearing Date: Monday, February 1, 2016

Time: 9:00 a.m.

Place: Conference Room 229

Committee on Commerce, Consumer Protection & Health  
The Senate, the 28<sup>th</sup> Legislature  
Regular Session of 2016

Re: Community Associations Institute's Testimony in Opposition to SB2662

Dear Chair Chair Baker, Vice Chair Kidani and Committee members:

I am the Vice Chair of the Community Associations Legislative Action Committee ("CAI"). CAI opposes SB2662 due to the following concerns:

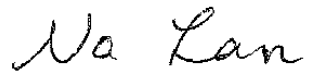
- (1) The Association should not be put in a position to decide the validity or priority of liens of the junior creditors; only the court can make that determination;
- (2) SB2662 would no doubt lead to more potential claims against the Association and its Board by prior unit owners and junior creditors on the issue of distribution of surplus proceeds, which would make it more difficult and expensive for associations to obtain CGL and D&O insurance coverages;
- (3) SB2662 is contrary to the fundamental common law principles on lien priority and would lead to different results on surplus proceeds distribution depending on whether the Association opts to foreclose by judicial action or by alternate power of sale process. HRS 667-100 only applies to Association's nonjudicial foreclosures. In an Association's judicial foreclosure, any surplus proceeds

January 29, 2016

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from the Commissioner's auction sale would be directed by the Court first to prior mortgagees per the priority of their liens and then to junior creditors and last to prior unit owners.

Sincerely yours,

A handwritten signature in cursive script that reads "Na Lan".

Na Lan, Vice Chair of CAI LAC Hawaii

**From:** [mailinglist@capitol.hawaii.gov](mailto:mailinglist@capitol.hawaii.gov)  
**To:** [CPH Testimony](#)  
**Cc:** [richard.emery@associa.us](mailto:richard.emery@associa.us)  
**Subject:** Submitted testimony for SB2662 on Feb 1, 2016 09:00AM  
**Date:** Saturday, January 30, 2016 4:50:07 PM

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**SB2662**

Submitted on: 1/30/2016

Testimony for CPH on Feb 1, 2016 09:00AM in Conference Room 229

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Richard Emery	Associa	Oppose	Yes

Comments: I am the VP of Government Affairs for Associa, America's largest Association management company, that represents approximately 550 Hawaii associations. We oppose the Bill as the nonprofit association should not be responsible for determining the proper distribution if excess proceeds and the decision should be left to the courts. Many things can happen in a foreclosure such as multiple junior creditors, death resulting in referral to the probate court, or bankruptcy of a party. This Bill may result in unnecessary cost, risk, and exposure to an 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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January 30, 2016

SENATE COMMITTEE ON COMMERCE, CONSUMER PROTECTION AND HEALTH  
REGARDING SENATE BILL 2662

Hearing Date: MONDAY, February 1, 2016  
Time : 9:00 a.m.  
Place : Conference Room 229

Chair Baker, Vice Chair Kidani, and Members of the Committee,

I am Arlette Harada and I am an attorney practicing in the area of collection and foreclosure on behalf condominium associations and homeowner associations. I ask that you vote in favor of Senate Bill 2662.

The current version of Section 667-100 of the Hawaii Revised Statutes, which Senate Bill 2662 seeks to modify, has caused confusion among foreclosing parties, their attorneys and purchasers at foreclosure. Some purchasers have requested that any excess proceeds from the sale of the unit be applied to the first mortgage pursuant to subsection (b)(4) of Section 667-100.

Association liens are generally junior to mortgage liens on real property. When an association forecloses its lien, the foreclosure is made "subject to" the senior liens and therefore, the senior liens remain encumbrances on the property being foreclosed. The ability of the senior lienholder to retain its lien and conduct its own foreclosure is well established by Hawaii Revised Statutes Section 667-3 and Hawaii case law. Therefore, the foreclosure extinguishes the association's lien and all junior liens on the property and the proceeds of the sale are to be paid to the association, to junior lienholders in order of priority and then to the foreclosed property owner, the remaining proceeds representing the foreclosed owner's "equity" in the property.

The current statute creates an ambiguity by stating that after the association is paid, "All other liens and encumbrances in the order of priority as a matter of law," are to be paid from the proceeds. Some purchasers and counsel are instructing escrow to pay the first mortgage, rather than holding the proceeds to pay the junior liens and then the owner. I understand that there have been foreclosure sales closed which followed this interpretation of this provision. If there is a junior lienholder, this interpretation would result in the first mortgage lien being paid before the junior lienholder although the senior lienholder retains its lien and ability to foreclose while the junior lienholder's lien is extinguished.

TESTIMONY REGARDING SENATE BILL 2662

January 30, 2016

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We have a pending matter where the property has a tax assessed value of \$604,000. The property auctioned for \$240,100, subject to the 1998 first mortgage lien of \$150,000, which means the mortgage probably has been paid down to under \$50,000. After the association was paid, there are remaining proceeds of over \$230,000. The purchaser instructed escrow to pay the first mortgage lien from the remaining proceeds. We instructed escrow to hold the remaining funds for the owner (there were no junior lienholders). If the purchaser is allowed to apply the proceeds to the first mortgage, he would be acquiring a property valued at over \$600,000 free the mortgage and all of the liens junior to the first mortgage for \$240,100 (rather than also having to pay the \$50,000 for the mortgage). The owner's equity would be reduced by the \$50,000. In this case, the purchaser would receive a windfall at the expense of the prior owner. Escrow deposited these funds to court but the matter has not yet been heard by a judge.

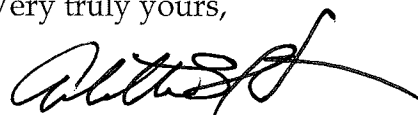
I spoke with the other bidder, who stopped at \$240,000 at the auction. She did not go higher in the bidding because she believed, per the terms of the foreclosure sale, that the excess proceeds would be paid to the foreclosed owner, not used to pay off the mortgage subject to which the property was sold. Other bidders are denied the ability to bid more to purchase the property if this ambiguity is allowed to continue.

Furthermore, this provision is contrary to the application of payments in judicial foreclosures where the proceeds are applied per Hawaii Revised Statutes Section 667-3. The treatment of the proceeds of sale should be consistent in judicial and non-judicial foreclosures, which provides that proceeds are applied to the foreclosed lien and then to the next junior lien with senior liens retaining their liens and ability to foreclose.

The point of the wholesale change to the non-judicial foreclosure law several years ago was to provide for adequate protections to owners when their property is foreclosed non-judicially such as having a reasonable opportunity to save the property and if the property is auctioned, maximizing the bids received at auction and minimizing the cost of the foreclosure. The current provision provides a possible loophole some purchasers are using to take the owner's equity from them.

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

Very truly yours,



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Arlette S. Harada