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EXPERT ANALYSIS

Condominium Association Liens: Statutory, Consensual or Both?

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The following is a common scenario. A debtor owns a condominium unit. Due to unforeseen circumstances the debtor falls behind on both the mortgage payments and the condominium association dues. The debtor, now with sufficient income to attempt to save his or her home, files a Chapter 13 bankruptcy.

At the time of filing, the value of the condominium unit is less than the amount owed on the first mortgage. As is often the case, there are also outstanding condominium association liens. Whether the condominium association liens can be stripped off without violating the anti-modification provision of 11 U.S.C.A. § 1322(b)(2) may be the determining factor as to whether a Chapter 13 plan is confirmable.

The Bankruptcy Code's anti-modification clause prohibits Chapter 13 debtors from modifying the rights of holders of claims "secured only by a security interest in real property that is the debtor's principal residence."

Claims secured solely by a security interest in the debtor's principal residence, therefore, may not be bifurcated into secured and unsecured portions.[1]

There is a split among the courts as to whether condominium and homeowner association liens are security interests, which are not subject to modification, or statutory liens, which are subject to modification.

As one esteemed bankruptcy judge recently framed the issue in *In re Keise*:

> In New Jersey, as in many parts of our nation, we are often faced with certain seemingly unresolvable conundrums: For instance, is a tomato a fruit or a vegetable? Should the breakfast meat be called pork roll or Taylor ham? ... In the present matter, the court is asked to resolve yet another difficult quandary challenging the courts within this district; to wit, whether the lien held by a New Jersey condominium or homeowners association is a statutory lien or a consensual lien?[2]

Condominium and homeowner association liens arise both by statute and pursuant to a master deed. While the language in the master deed may deviate, it normally includes language that provides for the fixing of a lien for unpaid dues, assessments and other charges.

State statutes also provide for the fixing of a lien. For example, the New Jersey Condominium Act, N.J. Stat. Ann. § 46:8B-21(a), also grants to the association a lien on each unit for unpaid assessments and other debts.

The statute specifically provides that "all such liens shall be subordinate to any lien for past-due and unpaid property taxes, the lien of any mortgage to which the unit is subject and to any other lien recorded prior to the time of recording of the claim of lien."

The statute further grants the lien a limited priority over prior recorded mortgages and certain other liens. Specifically, N.J. Stat. Ann. § 46:8B-21(b)(1) provides that the amount of the priority portion of the lien "shall not exceed the aggregate customary condominium assessment against the unit owner for the six-month period prior to the recording of the lien."

If there were no equity for the association lien, in the 3rd Circuit and most other circuits the association lien would properly be determined to be wholly unsecured and subject to avoidance without running afoul of the anti-modification clause of 11 U.S.C.A. § 1322(b)(2).[3]

Given the six-month priority, however, a portion of the lien is secured ahead of the existing mortgage lien, potentially rendering the entire lien secured and not subject to modification.[4]

The Bankruptcy Code identifies and recognizes three types of liens: judicial liens, security interests and statutory liens. A judicial lien is defined as a "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceedings." A security interest is defined as "a lien created by an agreement."

A statutory lien arises "solely by force of a statute on specified circumstances or conditions ... but does not include security interest or judicial lien, whether or not such interest or lien is provided by or is dependent on a statute and whether or not such interest or lien is made fully effective by statute."

Courts are not in agreement as to whether condominium association liens are statutory liens or security interests.

The Bankruptcy Code does not address the issue of whether the three types of liens are mutually exclusive. The legislative history, however, states that the "three categories are mutually exclusive and are exhaustive except for certain common law liens."[5] Accordingly, it has been held that a lien cannot be both a statutory lien and a security interest.[6]

Courts are not in agreement as to whether condominium association liens are statutory liens or security interests.

COURTS HOLDING THAT ASSOCIATION LIENS ARE STATUTORY

A number of courts have held that condominium association liens are statutory. In *In re Green*,[7] the U.S. District Court for the Eastern District of Louisiana ruled that under Louisiana law, homeowner association liens are statutory, not consensual, and the security interest could arise only through a privilege or a mortgage.

According to the court:

> The Louisiana Condominium Act grants a condominium association a special privilege in a debtor's condominium for amounts owed to the association. A "privilege is a right, which the nature of a debt gives to a creditor, and which entitles him to be preferred before other creditors, even those who have mortgages." While the term "privilege" is unique to Louisiana law, it is synonymous with the term "statutory lien," which is used outside of Louisiana. "[A] privilege arises only if and to the extent the law says it does; the law must be express, and privileges are interpreted strictly against the claimant.

A mortgage, on the other hand, requires the "parties [to] execute a written contract, which must be signed by the mortgagor, state the amount secured, and describe the immovable property," the court said.

The mere fact that the condominium declaration is recorded in the public record does not meet the requirements of a mortgage and therefore, the court determined, does not create a consensual security interest.

Thus, according to the court, the anti-modification provisions of 11 U.S.C.A. § 1322 do not apply. The District Court's opinion was later affirmed by the 5th U.S. Circuit Court of Appeals.[8]

In a decision not involving Section 1322, *Young v. 1200 Buena Vista Condominiums*,[9] the U.S. District Court for the Western District of Pennsylvania reversed a bankruptcy court holding

that a condominium association lien was a security interest, not a statutory lien. Interpreting Pennsylvania law, the court in concluded that condominium liens are statutory liens.

Central to the court's ruling was its determination that the lien originally arose solely by the force of statute.[10] According to the *Young* court, "if a lien first arises by statute and then there is later action that could be considered the formation of a security interest or a judicial lien, the lien remains a statutory lien."

In *In re Lopez*,[11] the debtor's plan proposed to pay the condominium association the six-month priority provided for under Colorado law[12] and strip off the balance because no equity existed after taking into account the amount due on the recorded mortgage.

The association objected to plan confirmation, arguing that the mere existence of equity for the priority portion of the lien precluded modification under Section 1322(b)(2).

Interpreting Colorado law, and relying on the *Young* decision, the *Lopez* court found that a condominium association lien is not entered into by agreement and, hence, is not a "security interest" as defined under the code.

Thus, the court concluded that the condominium association lien "is a statutory lien that may be modified in a Chapter 13 plan."

Accordingly, the court ruled, "only the super-priority portion of the [condominium association] lien is supported by value to which its lien may attach," while " the remainder of the ... lien is void under Section 506(d) upon completion of the plan."

Several other courts have held that the condominium association lien is a statutory lien.[13]

COURTS HOLDING THAT ASSOCIATION LIENS ARE SECURITY INTERESTS

Other courts have held that an association's lien is a security interest. In *In re Rones*,[14] the debtor attempted to cramdown a claim for outstanding condominium assessments, secured by a lien on the debtor's primary residence. The parties disputed whether the lien arose by statute or through the language in the condominium association's master deed.

The U.S. Bankruptcy Court for the District of New Jersey found that "by bargaining for, voluntarily accepting, and subsequently recording, a deed to a condominium unit that incorporates the master deed and bylaws, the unit owner agrees to be bound by the rules and regulations of each." It therefore concluded that there was a single, consensual lien on the property.

The court did, however, recognize the six-month priority accorded to the lien under the Condominium Act, and it bifurcated the claim by allowing the claim to be modified but ordering the six-month priority to be paid.

On appeal to the U.S. District Court for the District of New Jersey, the parties did not contest the Bankruptcy Court's determination that the lien was consensual. Instead, they limited the issue to whether a consensual lien, with a partial priority, could be crammed down.[15]

The District Court concluded that since a portion of the consensual lien had a statutory priority over the prior mortgage lien, it was partially secured, and therefore no portion of the lien could be modified pursuant to the anti-modification clause of Section 1322 (b)(2).

Other cases have also concluded that the liens are security interests. The court in *In re Robinson*[16] assumed, without discussion, that the condominium association lien was a security interest.

In *Phillippy v. Corkscrew Woodlands Associates Inc. (In re Phillippy)*,[17] the court, when asked to decide whether a condominium association lien was a judicial lien or a security interest, concluded that the lien was a security interest. That case contained no discussion as to whether the lien was statutory.[18]

THE LIEN IS BOTH A SECURITY INTEREST AND A STATUTORY LIEN

The jurist who likened the question before him to deciding the correct classification for tomatoes and breakfast meat ultimately decided that no choice actually had to be made.

In *In re Keise*, the court held that the homeowners association claim was a single claim secured by two separate liens: one statutory pursuant to the New Jersey Condominium Act and one consensual pursuant to the parties' agreement in the association's declaration of covenants and restrictions.

Focusing on the language of 11 U.S.C.A. § 1322(b)(2) precluding modification of a claim "secured *only* by a security interest," the *Keise* court concluded that "the claim is secured by *both* a security interest (consensual lien) and a statutory lien; accordingly, it is not afforded the protections of Section 1322(b)(2)." Therefore, the court held that only the six-month priority amount was secured, and the remainder was unsecured.

CONCLUSION

At first blush, it would appear that the holding in *In re Keise* goes against the general rule that the three types of liens are mutually exclusive. On further analysis, however, it appears that the court is correct.

One lien cannot be designated as both statutory and consensual. The *Keise* court, however, found that there were two separate liens, one that arose by consent, the other by statute.

It is actually possible that a homeowner or condominium association can have three liens on the same property. If, in addition to the lien created by the master deed, and that created by statute, the association holds a judgment against the debtor for unpaid fees and assessments, it would also have a judgment lien on the same property.

Therefore, even in jurisdictions that deem association liens to be security interests, a good argument can be made that there are other liens on the property that secure that same claim.

Nevertheless, until there is binding precedent, courts in most jurisdictions will continue to face the difficult quandary of whether an association lien is a security interest, a statutory lien or both.

NOTES

[1] *See Nobleman v. Am. Sav. Bank,* 508 U.S. 324, 332 (1993) (holding that a claim on debtors' principal residence that is secured by any equity is protected from modification under 11 U.S.C.A. § 1322(b)(2)).

[2] *In re Keise,* 564 B.R. 255, 255-256 (Bankr. D.N.J. 2017).

[3] *See, e.g., In re McDonald,* 205 F.3d 606 (3d Cir. 2000).

[4] *See Nobleman,* 508 U.S. 324.

[5] H.R. Rep. No. 595, 95th Cong., 1st Sess. 312 (1977).

[6] *Young v. 1200 Buena Vista Condos.,* 477 B.R. 594 (W.D. Pa. 2012).

[7] 516 B.R. 347 (E.D. La. 2014),

[8] *Riverbend Condo. Ass'n v. Green,* 793 F.3d 463 (5th Cir. 2015).

[9] *Young*, 477 B.R. at 598.

[10] Pennsylvania Uniform Condominium Act, 69 Pa. Cons. Stat. Ann. § 3315).

[11] 512 B.R. 663 (D. Colo. 2014).

[12] Colorado Common Interest Ownership Act, Colo. Rev. Stat. Ann. § 38-33.3-316.

[13] *See, e.g., In re Johnson,* 108 B.R. 81 (Bankr. W.D. Pa. 1989); *In re Stern,* 44 B.R. 15 (Bankr. D. Mass. 1984).

[14] 531 B.R. 526 (Bankr. D.N.J. 2015), *rev'd in part,* 551 B.R. 162 (D.N.J. 2016).

[15] *See Whispering Woods Condo. Ass'n v. Rones (In re Rones),* 551 B.R. 162 (D.N.J. 2016).

[16] 231 B.R. 30, 34 (Bankr. D.N.J. 1997).

[17] 178 B.R. 67, 69-70 (Bankr. M.D. Pa. 1994).

[18] *See also In re Bland,* 91 B.R. 421, 422 (Bankr. N.D. Ohio 1988) (lien is a security interest, not a judicial lien).

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