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# Where to Go from Here? Why Judicial Foreclosure is Preferable over Non-Judicial Foreclosure for Community Associations

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As a law firm specializing in all aspects of common interest development law, we have seen the field of assessment collection change radically since the economic downturn: debtors have all been battered by collection efforts during the recession and have become inured to threats and letters; the court system is clogged; and the sheriffs' offices are often backlogged for months in processing and serving collection documents. With so many competing creditors struggling to get a piece of the debtor's pie, those of us successfully collecting for our clients have had to modify our practices to be more proactive and creative.

One question we are frequently asked by managers and board members pursuing assessment collection is "what are the pros and cons of judicial versus non-judicial foreclosure?" Apparently various non-attorney collection firms frequently recommend non-judicial foreclosure (the only type of foreclosure a non-lawyer can perform) to associations as the preferred foreclosure process when pursuing assessment collection actions. However, non-judicial foreclosures are rarely the best choice for associations, where judicial foreclosures are most often the best option. This article will explain why and provide a brief summary of the differences between the two.

**I. Judicial Foreclosure and Options for Collection**

A judicial foreclosure is essentially a process by which the Association files a law suit in civil court against the debtor and obtains a judgment for money and foreclosure. This is an enforceable judgment against the debtor as an individual, including the right to foreclose against the property and force its sale.

After several years prosecuting judicial foreclosures and assisting clients in clean-up after non-judicial foreclosures have run their course, we have seen the pros and cons of both procedures. Without fail judicial foreclosures consistently emerge as the most effective method to collect unpaid assessments in this economy, because, among other things: (1) an association has much more flexibility in enforcing a judgment (even if the property is over-encumbered, the association still has the right to proceed against the individual owner for the debt); (2) an association is more likely to get paid following a judicial foreclosure; (3) a judgment is good for 10 years (and renewable for another 10 years); and (4) the cost is reasonable.

Once we receive the signed and entered judgment for money damages and foreclosure ("Judgment") from a court, we have several options for collecting on the Judgment, beginning with:

(1) Recording "Abstracts of Judgment" ("Abstracts") in all applicable counties. Abstracts act as "liens" on any real property in these counties and serve as notice to any person or entity seeking to determine the validity of title of property of a named defendant, or the credit worthiness of a named defendant. Once an Abstract is filed by an association, it becomes a secured creditor in the event of a bankruptcy filing or similar action.

(2) Garnishing wages and seizing bank accounts following an investigation to determine whether the debtor is employed and the scope of bank accounts. If the debtor is employed, then garnishing the debtor's wages is the fastest and cheapest access to funds. Seizing bank accounts is also a low-cost and rapid turn-around process for collecting.

(3) Conducting Judgment Debtor Examinations at the courthouse. If a judgment is not completely satisfied through wage garnishment or seizure of accounts, and assuming the debtor has not agreed to a settlement, we subpoena the debtor through an "Order for Judgment Debtor Examination" ("OJD"). An OJD is an examination of the debtor by an attorney, under penalty of perjury, held at the courthouse. The debtor is subpoenaed to appear and ordered to produce various documents such as tax returns, bank statements, copies of leases, deeds, etc. If the debtor fails to appear or appears and fails to produce documents, we request that the judge order a bench warrant for the debtor's arrest. The OJD is a very effective tool in getting key collection information and resolving cases.

## II. Non-Judicial Foreclosure and Its Pitfalls

A non-judicial foreclosure for non-payment of homeowner assessments operates in the same manner as the common bank foreclosure on a mortgage. The process is complicated, but in essence a notice of default is sent out to the debtor, giving the debtor a time to cure the default. If the debtor fails to cure the default, the property is noticed for sale at least 90 days from the notice. If, at the end of those 90 days the default is not cured, or the sale has not been delayed, the property is sold. Whoever is the successful bidder at the foreclosure sale, whether an association or a third party, will now own the property subject to all "superior" liens, namely all liens recorded against the property prior to the date of the assessment lien. Typically, these liens would be any mortgages on the property.

If no one bids, the association becomes the owner of the property, subject to all superior liens, and subject to the debtor's right to redeem the property within 90 days after the sale. Thus, if the property is worth $250,000.00, but has a $500,000.00 mortgage superior to the assessment lien, the association would now own the subject property, worth $250,000.00, subject to the $500,000.00 mortgage. If there actually is enough equity in the property (rare in this economy) a third party will most likely come in with a bid high enough to purchase the property, if they can get it for a good price, and pay off the association in full. In this instance, the association is paid and the collection process is completed. However, as demonstrated by the above illustration, in the more likely situation where there is no equity in the property, the association has no benefit from a non-judicial foreclosure.

In addition to these issues, there are several other pitfalls in the non-judicial foreclosure process.

### A. Inability to Collect from Individual Debtor(s)

In a non-judicial foreclosure, the creditor only has one shot to collect- and that is from the foreclosure sale of the property. The creditor cannot collect against the individual debtor for money damages at all once there has been a foreclosure. For example, if a debtor owes the association $5,000.00 and a buyer pays $1,000.00, an association would receive only $1,000.00 less the costs of the sale (or the association can bid and take ownership of the property). Thereafter, the association would have no other rights to collect the balance of the unpaid debt from the delinquent owner. In the judicial foreclosure process, on the other hand, once a judgment is obtained, an association can garnish wages, levy bank accounts, and sell assets, including the subject property, as discussed above. Even if a property is sold for less than the debt, if the sale is pursuant to a judicial foreclosure, the association can still proceed against the individual debtor for the remainder of the debt.

### B. Lengthy Process in the Long Run

Associations that use non-judicial foreclosure often do so because they believe that since it does not require review by a court it appears quicker than going through the court system. However, because: (a) the proceeding is conducted with the assistance of private trustees, who are often backlogged by months; and (b) non-judicial foreclosure sales are typically postponed one or more times, as a practical matter, a non-judicial foreclosure is often times much slower and more drawn out than the judicial proceeding. Additionally, under Civil Code §5715(b), the debtor has a 90-day right of redemption after the date of the sale before title can finally be recorded.

### C. Complex Procedure

Non-judicial foreclosures are often conducted without attorneys. However, the procedure is complicated and can lead to legal issues and snags, as the Civil Code and case law ensure that debtors in the non-judicial foreclosure are afforded basic due process. Thus, courts will scrutinize all non-judicial foreclosure sales for fairness and for a gross inadequacy of price.

### D. Taking Ownership of Unit – Insurance, Taxes, and Utilities

Following a non-judicial foreclosure, if an association intends to keep the property, it must ensure that separate liability and property damage insurance policies are taken out on the property. If the association rents out the unit, it is now acting as a landlord and has a whole new slew of liabilities to worry about in dealing with its tenants. Furthermore, although associations do not pay property taxes on common areas, they must pay taxes on any units/lots acquired through foreclosure. They may also be required to assume any tax liens on the unit. Finally, the unit's utilities will need to be put into the association's name and then paid as they come due.

### E. "Rent Skimming"

Where an Association takes ownership of a debtor's unit but fails to pay the senior mortgage holder from rents received from renting the unit, the association may find itself in serious trouble. This practice, also known as "rent skimming", may violate Civil Code §890 et seq. and could result in liability for actual damages (up to triple the actual damages suffered by the senior mortgage holder) and attorney's fees and costs in addition to the imposition of criminal penalties. We have heard certain law firms and collection companies claim that this should not be a concern because the laws for rent skimming are rarely enforced. We do not feel it is appropriate counseling clients or potential clients that it is okay to violate the law merely because the risks of getting caught are slim, and would never make such a recommendation!

### F. Senior Lien Holder Rights

In the non-judicial foreclosure process, where the first lienholder forecloses ahead of the association (which is often the case), the association's lien will be "wiped out" and the money owed by the debtor becomes unsecured. Although the association can still make a claim on any surplus funds resulting from the senior lienholder's sale, there normally are none. The association would have been better off pursuing a money judgment in the first place, since the association will now have to start from zero and file suit to collect after having wasted all that time and money in the non-judicial process.

## III. Conclusion

It is often claimed that non-judicial foreclosure is always much quicker, cheaper, and efficient than the judicial foreclosure. As this article explains, this is most often not the case. Without fail judicial foreclosures consistently emerge as the most effective method to collect unpaid assessments in this economy, because of the flexibility involved, the likelihood of recovering funds, the length of the judgment, and the reasonable cost. Non-judicial foreclosure by an association should only be considered as a last option, as it is more expensive in the long run, much riskier, and more time consuming.

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*1 See eg Bank of Seoul & Trust Co. v. Marcione (1988) 198 Cal.App.3d 113, at 119. You can see one recent horror story of non-judicial foreclosure gone wrong concerning the Castle Green Condos in Pasadena at Multani v. Witkin & Neal, (2013) 215 Cal. App. 4th 1428.*