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Legally Speaking...

Dealing With Condo Unit Foreclosures

Residents Default on their Mortgages, the Association Gets Sued

By Adam J. Cohen, Esq.

Residential foreclosure rates have nearly doubled as compared to a year ago, thanks to higher costs of living, declining property values, and record defaults on “subprime” loans to homeowners with poor credit ratings. Mortgage banks, municipalities, judgment creditors, and others have the right to foreclose liens on real estate to collect the debts owed to them. In these troubled times, more and more residents of your condominium are likely to find themselves facing foreclosure.

This can have major implications for your community as a whole. If a creditor starts a foreclosure on one of your units, it will usually name the entire association as a defendant in the lawsuit because Connecticut law says the bank will not take full title unless all subsequent encumbrancers are made parties. The association is not being sued for money and is not accused of doing anything wrong, but it still needs to act to protect its interests. The association’s rights to collect past-due common charges on the foreclosed unit might be eliminated under complicated priority rules, which say that only recent charges trump the mortgage and older ones might get “foreclosed out” depending on the property’s value.

In addition, an “under foreclosure” sign might be placed on the property, interested bidders might start snooping around, or a public auction might occur on its front lawn – all of which compromise security and property values. The unit owner being foreclosed is also likely to discontinue monthly payments to the association as well, or may file bankruptcy to stop collection efforts by all creditors, or might even abandon or deliberately damage the property. The other unit owners will need to make up the budgetary shortfall while watching their own units’ values suffer from the resulting cycle of nearby distress sales and vacancies.

If your association is named in a foreclosure lawsuit, the first thing the board should do is hire a lawyer with experience in foreclosures generally and condominium laws specifically. The court will not allow anyone other than a licensed attorney to file papers or speak on behalf of a condo association. Second, compile all records of debts which the foreclosed resident owes to the association: dues, capital charges, fines, and so on. The foreclosing bank may be willing to advance them on the debtor’s behalf (and add them to its own mortgage debt claimed in the lawsuit), or you will probably need to file an affidavit

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itemizing the amounts owed. If those debts are approaching the two-year mark, consider filing a cross-claim to foreclose them in the same lawsuit. Doing so will prevent them from losing their secured status under Connecticut law, which would mean that other creditors would be paid more of the association’s share of the recovery.

The court will usually appoint a neutral lawyer to advertise and conduct a public auction of the unit. The highest bidder must leave a deposit and close within thirty days, but the court will likely “veto” the sale and order the auction to be held again if the winning bid is less than 60% to 70% of the unit’s appraised value. In theory, the auction proceeds are allocated to the creditors in accordance with their priority until the proceeds run out. Generally, after the auction expenses are deducted and any delinquent municipal taxes paid, the association will be paid its last six months of unpaid condominium charges, but will typically recover older charges only after the first and second mortgages are satisfied.

As an alternative to a sale, Connecticut law allows the court to simply transfer title to the foreclosing creditor if the debt is approximately equal to or exceeds the unit’s value. In other words, a mortgage bank can seize ownership of a “negative equity” property without an auction. This is called a “strict” foreclosure. The other creditors are given the choice between buying the property outright or losing their liens. The association often has the same choice, but it can still charge the new owner for at least the last six months of condominium charges unpaid by the prior owner. Whether the foreclosure is strict or by auction, you should monitor the process closely and ensure that the new owner understands his financial and other obligations to the association upon becoming a member. ■

Adam J. Cohen is an attorney with the Law Firm of Pullman & Comley, LLC headquartered in Bridgeport, Connecticut. He is the Chair of its Community Law Section. He represents and gives seminars to condominiums, tax districts, and other communities in matters ranging from revenue collection strategies to commercial disputes, and is the author of regular newsletters with circulations throughout Connecticut called Special District Update and Condominium Update.