

The ins and outs of foreclosure proceedings

Understanding the process helps neighborhood associations decide when to take part

By Robert Ryan

COLUMNIST: HOMEOWNERS ASSOCIATIONS

As an officer of your neighborhood association, you are served with a copy of a foreclosure complaint and summons naming your association as a party in that litigation against one of your neighbors. As evidenced by each day's newspaper, more and more neighbors are being drawn into foreclosure due to an inability to pay their mortgage lender. To assess your next step, it is important that you understand how the foreclosure process works.

In Kentucky, a mortgage lien holder desiring to foreclose must file a lawsuit in the Circuit Court in the county where the property is located. The suit must name all other lien or interest holders in the property, including spouses and holders of mechanic's, tax, judgment, association and other mortgage liens against the property — even unrecorded interests the foreclosing lender is aware of. At the time of the filing of the lawsuit, a Lis Pendens notice is filed with the local county clerk's office to put all on notice of the pending foreclosure action and make a subsequent lien claimant's interest subject to the results of the litigation.

Once served with the complaint, the neighborhood association, like the homeowner, has 20 calendar days to respond and assert any defenses or claims. If the homeowner fails to respond, refinance or work out a loan repayment plan, the foreclosing lender will request that the Circuit Court enter judgment in its favor for the unpaid loan balance and the costs of the foreclosure action. The lender will also seek an order of sale of the property to satisfy the judgment by the Circuit Court Master Commissioner.

After setting a sale date, the Master Commissioner provides notice of the sale by advertisement in an approved newspaper that is circulated in the county where the property is located. Required to run at least once per week for a period of three weeks prior to the sale, the advertisement must contain the date and time, location and other terms of sale, including the amount to be raised by the sale. Typically, Master Commissioner foreclosure sales are held at the local courthouse.

Before the sale, the property must be appraised under oath by two disinterested homeowners residing in the same county, who are appointed by the Master Commissioner. Their appraisal is filed in the foreclosure action. On the sale date, the foreclosure auction sale is conducted by the Master Commissioner using the highest bidder format.

Should the highest bid for the

property be less than two-thirds of its appraised value, the property owner retains the right to redeem the property for a period of one year by paying the purchase price plus 10 percent interest. To cut off that right, the lender will generally bid slightly more than two-thirds of the appraised value of the property at the foreclosure sale. The lender is permitted to credit its bid against the amount of its judgment. Other high bidders are generally required to deposit 10 percent of their bid and execute a performance bond with the Master Commissioner for the balance of the bid amount.

The Master Commissioner will prepare and file a report of sale. If no objection is made within 10 days, the lender will ask the Circuit Court to confirm the foreclosure sale and order the Master Commissioner to execute a deed upon the property owners' behalf, which will convey the legal title to the property to the highest bidder free and clear of any lien rights of the parties in the litigation. After confirmation of sale by the Circuit Court, the Master Commissioner will arrange for closing where the highest bidder will pay the balance due on the bid amount in exchange for the deed from the Master Commissioner. The Master Commissioner takes a statutory fee, then advertising and other sale costs and any unpaid property taxes are paid. After those payments are made, the foreclosing lender and other lien holders, including the neighborhood association, are paid in the order of their priority.

The first difficult question for the association is deciding whether to take part in the litigation. As an association officer, you should be familiar with your

neighborhood restrictions, especially if a further lien filing is required. Most restrictions provide the association second priority behind a valid first mortgage lien. Unless the high bid exceeds the first mortgage holder's loan balance, the costs of the foreclosure sale, and any unpaid property taxes, the association will not receive any recovery from the Master Commissioner foreclosure sale.

Although not controlling in the foreclosure, the local Property Valuation Administrator's tax value for the property should be obtained. If it appears from the Complaint that there is a likelihood of a recovery for the association, its counsel should be contacted to timely appear and

assert the association's claim in the litigation. It is also important that the new purchaser of the property be promptly contacted about paying subsequently accruing association assessments. Unfortunately for the association, any shortfall on the property assessment will need be absorbed by the other association members.

