

New Jersey Bankruptcy Court Issues Ruling Regarding Condominium Association Liens in Chapter 13 Proceedings

Robert J. Flanagan III

Greenbaum, Rowe, Smith & Davis LLP Client Alert

June 2015

On June 11, 2015, the United States Bankruptcy Court for the District of New Jersey recognized that a condominium association's lien is entitled to a limited six-month priority over a first mortgage.

In re: Mark and Ronda Rones, the Court held that, under the Bankruptcy Code, a condominium association lien is a security interest and, despite the language of 11 USC 1322, could be stripped from the debtor's personal residence as part of a debtor's Chapter 13 plan. The provisions of 11 USC 1322(b)(2) state that a Chapter 13 plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence...."

In order to reach its conclusion, the Court had to find that the condominium association lien was of the nature of a security interest, and not a statutory lien. The New Jersey Condominium Act grants a condominium association a priority for the "aggregate customary condominium assessments against the unit owner for the six month period prior to the recording of the lien." Otherwise the lien is subordinate to taxes and the holders of properly recorded mortgages encumbering the unit. In other words, the statute reversed the traditional rule of "first in time, first in right" in favor of preferring a condominium association, but only to the extent of six months of arrearages.

In *Rones*, the debtors owned a condominium unit in the Whispering Woods Condominium that was created by the recording of a master deed in the Middlesex County Clerk's office and administered by a condominium association. The master deed references the Condominium Act, and the bylaws of the association. The debtors failed to pay all fees and assessments as required under the bylaws, and the condominium association, pursuant to the master deed and the Condominium Act, filed a notice of lien for the unpaid fees and assessments.

The debtors' bankruptcy petition and schedules reflected a first mortgage on the unit in an amount exceeding the unit's value. The debtors also listed the association as a creditor with a total claim of \$14,324.65, listing the secured portion at \$1,494.00. The debtors' bankruptcy plan proposed to pay the secured portion of the association's claim in full, and to treat the balance as unsecured.

The association objected to the debtors' plan, and stated that it had a secured claim equal to the full amount of the recorded lien at the time of the bankruptcy filing that was \$18,761.76. The association argued that the Bankruptcy Code prohibits "stripping" or "cramming" down the recorded lien because the

sole collateral was the debtors' principal residence, and the six-month priority set forth in the Condominium Act partially secured the lien.

The Court analyzed the lien and held that, under the Bankruptcy Code, a condominium association lien is a "consensual lien" and not a statutory lien, because it arises from the condominium association's master deed and bylaws. The Court held that the act of purchasing the unit "and voluntarily accepting and recording the unit deed" subjects the unit and its owner to the master deed and bylaws, and thus "gives rise to the lien."

Further, the Court found that the Condominium Act provides a condominium association lien security for the six-month priority, but does not secure the lien beyond that. Therefore, if the amount due on a first mortgage exceeds the value of the unit, the condominium lien is wholly unsecured and may be "stripped off" in a Chapter 13 plan.

In light of the foregoing, the Court determined that when there is a first mortgage that exceeds the value of the condominium unit, a debtors' Chapter 13 plan can strip down the condominium association lien, and treat the portion equal to six months of regular monthly assessments as secured, and the remainder as unsecured.

Common interest community associations should contact their counsel for guidance as to the impact of this decision on the treatment of their liens in any bankruptcy case and to ensure that any liens filed have been done so in accordance with the Condominium Act so as to perfect the six-month priority if applicable.

The author of this Alert, **Robert J. Flanagan III**, is an associate in the firm's Litigation Department and a member of the Community Association Practice Group.