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Condominium Associations as Landlords:

Legal rights and Issues involved in an Association's

Leasing of Units after Foreclosure of Condominium liens

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Michigan Condominium Association Boards routinely file lien foreclosure lawsuits while seeking to recover overdue condominium assessments. While the goal of each such lawsuit is to motivate and facilitate payment of the unpaid assessments – whether from a neighborhood resident or an absentee international bank post-mortgage foreclosure – the process occasionally leads to the result implied in the lawsuit's name: the foreclosure of the lien through a sale of the unit at a public auction. In the absence of a third-party purchaser at the sale, title to the unit reverts back to the Association, vesting in the name of the Association after the expiration of a redemption period (which is typically six months after the sale date).

Association ownership of a unit following such a foreclosure comes in two flavors: ownership subject only to a first mortgage (i.e., a mortgage recorded prior to the recording of the Association's lien), or "free and clear" title not subject to any mortgage on the unit. In the latter (and usually unlikely) situation where an Association comes into sole ownership of a unit that is not subject to any mortgage, the fortunate Association can retain the services of a local realtor and sell the unit to recover its losses (and perhaps even obtain a profit from the sale).

Most Associations are not quite so fortunate, as most condominium units are usually subject to a first mortgage at the time of the Association's foreclosure sale. During the present recession, many condominium units are still "under water," even after all secondary liens have been stripped away because the unpaid amount of the first mortgage exceeds the fair market value of the unit. When this happens, the Association's foreclosure sale and subsequent eviction action can still provide the Association with title to the unit and the right to remove the non-paying co-owner. In such cases, the Association's title remains subject to the interest of the first mortgage lender (meaning that mortgage lender is free to begin its own foreclosure proceeding at any time, which will "trump" the Association's foreclosure), but the lender cannot force the Association to assume the mortgage or to make payments on the mortgage.

Upon completing the foreclosure sale of a unit subject to a first mortgage and the eviction of the former co-owner, the Association's title to the unit may, at that point, be leveraged by more active Association Boards and Property Managers into a unit lease. Leasing the unit may enable the Association to recover some (or perhaps all) of the uncollected condominium assessments and attendant legal fees of collection, **at least where a proper tenant can be found.**

This article will address a few of the questions that an Association's Board of Directors may ask when choosing to begin the leasing of a unit that has been subject to an Association's foreclosure sale.

I. Length of Lease

Assuming that a mortgage lender has not begun its own foreclosure proceeding before the lease begins, the Association may enter into a lease for at least nine months and, in some cases, for twelve months or more. The Association's Bylaws will often dictate the minimum length of the lease term.

In Michigan, a party foreclosing a mortgage by advertisement is required to advertise the pending sale for four consecutive weeks. Within 15 days after publishing the first notice, the foreclosing lender is required to post a notice of the sale on the property. Following the advertisement period, the Sheriff's Sale is held. Once a lender forecloses its mortgage upon the original co-owner's interest in the condominium unit, that co-owner has a six month period of redemption, during which he or she can buy that interest back (or "redeem" the unit) from the foreclosing party. If the unit is vacant or has been abandoned, the redemption period may be shortened by the foreclosing party to one month from the sale date. Once redemption period is over, the original co-owner's interest in the unit is forever lost and title to the unit becomes fully vested in the foreclosing party.

Federal legislation enacted during the current economic crisis prevents a foreclosing lender from immediately evicting the Association's tenant in those cases where the tenant took possession of a leased unit prior to the mortgage foreclosure sale. The *Protecting Tenants at Foreclosure Act* (2009/2010) ("PTFA") provides protection for tenants who reside in units whose "federally-related mortgage loan" (e.g., Fannie Mae, Freddie Mac, Ginnie Mae) is foreclosed. The PTFA states that any tenant who entered into a bona fide lease for a unit before the sheriff deed was filed for that property may stay in the rented property until the end of his or her lease term. The only exception to this rule is in those instances where the foreclosing lender is able to turn around and sell the unit to a purchaser who will be occupying the unit as a primary residence. In that latter case, the foreclosing lender can force the tenant to leave the unit after 90 days, provided that the lender has given the tenant 90 days' notice to vacate.

The PTFA was approved through December 31, 2014. Absent the PTFA, Michigan law dictates that a lease of residential property expires at the termination of the redemption period following the foreclosure sale.

II. Type of Tenant

A lease tenancy subject to all of the possible terminations by a foreclosing lender discussed above is not for everyone. Condominium associations leasing out units after foreclosure of an assessment lien should find a tenant that understands that he or she will, at some point, be dealing with a foreclosing bank and/or its REO department. The tenant must be willing to accept the risk of a possible eviction by the foreclosing lender prior to the end of the tenant's expected lease term as such risk might be explained to him or her by the Board, its Property Manager, and/or the Association's attorneys.

An ideal tenant for the Association is someone who can understand and agree to all of the legal details and conditions described above. Such a tenant should appreciate that he or she is getting a 10-20% discount on the market rate for a leased condominium unit in exchange for risking the hassles of ignorant REO agents and the possible need to move out of the unit before the originally-expected lease end.

III. Type of Lease

In no event should the Association enter into such a lease agreement with a tenant using a random form found on the internet. Leasing foreclosed condominium units may be an economic opportunity, but it is a specialized opportunity that must be undertaken with care. Before beginning a leasing program with a foreclosed unit, the Association should consult with a qualified attorney that can assist the Board with preparing a lease agreement that will protect the Association's interests while meeting all of the requirements of Michigan law.

The following are some considerations that should be addressed with greater care in an Association foreclosed-unit lease as opposed to a typical landlord/tenant lease:

- **Lease term/termination:** The lease must address the possibility of a lender mortgage foreclosure and eviction prior to the expected end of the established lease term. The tenant must acknowledge that he or she shall have no claim against the Association whatsoever for finding replacement housing in the event that the lender forecloses its mortgage and/or if it sells the unit to a potential resident and gives the appropriate 90-day notice to vacate required under the PTFA. The tenant should also agree to broadly hold the Association harmless from any and all damages that he or she might incur arising out of or relating to his/her leasing of the unit (at least to the extent permitted by Michigan landlord-tenant law). At the same time, these provisions must be drafted in such a way that a foreclosing lender cannot use them as leverage to end the tenancy sooner.
- **Notices:** Tenants will receive notices from foreclosing lenders that are not also sent to the Association. The lease agreement must direct the tenant to pass along any and all such notices to the Association.
- **Cash for Keys:** Once an Association begins to rent units, REO agents may attempt to induce a tenant to quit paying rent to the Association and to move out of the unit with a “Cash for Keys” offer or similar incentive. It may be appropriate for the lease agreement to provide the Association with a contractual right to some or all of that incentive, should a tenant choose to leave the Association in the lurch.
- **Bylaws:** Any lease agreement prepared by the Association should include all of the provisions required for leases under the Association’s Condominium Bylaws. The lease agreement should comply in all respects with the Bylaws and the Michigan Condominium Act.

IV. Final Provisions Necessary for Introducing a Leasing Program

The board members or property management personnel who oversee the leasing program must be well-versed in all aspects of residential leasing in Michigan. Our legislature enacted specific laws to address many of the rights and duties of landlords and tenants, many of which must be precisely observed.

In the time leading up to the closing of each lease tenancy, the Association should commission a title search through legal counsel, so that the issue of prospective tenancy length can be addressed as accurately as possible when the security deposit is paid.

IV. Conclusion

As long as Michigan continues to suffer through the current economic doldrums and the wind-down of the mortgage crisis, Boards increasingly will face difficult budgetary decisions. Recent federal legislation affords proactive Associations and their property managers the opportunity to address some of these monetary difficulties by taking “underwater” condominium units away from non-paying co-owners and leasing them out to tenants as a means of recouping some of the Association’s losses on such units. Associations that wish to take advantage of this opportunity should consult with experienced attorneys knowledgeable in both condominium and landlord-tenant law before attempting to set such a project in motion.