

How the *Westin* was Won, then Lost:

An Epic Journey through Lien Country Ends When a Trust Deed Playing a Mortgage Foils a Judicial Assessment Lien Foreclosure
by Ben Thompson and Kathy Busch

Prologue

In the early 21st century, an unsettled section of virgin land in the glorious frontier of Nebraska was marked on a plat map. Scores of settlers were attracted by the promise of new construction, low interest rates, and an association to provide the community with lawn care, snow removal, and exterior maintenance. The promised land came to be known as Westin Hills.

The initial settlers, led by a visionary developer, were excited to be part of the adventure. The developer staked a claim to the land with a plat map and a declaration of covenants that was recorded with the local register of deeds. To fulfill the promise of common area maintenance and exterior services by the association, the landowners agreed to pay an annual assessment to offset the association's expenses. They even went so far as to pledge their parcels of land as collateral to secure payment. The pledge was for a "continuing lien" that was to run with the land.

The association was formed, the first assessment was imposed, and the developer began to sell lots to eager settlers.

One of the first in line financed the purchase of her new home with a bank loan. To ensure repayment, the bank asked her to sign a promissory note and execute a "deed of trust" giving a third party trustee power to sell her property if she defaulted. The trust deed was recorded with the register of deeds along with her deed to the property. The new homeowner had arrived at the promised land, and she moved in to her recently completed home in Westin Hills.

The Good Life (2002-2006)

Life in Westin Hills was good for the new homeowner and her neighbors for several years. They enjoyed stable income and looked forward to steadily increasing home values to support their retirement. Some took advantage of home equity loans and cash out refinancing. They dutifully paid their annual assessments in monthly installments to the association and the required mortgage payments to the lender.



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The Housing Bubble and The Subprime Mortgage Crisis (2006-2009)

Unfortunately, home prices peaked in 2006, and then started to decline, eventually reaching new lows in 2012. It became clear that the rush to settle the great frontier and build new homes had created a “housing bubble,” the bursting of which contributed to the Great Recession. Stable income became disrupted by unemployment for many as the American economy contracted. The new homeowner was not immune to the financial crisis, and she soon began to fall behind on her assessment payments. Eventually she fell behind on her home loan as well. She would later file bankruptcy to seek protection from her creditors.

The Long Winter (2009-2010)

Around the same time, the association’s promise of snow removal became an expensive burden. Heavy snowfall blanketed Westin Hills during the winter of 2010, with the ground covered in snow for nearly three months. The expense of snow removal drained the association’s reserves and required special assessments to keep the developer’s promise to the many homeowners. Homeowners who were able to continue paying the assessments began to express concern about the number of delinquent neighbors.

The Foreclosure Showdown (2010-2012)

As the situation grew dire, the association and the bank began to seek payment from the new homeowner. The association acted first. Saddled with significant expenses and dwindling assessment payments, the association recorded a notice of the new homeowner’s delinquency with the register of deeds. Six months later, the association filed a lawsuit against the homeowner in state district court to foreclose its lien.

Over nine months after the association’s notice of delinquency, and over three months after the association filed its judicial lien foreclosure suit, the lender recorded its own notice of default. Six months later, the trustee under the trust deed sold the property at a private trustee’s sale. The highest bid was from the lender, which assigned its bid to Federal National Mortgage Association, commonly known as Fannie Mae, which acquired title to the property through a trustee’s deed. Meanwhile, the association’s lawsuit continued.

As an absentee landowner, Fannie Mae then neglected to pay its share of the annual assessments as well. After several months, the association filed notice of Fannie Mae’s delinquency with the register of deeds and eventually named Fannie Mae as defendant in the lien foreclosure lawsuit.

Summary Judgment (2011)

With the original homeowner dispossessed and bankrupt, Fannie Mae became the focus of the lawsuit to foreclose in Westin Hills. The lender’s private trustee’s sale had already been held, and Fannie Mae now held title free and clear. The association sought foreclosure due to Fannie Mae’s own delinquency, as well as the previous homeowner’s delinquency. Fannie Mae argued that the association’s lien for the previous homeowner’s delinquency was extinguished by the trustee’s sale that occurred during the pendency of the assessment lien foreclosure lawsuit. It offered no apology or explanation for its own delinquency.

The race-notice recording act was once again the hook upon which Fannie Mae’s hat was hung, with the argument that the covenants provided inadequate notice of the assessment and resulting lien and that the trust deed took priority pursuant to the recording act. Our response to the recording act argument

Truth be told, this same story was being played out in many neighborhoods across the country, even in the resilient state of Nebraska. Our law firm has had the privilege of working with over nearly 40 homeowners’ associations in the state, many sharing the same struggles as Westin Hills. The list of delinquent homeowners was overwhelming for many of the associations, and it was a particular threat to townhome associations like Westin Hills with an obligation to provide services despite the economy.

Another common thread in these neighborhoods is a clause in the covenants that typically subordinates the association’s assessment lien to first mortgages. With declining home values, many of the delinquent homeowners had little, if any, equity left. It was apparent that if the assessment lien was in fact subordinated to the lender’s lien, there would be nothing left over for the association. Bankruptcy frequently ruled out any recovery in a suit for damages. The lien priority issue became paramount.

A number of the covenants’ subordination clauses provided an opening. The language merely referenced “first mortgages.” However, since the 1980’s, the vast majority of home loans in Nebraska have been secured by trust deeds, not traditional mortgages.¹ Nebraska case law recognized that the lender’s election of a remedy could determine whether the trust deed was treated as a trust deed or a mortgage for certain purposes.²

With lenders nearly always electing to foreclose trust deeds at private trustee’s sales rather than judicial foreclosures, we had a solid argument. We filed a handful of lien foreclosure actions in Douglas and Sarpy counties, arguing that the lenders elected to foreclose nonjudicially and therefore the assessment liens are not subordinated to the trust deeds and take priority. We early on aborted the initial strategy of seeking to halt the quick paced trustee’s sales by injunction, instead letting the lender elect its remedy and accept the consequences.

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was to shift the focus from the general recording act to the more specific priority provisions in the Nebraska Trust Deeds Act.

After all, there is a reason for the double standard whereby trust deeds get to take priority at filing, long before the homeowner becomes delinquent, while assessment liens do not always enjoy priority from the date of filing the covenants (sometimes not taking priority until a notice of delinquency is recorded, as required by the Nebraska Supreme Court in the previous cases⁷).

It's comparing apples to oranges when determining who won the race to the courthouse by looking at a trust deed without a delinquency versus an association's notice of delinquency (rather than the covenants). Our argument was that in the case of trust deeds, the reason for priority as of filing is not the race-notice recording act, but the Nebraska Trust Deeds Act.⁸ It expresses the public policy that trust deeds should be treated differently and given priority as of filing regardless of delinquency. It also extends that special priority to future advances secured by the trust deed.

Our new argument focused on the limiting language in the specific priority provisions in the Nebraska Trust Deeds Act. It does not extend priority over "persons who acquire rights in or liens upon the trust property" prior to the time the trust deed was filed.⁹ Our argument was that regardless of when the assessment lien was perfected for purposes of notice, the association's *right* to a lien on the property was acquired when the covenants were filed, prior to the trust deed, and therefore the association had lien priority by virtue of the special priority provisions of the Nebraska Trust Deeds Act, which controlled over the general recording act.

Despite a robust evidentiary record with specific evidence of the developer's intent for a continuing lien and the date of the first assessment in the community, the trial court declined to find that the assessment lien took priority over the trust deed. The general recording act was again found determinative.

The Appeal (2012)

So back we went to the Nebraska Supreme Court. Fannie Mae wisely paid up for its share of the delinquent assessment while the appeal was pending, limiting the issue to whether the assessment lien for the previous homeowner's delinquency survived the bank's private trustee's sale. We renewed our argument that the Nebraska Trust Deeds Act carves out an exception that benefits the association by respecting the rights given it in the covenants.

The argument was flatly rejected by the Nebraska Supreme Court:

The Association contends on appeal that the Nebraska Trust Deeds Act—specifically § 76-1002(1), (2), and (3)(a)—controls the priority issue in this foreclosure of lien case. The provisions upon which the Association relies concern the priority accorded future advances necessary to protect that secured property and debts and obligations created simultaneously with the Deed of Trust. These items are not at issue in this case, and we conclude that the Nebraska Trust Deeds Act is not applicable.¹⁰

Unfortunately the opinion does not provide any further guidance on why trust deeds receive priority without a delinquency, when the association was required to not only wait until the assessment was delinquent but further, not take



The "trust deed is not a mortgage" argument initially gained traction. We collected on a number of accounts. The first trial court to consider the argument at summary judgment granted the association's motion. The pushback from the lenders was immediate. In a desperate effort to get the trial courts to come around, the lenders regrouped and advanced a new argument – that the trust deed took priority pursuant to the recording act³ because it was recorded before the association's notice of delinquency. A bill was introduced in the Nebraska Legislature to attempt to subordinate homeowners' association liens to any first mortgage, trust deed, or similar instrument.⁴

The conversation shifted from trust deeds as mortgages and subordination clauses in covenants to lien attachment, perfection and arcane words like "choate." Unfortunately, the evidentiary record at that stage of summary judgment was limited. The trial courts accepted the lenders' new argument,

and we took the issue on appeal to the Nebraska Supreme Court. The Court affirmed in 2010, finding in an unpublished opinion that the assessment lien did not "attach" until the assessment became delinquent and a notice of delinquency was recorded.⁵

In the meantime, the legislation that had been introduced became law in March 2010.⁶ Muddying the waters even more, the law purported to create an association lien for assessments (seemingly independent of any contractual liens arising out of covenants). The Nebraska Supreme Court did not interpret the new law, instead noting that it did not apply.

With the pace of foreclosures quickening and associations continuing to be impacted, we continued to search for a legal solution to lien priority for the associations. If one existed, it was to be found in Westin Hills.

priority until a notice of the specific delinquency was recorded. Lien priority analyses are very fact-specific and associations may have better luck with more clear language in the covenants.

When a Trust Deed is a Mortgage

While the covenants' subordination clauses were found not to be determinative, some takeaways exist on the topic of trust deeds playing as mortgages. A traditional mortgage is still an option to secure the loan, but the Nebraska Trust Deeds Act provides lenders with much more flexibility and expediency, particularly when it comes to foreclosure. A mortgage can only be foreclosed judicially, whereas a trust deed with a power of sale clause can be foreclosed privately outside court or judicially, at the lender's option.¹¹ Good reasons exist¹² to choose one method over the other, but the choice comes with consequences.

Recall that our original argument was that a trust deed, which the lender elected to foreclose nonjudicially through a private trustee's sale, was not a "mortgage" for purposes of the subordination clause in the covenants. This particular issue was never addressed by the Nebraska Supreme Court, although the bill introduced in 2010 speaks to all such security instruments.¹³ It remains to be determined whether this law applies to contractual assessment liens authorized by covenants.

However, there are other situations where the distinction between a mortgage and a trust deed still clearly matters. An early effort to have trust deeds treated as mortgages failed. It relied on section 76-251 of the Nebraska Revised Statutes, which provides:

Every deed conveying real estate, which, by any other instrument in writing, shall appear to have been intended only as a security in the nature of a mortgage, though it be an absolute conveyance in terms, shall be considered as a mortgage. The person for whose benefit such deed shall be made shall not derive any advantage from the recording thereof, unless every writing operating as a defeasance, or explaining its effect as a mortgage, or conditional deed, is also recorded therewith and at the same time.

The argument was raised in a constitutional challenge to the Nebraska Trust Deeds Act, which had been recently enacted.¹⁴ In upholding the act, the Nebraska Supreme Court stated: "To the extent that section 76-251, R.R.S. 1943, may be in conflict with the Nebraska Trust Deeds Act, it is modified by implication."¹⁵

The distinction recognized turns on the remedy chosen by the lender. Section 76-251's mandate that all security instruments "shall be considered as mortgages" does not extend to those cases where a lender chooses to proceed with a nonjudicial foreclosure by exercising the power of sale under the trust deed. In those instances, the trust deed will not be considered a mortgage.

When the Distinction Matters: Applicable Statute of Limitations for Foreclosure Action

The Nebraska Court of Appeals has also recognized that a distinction exists between trust deeds and mortgages. When a trust deed secures a promise in writing, a trustee's sale of the property secured by the trust deed must be made within the time period prescribed by law for the commencement of an action on the underlying promise secured by the trust deed, which, by Neb. Rev. Stat. § 25-205(1), is 5 years from maturity.¹⁶

A cause of action on a mortgage accrues, and must be brought, within 10 years of the date the debt secured by the mortgage matures, unless a payment has been made thereon or the statute of limitations has otherwise been tolled.¹⁷ If a creditor elects to judicially foreclose on the real property pledged under a deed of trust, the applicable 10-year statute of limitations is found in Neb. Rev. Stat. § 25-202.¹⁸

When the Distinction Matters: Availability of Homestead Exemption

In another case, the Nebraska Court of Appeals found that the homestead exemption was not available when a trust deed was foreclosed judicially like a mortgage.¹⁹ At the time, an exclusion existed in Neb. Rev. Stat. § 40-103 making homesteads susceptible in mortgage foreclosures, without referencing trust deeds.²⁰ The court found the exclusion from the requirements of the notice and set-aside provisions of § 25-1531 operable when the trust deed was foreclosed judicially like a mortgage.²¹

The Nebraska Trust Deeds Act's amendment by implication of Neb. Rev. Stat. § 76-251 is that every deed, including trust deeds, which is intended as security, even though the deed provides for an absolute conveyance, is considered a mortgage except when, under a trust deed and as allowed under Neb. Rev. Stat. § 76-1006, the trustee exercises the power of sale without judicial proceedings, as opposed to the beneficiary's using the judicial procedure for foreclosure of mortgages.²² A trust deed can be the functional equivalent of a mortgage, depending upon the remedy selected by the beneficiary, the options being a nonjudicial trustee sale or judicial foreclosure under Neb. Rev. Stat. § 76-1005.²³

When the Distinction May Not Matter: Applicable Statute of Limitations for Deficiency Action

A case currently pending before the Nebraska Supreme Court presents the issue of the applicable statute of limitations for a deficiency action after a judicial foreclosure of a trust deed.²⁴ The trial court granted summary judgment in favor of the borrowers after it concluded that the applicable statute of


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limitations was set forth in Neb. Rev. Stat. § 76-1013 of the Nebraska Trust Deeds Act and that the action was barred by such statute. The Nebraska Supreme Court has recognized that a post-foreclosure deficiency judgment is an action separate and apart from the foreclosure itself,²⁵ which may have an impact on the outcome of this case.

Epilogue

On June 1, 2012, the Nebraska Supreme Court issued a reported opinion affirming the trial court's ruling in *Westin Hills West Three v. Federal National Mortgage Association*.²⁶ The Court found the bank's trust deed had priority over the association's assessment lien; that the language of the declaration did not imply that the deed of trust should have been subordinated to the assessment lien initially identified in the declaration; and that the actual assessment charged, which did not become delinquent until after the filing of the trust deed, did not enjoy the priority date of the declaration by relation back.²⁷ Consequently, the assessment lien was deemed extinguished by the trustee's sale.

In 2013, another bill was introduced in the Nebraska Legislature that would give all mortgages, deeds of trusts, and similar instruments priority over homeowners' association assessment liens.²⁸ It also seeks to bar associations from accomplishing priority through more specific provisions in covenants that might be interpreted by courts as giving adequate notice of the assessment lien to satisfy the race-notice recording act requirements. This was a follow-up attempt to two bills introduced in 2011 seeking similar objectives.²⁹ Time will tell if the latest effort to determine priority receives the Legislature's attention.

We continue to seek justice for homeowners' associations on the prairie. 

Endnotes

¹ Several Nebraska commentators have written in detail about trust deeds since the Nebraska Trust Deeds Act was passed in 1964. If you are interested in learning more, see Brandon Tomjack, "Nebraska Deed of Trust Foreclosures: Bidding Strategies for Lenders and Lawsuits for Deficiencies," *The Nebraska Lawyer*, April 2009; Camille Hawk, "Simon Says' – A Practical Guide to the Non-Judicial Foreclosure of Real Property," *The Nebraska Lawyer*, June 2003; Dennis Collins, "Trust Deeds – Boring? or Loaded with History? Or Both?" *The Nebraska Lawyer*, January 2001; Richard Butler, "Trust Deeds in Nebraska: A Survey and Analysis," 29 *Creighton L. Rev.* 99 (1995); Comment, "In Deed An Alternative Security Device: The Nebraska Trust Deeds Act," 64 *Neb. L. Rev.* 92 (1985) (by Dick Garden, Jr.); Richard Butler, "Trust Deeds Come of Age in Nebraska: A Survey and Analysis," 17 *Creighton L. Rev.* 283 (1983); Kessner, "The Trust Deed as Security in the Real Estate Transaction," 50 *Neb. L. Rev.* 386 (1970).

² *Blair Co. v. American Sav. Co.*, 184 Neb. 557, 169 N.W.2d 292 (1969); *PSB Credit Services, Inc. v. Rich*, 4 Neb. App. 860, 552 N.W.2d 58 (1996) *aff'd*, 251 Neb. 474, 558 N.W.2d 295 (1997); *Travelers Ins. Co. v. Nelson*, 4 Neb. App. 551, 546 N.W.2d 333 (1996).

³ Neb. Rev. Stat. § 76-238.

⁴ Laws 2010, LB 736, § 1, eff. March 4, 2010, codified at Neb. Rev. Stat. § 52-2001.

⁵ *Sunridge Townhome Owners Association v. Abbott*, S-09-1086 (filed June 17, 2010); *Grayhawk West Townhome Owners Association v. Birth*, S-09-1204 (filed June 17, 2010).

⁶ Laws 2010, LB 736, § 1, eff. March 4, 2010, codified at Neb. Rev. Stat. § 52-2001.

⁷ *Id.*

⁸ Neb. Rev. Stat. § 76-1002(3)(a) (stating that items secured by a trust deed "are equally secured by the trust deed from the time of filing the trust deed as provided by law and have the same priority as the trust deed over the rights of all other persons who acquire any rights in or liens upon the trust property subsequent to the time the trust deed was filed").

⁹ *Id.*

¹⁰ *Westin Hills W. Three Townhome Owners Ass'n v. Fed. Nat. Mortg. Ass'n*, 283 Neb. 960, 964-65, 814 N.W.2d 378, 383 (2012).

¹¹ "At the option of the beneficiary a trust deed may be foreclosed in the manner provided by law for the foreclosure of mortgages on real property." *Neb. Rev. Stat.* § 76-1005.

¹² For instance, a lender may choose to judicially foreclose a trust deed when issues exist as to "determination of title, lien priorities, reformation of the trust deed, or appointment of a receiver." Richard Butler, *Trust Deeds in Nebraska: A Survey and Analysis*, 29 *Creighton L. Rev.* 99, 102 (1995).

¹³ LB 736 (2010), became Neb. Rev. Stat. § 52-2001.

¹⁴ *Blair Co. v. American Sav. Co.*, 184 Neb. 557, 169 N.W.2d 292 (1969).

¹⁵ 184 Neb. at 559, 169 N.W.2d at 294, citing *Chicago & N.W. Ry. Co. v. County Board of Dodge County*, 148 Neb. 648, 28 N.W.2d 396 (1947).

¹⁶ *PSB Credit Services, Inc. v. Rich*, 4 Neb. App. 860, 552 N.W.2d 58 (1996) *aff'd*, 251 Neb. 474, 558 N.W.2d 295 (1997).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Travelers Ins. Co. v. Nelson*, 4 Neb. App. 551, 546 N.W.2d 333 (1996).

²⁰ Neb. Rev. Stat. § 40-103 was amended to explicitly reference trust deeds in 1997. Laws 1997, LB 372, § 5.

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *First National Bank of Omaha v. Davey*, S-12-0761 (argued March 7, 2013).

²⁵ *Parratt v. Hartsuff*, 75 Neb. 706, 106 N.W. 966, 969 (1906).

²⁶ 283 Neb. 960 (2012).

²⁷ *Id.* The Court explicitly stated that the case was "decided without reference to § 52-2001." 283 Neb. 960, 971, 814 N.W.2d 378, 387.

²⁸ LB 442 introduced January 22, 2013.

²⁹ LB 613 and LB 614 introduced January 19, 2011. A bill with a more balanced approach and fairness to homeowners associations was LB 571, also introduced January 19, 2011. LB 613 advanced out of committee but was later indefinitely postponed.