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In the ‘Shadow Wood’ of *SFR*: Nevada Supreme Court Weighs in on Lender HOA Challenges

In a September 2014 ruling, the Nevada Supreme Court jolted the lending community by holding that a homeowners association’s (HOA) non-judicial foreclosure sale can extinguish a mortgage lender’s previously-recorded first deed of trust on a property if that foreclosure is to recover assessments categorized as super priority amounts (or nine months of regular assessments, plus any amounts required for abatement) as set forth in Nevada Revised Statute (NRS) 116.3116. *SFR Invest. Pool I, LLC v. U.S. Bank, N.A. et al.*, 334 P.3d 408 (Nev. Sept. 18, 2014). Using ambiguity in NRS 116 and based on the *SFR* ruling set forth above, HOAs continued to conduct foreclosures of HOA assessment liens, selling properties at auction for just small fractions of the amounts owed to lenders.

In the wake of a plethora of ongoing Nevada HOA litigations, on Jan. 28, 2016, the Nevada Supreme Court jumped into the HOA fray once again in rendering its decision in *Shadow Wood HOA v. N.Y. Cmty. Bancorp.*, 132 Nev. Adv. Op. 5 (2016). In *Shadow Wood*, lender New York Community Bank missed several months of super priority HOA assessments prior to its foreclosure upon a first priority deed of trust. In addition, the lender failed to pay the HOA assessments after the foreclosure. The HOA then foreclosed on the past due assessments, and a third-party purchased the property at the sale thereby effectively wiping out the lender’s interests in the property. The lender then filed an action against the HOA and the purchaser of the property. In its complaint, the lender sought, among other things, declaratory relief and quiet title. The trial court ruled in favor of the lender on summary judgment, finding that under NRS 116.3116 the HOA could only recover nine months of assessments, and that the purchaser was not a bona fide purchaser at the sale. The sale was set aside and the trial court also declared that the lender held title to the property at issue.

On appeal, the Nevada Supreme Court vacated the trial court’s ruling and remanded the case back. In a positive nod to lenders who may be challenging an HOA sale, the Nevada Supreme Court clarified that even though the provisions of NRS 116.3116 provide that deed recitals in an HOA’s trustee deed are conclusive, a reviewing court can in equity consider quiet title actions that challenge the propriety of such sales. Specifically, the Court held that, “History and basic rules of

statutory interpretation confirm our view that courts retain the power to grant equitable relief from a defective foreclosure sale when appropriate despite NRS 116.31166.”

However, in ruling against the lender on appeal, the Court held that on the facts before it the lender failed to show that the foreclosure sale price was so low that the sale should be set aside as commercially unreasonable—citing a treatise as persuasive authority that 20 percent of a property’s fair market value is generally the benchmark. According to the Court, the lender also failed to show as a matter of law that the HOA acted “unfairly and oppressively” in seeking to collect more than the nine months’ of assessments that accrued prior to the HOA sale, since the lender was delinquent on all of the assessments that came due after the lender initially took title to the property.

Finally, the Court also addressed whether the third-party purchaser at the HOA sale, Gogo Way Trust, was a bona fide purchaser of the property, and what bearing that had on the equitable relief requested by the lender. On this issue, the Court held that there was insufficient evidence to support a finding that the third-party purchaser received notice of the lender’s and the HOA’s future title dispute, and that the “potential harm” to the purchaser had to be taken into account when the case goes back to the trial court for further proceedings.

In sum, while the Nevada Supreme Court’s ruling in *Shadow Wood* provides needed guidance to litigants on the issue of whether deed recitals can control the outcome of a case in all circumstances (*i.e.*, equitable principles can be invoked to remedy a flawed or defective sale), the Court’s heavy reliance and focus on the various facts surrounding a given sale to determine propriety is sure to lead to continued HOA litigation and challenges for lenders.

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