Payment Plans: Getting Paid while Getting Leverage

By Shani O. Zakay, Esq.

Payment plan agreements, or payment plans, play an instrumental part in Associations' struggle to minimize delinquencies. In fact, payment plans are so important that the California legislature made sure to require boards to consider them in a meeting when a delinquent owner makes a request.[1] Civil Code Section 5665, which is part of the recently re-codified Davis-Stirling Act, compels boards to meet with a delinquent owner, in executive session, within 45 days of a written request to discuss a payment plan. But many times the circumstances surrounding the request make it disadvantageous for the board to entertain. Consider the following: A repeat rule-violator has been delinquent for two years. The board retained a collection attorney to initiate legal action, and litigation is already underway. The debt nears $5,000, not counting the $1,500-$2,500 the board had to pay the attorney to get to this point. At the 90th hour, the board receives a written request to meet and discuss a payment plan. The board must comply and the directors are unhappy. Why should they allow a payment plan after spending $2,000 in attorneys' fees and costs? Why should they settle after spending over a year chasing the delinquent owner? How can they trust an owner who has proved to be a problem to not default on the payment plan? How can they insure that, if the owner defaults, they're not back to square one—minus $2,000 in expenses and over a year wasted? Those are not uncommon questions. Payment plans are only effective when done right. This article attempts to provide some answers and solutions.

We'll start with the "Why." Why should boards ever entertain a long-term payment plan when they have a legal right to collect the money immediately and in its entirety? The answer requires a deeper look into the efforts traditional collection methods demand.

The alternatives to a payment plan include legal action and foreclosure; both are effective collection tools that come at a cost. The average legal action (assuming no real opposition by the delinquent owner) will cost the association between $2,000 and $3,000 in attorneys' fees and costs. The cost of non-judicial foreclosure falls in the same range. Of course, those costs are almost always pushed back to the delinquent owner, but collection is never guaranteed and those expenses may not be recovered. Next, a legal action, on average, takes 6 to 9 months to conclude with a judgment. Even then, the association can expect at least 2 to 3 months before assets are located and collected on (if any exist). Non-judicial foreclosure, again, falls in the same range. Depending on whether the foreclosed property has any equity, foreclosure may or may not lead to actual recovery, however. Without taking anything away from the effectiveness of those methods, the board must be prepared to spend money and be patient.

[1] California Civil Code Section 5665.

Payment plans require less patience and almost no monetary expense. The cost of drafting a good payment plan, even when utilizing an experienced attorney, is minimal, and can be incorporated into the settlement amount. In fact, many management companies and collection firms charge a "payment plan fee" intended to cover that exact cost. Once the payment plan is executed, the association does not have to wait to see the money; the cash-flow is immediate. The $5,000 debt may not be paid right away, but at least parts of it will start flowing into the association's bank account in a matter of days or weeks. Finally, and this is especially true with respect to debtors who are current owners and residents of the association, a board's willingness to work with a delinquent owner is perceived positively by the membership and can go a long way in improving the popularity of the board members with their neighbors.

So "How" do we make sure we do it right?

1. Put it in writing

Often times when agreeing to a payment plan with a delinquent owner at a meeting, boards decide to, in the spirit of cooperation, forgo the formalities of a written agreement, and instead rely on the oral promises exchanged at the meeting, or the recorded minutes reflecting the agreement. While a good spirit of cooperation is encouraged, forgoing the written agreement is a very bad idea. As agreeable and understanding as the owner may seem at the meeting, if he or she ever defaults on the payment, a dispute will inevitably arise. The terms you thought were so clear will come into question, and recollection of the details will be challenged. In these situations, even the minutes will be insufficient. For example, the difference between a 3-day grace period and a 10-day grace period can be the difference between compliance and default. But, without a written agreement addressing the issue specifically, a dispute over the grace period could end up in court. The evidentiary issues created by the lack of a written memorialization of the parties' agreement are well recognized by the courts as well. Thus, a party seeking to enforce a written agreement that has been breached must do so within 4 years of the breach.[2] On the other hand, a party seeking to enforce an oral agreement that has been breached must do so within only 2 years of the breach,[3] presumably to ensure that not too much time has passed so as to diminish the parties' recollection of the terms of the agreement. This can be important if the association finds itself in a situation where legal action is required to enforce the payment plan agreement.

2. Demand financial information

The key in achieving a successful payment plan is leverage. When agreeing to a payment plan, the association, no doubt, is compromising. To be practicably enforceable, the agreement must also require the owner to make sacrifices. It must give the owner something to lose, so as to incentivize him or her to maintain compliance.

One way to gain leverage is by requiring the delinquent owner's financial information as a condition to entering into the payment plan. Information regarding the delinquent owner's

[2] SOL
[3] SOL

employment and bank accounts is essential for multiple reasons. If spouses and adult-children are also involved, their information should also be demanded. Don't be shy. You should ask for the identity of the employers and the monthly income earned, as well as the bank account numbers and balances as of the date of the payment plan.

The first reason we want this information is to ensure the delinquent owner is entering into an arrangement he or she can actually afford. An owner with $300 in monthly disposable income should not enter into a plan requiring him or her to pay $750 per month because it's unlikely he or she is going to be able to comply. That agreement will surely fail. This reason should be disclosed to the owner, as an explanation for the association's request.

The second, and probably more important, reason we want this information is to develop a record on the owner's assets, so that in the event of a breach, we know where to find the money. Getting a judgment against a debtor is difficult enough. Locating the debtor's assets (employment, bank accounts, etc.) after the judgment was awarded is usually even harder. With the information being provided by the owner as a condition to entering into the payment plan agreement, the association can save time and money locating the owner's assets if the agreement is breached and the association is forced to resume collection efforts. Most owners understand that concept, and are thereby encouraged to maintain compliance with the payment plan. In other words, it creates leverage.

Some sophisticated debtors may resist, and the association can still enter into the agreement without the information. However, if this requirement is included in the association's collection policy as a necessary condition to every payment plan, the debtor will be hard-pressed not to comply, especially when facing aggressive collection efforts by the association otherwise.

3. Incorporate a Stipulated Judgment

As already mentioned above, leverage is key. Another way to gain leverage is by requiring a stipulation for a judgment as part of the payment plan agreement. A stipulation for a judgment is a legal document, drafted on pleading paper, both the association and the delinquent owner execute. By executing this document, the owner agrees to have a judgment entered against him or her in the event of default on the payment plan. In other words, if the association is required to enforce the payment plan agreement in court after default, it may simply be able to submit to the court the stipulation for a judgment signed by the owner, and circumvent the usual legal requirements necessitating proof by the association that the money is actually owed. In short, it means the association can get a judgment without having to prove its case for 6 to 9 months.

The benefit in a stipulated judgment is twofold. First, if legal action becomes necessary, it will be significantly less time consuming and less expensive. Second, it projects the seriousness of the matter and the extent of the association's wiliness to pursue potential defaults onto the delinquent owner. With a signed document where he or she agreed to have a judgment entered in favor of the association, the owner will think more than twice before defaulting on the plan. He or she will be incentivized to comply. In other words, it creates leverage.

With a stipulated judgment and financial information on the debtor, defaulting on a payment plan with the association carries serious consequences for the owner, and that is exactly what we want.

4. Consider Probationary Periods

Another tool in the association's arsenal is the probationary period. Probationary periods are important when the association agrees, as part of the payment plan agreement, to waive some of the amount owed. When dealing with a repeat offender, or an owner who has been delinquent for multiple years, but still demands that some fees or charges be waived, the collection policy should expressly require a probationary period. That probationary period can require a delinquent owner to remain current on his or her monthly dues for a specified period of time (one or two years) even after successfully completing the payment plan. If the owner falls into arrears again during the probationary period, the money the association previously agreed to waive as part of the payment plan can be retroactively add back as a penalty.

By using a probationary period, the association not only creates an incentive to comply with the payment plan agreement, but also an incentive to remain current on the payment of monthly dues after the payment plan agreement is complete. The penalty in adding back the previously waived charges creates leverage.

5. Keep the Lien

Finally, no matter how short the plan is, or how small the debt is, the association should always require an assessment lien be recorded (or remain recorded) against the subject property for the entire duration of the payment plan. Most associations record a lien against a delinquent owner within 3 or 4 months of the delinquency. Accordingly, when an owner requests to enter into a payment plan, the association probably already recorded a lien against that owner's property. The assessment lien is a powerful tool that creates strong security for the debt owed to the association. The benefits associated with liens can be addressed in another article. But suffice it to say, the lien should stay recorded until the debt is paid in full.

To summarize, the benefits of payment plans are indisputable, and boards should always consider an owner's request to settle in that manner. When done wrong, payment plans can result in a disaster. When done right, however, payment plans can prove to be the long-term solution to an association's delinquency problems.