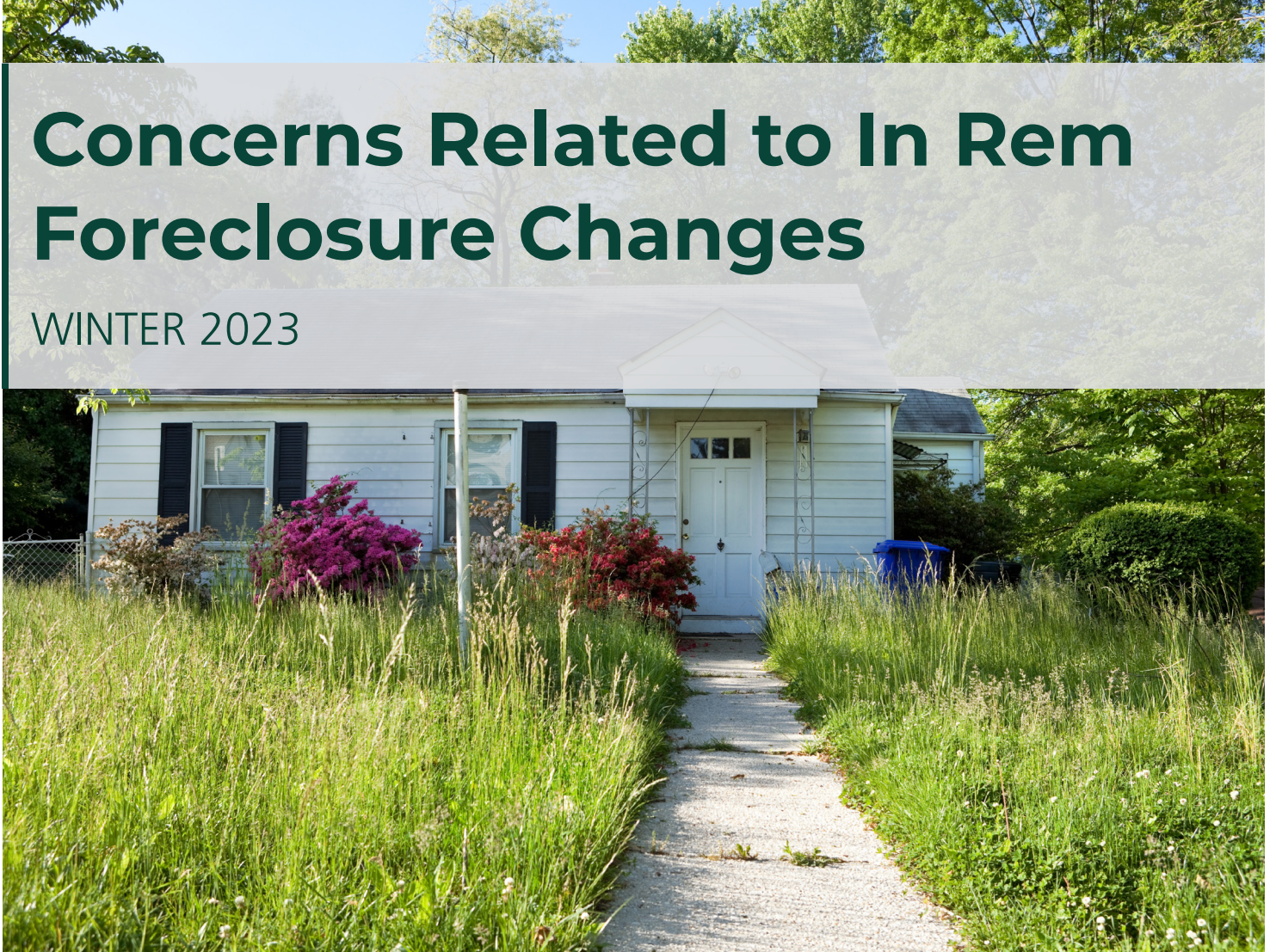


**NYSAC**  
— NEW YORK STATE —  
ASSOCIATION OF COUNTIES

# Concerns Related to In Rem Foreclosure Changes

WINTER 2023



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# Executive Summary

The Governor's Budget proposes to amend NYS Real Property Law that fundamentally alters the process and reasons counties foreclose and auction tax delinquent properties. The proposal requires counties to return excess funds received from auction to the prior property owner after covering delinquent taxes and administrative costs incurred by the enforcing officer, in addition to paying all other lienholders and claims against the property. A U.S. Supreme Court case is pending on this issue and is on the docket for this summer. The New York State Association of Counties (NYSAC) and New York State County Treasurers' and Finance Officers' Association (NYSCTFOA) agree that the U.S. Supreme Court will likely rule affirming this position this summer.

## Primary Concerns

- **Timing** - The proposal carries no state budget impact and therefore should not be in the budget bill. There is plenty of time to develop a new statutory framework outside of the budget process and it should be informed by the final Supreme Court Decision.
- **The State Must Provide Financial Support for this Change** - Many tax enforcement officers agree the intended policy of returning excess funds to the prior property owner is proper, after delinquent taxes and administrative costs are reimbursed to counties, but they also agree the state must hold all taxing jurisdictions fiscally harmless under this policy change.
- **Administratively Unworkable**
  - ◇ Administrative costs are largely undefined under the proposal,
  - ◇ Various sections of the proposed amendment conflict and create multiple requirements and restrictions that are at odds,
  - ◇ Instances of vague language and seemingly different uses of the same terms creates the need for counties to best interpret the law on their own, and
  - ◇ Logistical complexities envisioned under the draft would require a huge increase in staffing at the local level.
- **Liability** – the proposal would increase liabilities for counties significantly.
  - ◇ Prior property owners and lienholders will now have standing to file suit against counties that they feel have not represented their interests,
  - ◇ Any distribution of funds insufficient to pay all the liens and provide the prior owner with their full equity will likely be met with lawsuits;
  - ◇ The bill envisions paying prior owners immediately upon final sale by the county even though prior owners have the ability to object in court to the sale for up to two years after the sale, and
  - ◇ Any liens deemed invalid may be met with lawsuits.

- **Burdens the Court System**
  - ◊ Adjudicating liens will be a requirement of counties that have not ever had the right, authority, or means to do so; and
  - ◊ All liens and claims will have to be submitted and reviewed by the courts.
- **Enriches the Private Sector**
  - ◊ The proposal would mandate that the County, (who has a preferred action) pay the lender, (who has a statutorily inferior lien), to the detriment of County taxpayers.
  - ◊ This contradicts decades of case law, and some would say this demonstrates that the banking industry would be unjustly enriched under this proposal.

We encourage the Legislature and the Executive to remove this proposal from the Budget and work with counties and other municipalities that enforce state tax foreclosure laws so a more workable solution can be developed. We are confident a new proposal can be crafted by joint effort of the NYS executive agencies, NYSAC, and various county representatives, over the proceeding 90 days, that better effectuates the proper policy that excess funds received from the auctioning of tax-foreclosed properties be returned to the property’s prior owner.

# Justification for Amending Proposed In Rem Changes in the SFY 2024 Budget

## Proposed Changes to In Rem Foreclosure

The Budget proposes that when a tax delinquent property is foreclosed upon by the county and sold, any money the county receives that exceeds the liability amount (e.g., overdue taxes, penalties, interest, mortgage liens, etc.) will be returned to the property owner, minus applicable administrative costs to the local government. Effective October 1, 2023, and would apply to tax enforcement proceedings commenced on and after that date.

If the proposed amendment to NYS Real Property Tax Law is enacted as written via inclusion in the Governor’s Budget Bill, counties will likely respond with self-imposed moratoriums on tax foreclosures and auctions in order to await further action from the legislature, clarification from state agencies (OSC/ORPTS/DTF), or the establishment of precedent by the courts stemming from certain eventual lawsuits. The needed actions, clarification, and precedents may take years to materialize, during which, as the incentive to stay current with property taxes diminishes, delinquent taxes will increase, abandoned and blighted “zombie” properties will proliferate, and county government finances will be increasingly strained putting upward pressure on tax rates which will only further exacerbate the problem.

## Timing

NYSAC strongly opposes this proposal. We encourage the Legislature and the Executive to remove this proposal from the Budget and work with counties and other municipalities that enforce state tax foreclosure laws so a more workable solution can be developed.

We believe the state has every reason to move slower on these reforms and wait to review any decision that may come out this year from the U.S. Supreme Court in the Tyler v. Hennepin County, Minnesota case. This case seeks to clarify issues on whether (1) taking and selling a home to satisfy a debt to the government, and keeping the surplus value as a windfall, violates the Fifth Amendment's takings clause; and (2) the forfeiture of property worth far more than needed to satisfy a debt, plus interest, penalties, and costs, is a fine within the meaning of the Eighth Amendment. Oral arguments are scheduled for April 26, 2023.

*Counties believe no action should be taken by the state to change real property tax foreclosure laws until we have a full understanding of the Supreme Court Decision. Counties fully understand the need to be prepared for possible federally required changes and county proposals included here should be considered as part of that effort.*

*Depending on the Court decision there may also be the ability to apply a much narrower scope/focus (such as owner-occupied parcels only) and provide significantly more time to implement a transition to a modified real property tax foreclosure process beyond the proposed October 1, 2023, effective date.*

There are three fundamental concerns stemming from this proposal:

- Significant liability exposure for tax foreclosing municipalities and local taxpayers
- The significant expansion of publicly financed staff (or contracted services) required to implement this proposal (when private sector for-profit staff is already in place to protect private interests), and
- A large new fiscal burden counties and others that administer the tax foreclosure process will face under this proposal.

In addition, this proposal has no fiscal impact on the state according to budget documents and should be removed from the budget. The state has sufficient time to modify and improve this proposal in a more thoughtful and workable manner outside of the budget process and before the end of the legislative session.

Finally, the proposal is replacing a tax foreclosure system that has been in place for over 30 years, including a large volume of case law in support. Care needs to be taken when changing longstanding public policy, especially without debate and when the law in question is complex, in order to prevent unintended consequences.

## **Increased Liability for Counties and Other Tax Enforcement**

There are numerous open issues stemming from the budget proposal, some of which may not be correctable without the state providing additional financial resources and legal protections to assist localities in their effort to enforce state real property tax laws.

At the core of these concerns are open questions in the proposal that provide no guidance on how to proceed when there is a disagreement among owners, settling proceeds in cases of divorce, deceased owners, bad title, multiple owners, determining the validity of liens, what to do if bankruptcy is declared after settlement, or liens are discovered after settlement, among others.

These unanswered questions in the proposal expose county officials and local taxpayers to significant legal liability and additional expense. Bankruptcy actions can occur up to two years after a tax foreclosure sale, requiring the tax enforcing jurisdiction to defend in court with no availability of surplus funds to offset these costs and a potential second round of payouts. It is important to note that Trustees in Bankruptcy earn a percentage of the total value of the marshalled assets of the Estate and have a fiduciary responsibility owed to the Creditors to maximize the value of the Estate in Bankruptcy and marshal those assets. These new costs will fall on local taxpayers.

The proposed process could also interfere with public goods goals where a property is transferred to

- a landbank,
- a municipality that utilizes the property for a public good including a park or public safety benefit, or
- an IDA to promote housing or economic development in an underserved or vulnerable community.

Would the prior owner(s) have a right to litigate that the highest cash value was not sought by the tax enforcing entity? These fiscal and liability concerns for taxing jurisdictions need to be more fully defined and legal liability protections provided by the state.

## Higher Costs for Counties and Local Taxpayers

As drafted, counties will incur significantly higher costs under the proposal. Currently, surpluses derived from some sales are used to offset losses on other parcels and to hold multiple other taxing jurisdictions harmless during the tax foreclosure process. These offsetting receipts will not be available under the new proposal. Counties will be burdened with higher costs from carrying out a much larger administrative process, while also incurring higher interest and opportunity costs related to holding other taxing jurisdictions harmless.

These increased losses will need to be levied again and spread out among all other property owners in the taxing jurisdiction in subsequent years.

The legislation, as drafted, will vastly expand the scope of work of the tax foreclosure enforcement officer. With the requirement to settle all outstanding liens county officials will be required to hire, or contract, sufficient staff to manage and account for mortgage liens, fulfill real estate transfer obligations, provide property management functions, become a party to litigation in court and act as an escrow agent for potentially years in cases where there is a dispute between owners regarding the proceeds of sales.

### *Additional State Financial Support*

*Counties highly recommend the provision to settle all outstanding liens be removed from this legislation to help alleviate significant cost increases and legal liability on counties that will occur under this proposal. However, if the state does not remove the requirement to settle all liens, we believe the state must provide their financial support to help localities enforce state tax foreclosure laws. The higher costs described above will have to be borne by local taxpayers if no additional state support is provided.*

Counties believe the state should provide state fiscal support to this new process by either:

1. The state taking on the responsibility of holding all taxing jurisdictions harmless during the tax foreclosure process, including counties, or
2. Creating a property tax foreclosure stabilization fund that allows tax foreclosing municipalities to apply for reimbursement from the state on an annual basis to recover losses they experience under the state's tax foreclosure laws.

## The Danger of Enriching Private Sector Entities

The main benefactor under the proposed reforms will likely not be the prior property owner(s), but for-profit entities such as banks that will be able to supplant their own workforce with a taxpayer supported county workforce and still have their lien fully settled. County officials believe there is a real danger that requiring public employees to carry out this private sector function will encourage banks and lienholders to not directly exercise their rights to protect their interests – forcing that administrative burden on local taxpayers.

It could easily become more profitable for a bank to not pay delinquent taxes in a bid to protect their lien rights and invest those savings in other interest-bearing assets that could accrue over many months or a year or more while the publicly financed tax foreclosure process is completed, including making the bank whole when the bank or other private lien is settled by the county. Under this proposal banks would now be benefited by approximately five percent earnings (today's 2-year rate, or a 11th month CD) on the value of all tax delinquent parcels in the State of New York; plus all legal and administrative fees related to foreclosure.

The proposal could also interfere with current interventions a bank or other lienholder may take to secure their interest in the property. A lienholder may simply rely on the county to do their work and not engage with the property owner on a lower cost alternative. A lienholder solution that may disappear or be less likely under the proposal is offering the property owner a loan modification, installment option, reverse mortgage or other action that may help improve the property owner's finances and avoid a tax or mortgage foreclosure.

County tax enforcement officials strongly urge the Executive and Legislature to remove the requirement that tax enforcement officers settle all outstanding liens and maintain current state law tax foreclosure requirements of notice to lienholders.

If issues arise in the future that makes it necessary to reconsider satisfying all liens during this process the statute can be amended at that time.

# Administrative Costs Need More Definition

The proposal does not clearly define administrative costs which counties believe will be substantially larger under this new proposal and could reduce any surplus that might accrue to the property owner(s).

Counties believe administrative costs must be clarified in statute to include, but not be limited to:

- staff salaries and benefits,
- advertising costs,
- title searches and fees,
- related overhead and interest expenses,
- related accounting costs,
- contracted and direct services to secure and sell the property,
- software licensing fees and maintenance costs for tax tracking and enforcement, and
- litigations and attorney fees.



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