
Coates' Canons Blog: In Defense of In Rem

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Article: <https://canons.sog.unc.edu/in-defense-of-in-rem/>

This entry was posted on December 10, 2015 and is filed under Finance & Tax, Property Taxes

The in rem property tax foreclosure process under G.S. 105-375 has recently come under criticism from some title insurance companies and attorneys. They raise two related arguments against using in rem. First, they argue that courts are quick to overturn in rem sales based on concerns about the notice given to owners and lienholders during the in rem process. Second, they claim that the limited availability of title insurance for properties sold at in rem foreclosures suppresses the sale prices of these properties, impairs their resale value, and consequently harms local governments' real property tax bases.

I was skeptical of these arguments so thought it best to get input from the real experts—local tax collectors—to learn if these concerns cause them to question the usefulness of the in rem process. The answer was a resounding “no!”

1. **Are courts more likely to overturn in rem foreclosure sales than mortgage-style foreclosure sales due to notice concerns?**

I can't find a single appellate case from the last 25 years in which an in rem foreclosure was overturned by a court for any reason, much less for notice concerns.

The very few appellate cases from recent years in which courts invalidated tax foreclosure sales based on inadequate notice involved “regular” mortgage-style foreclosures under G.S. 105-374. See for example *County of Jackson v. Moor* (N.C. App. 2014) and *County of Durham v. Daye*, 195 N.C.App. 527 (2009). In *Moor*, the county was foreclosing on property owned jointly by husband and wife. Service was made on the husband at his place of employment but not on the wife. The fact that the wife was aware of the foreclosure did not excuse the county's failure to actually serve her. In *Daye*, the county attempted to serve unknown heirs by publication but never gave notice of the foreclosure to the tenants living in the house being foreclosed upon or ask those tenants if they knew how to contact the property owners (which they did).

These cases emphasize a lesson that experienced tax collectors already know: notice is extremely important in a tax foreclosure regardless of the process being used. The city or county must use extreme care to identify and notify all parties with interests in the property being foreclosed upon. It's irrelevant whether the foreclosure is a mortgage-style proceeding overseen by an attorney or an in-rem proceeding run by tax office employees; without a diligent effort to locate and serve all owners and lienholders, any type of foreclosure runs the risk of a successful legal challenge.

Feedback from local tax collectors confirms my research: courts rarely overturn in rem tax foreclosure sales. Multiple veteran tax collectors, each with 15-plus years of experience, report that they have yet to see a single in rem foreclosure sale successfully challenged in court. This may be due to the fact that tax collectors have learned from past mistakes and now do much better jobs of locating and serving all parties with interests in the properties being foreclosed upon.

2. **Are properties purchased at in rem foreclosure sales negatively impacting local governments' tax bases due to title insurance problems?**

It's true that title insurers have concerns about properties purchased at in rem foreclosure sales. Here is a comment from experienced title attorney:

I can confirm that we often are unwilling or unable to provide title insurance for tax foreclosures generally, but especially in rem foreclosures, without substantial due diligence, if at all. We do worry about whether the city, county or attorney handling the tax foreclosure have done adequate research to identify, locate and personally serve all owners of any interest in the property – fee, life tenant, heirs, remaindermen, contingent remaindermen, lienholders, mortgagees, etc. With a civil action foreclosure, this must be “vetted” by a judge before the final entry, rather than just a unilateral judgment being filed without any third party oversight. Having the blessing of a judge that all has been properly done, notice clearly researched and given, etc. goes a long, long way toward assuring marketability of the properties and the titles.

Other real estate attorneys confirm the skeptical view of in rem foreclosures held by title insurance companies. I think this view is based on a misunderstanding of the in rem process.

Service of notice on owners and lienholders is usually accomplished in the same manner regardless of whether the foreclosure is in rem or “regular” mortgage style. Both foreclosure procedures permit service via registered or certified mail, return receipt requested. G.S. 105-374(c); G.S. 1A-1, Rule 4; G.S. 105-375(c)(3). Both procedures require additional efforts if service via mail fails, including posting notice on the property and publishing notice in the newspaper for at least two weeks.

The argument that a judge “blesses” service in a mortgage-style foreclosure doesn’t hold water. In both types of proceedings, the county will be required to provide the court proof of service, including publication if required. So long as that proof is provided, a judge will not investigate the adequacy of service any more than the clerk of court will in an in rem proceeding.

As for identifying all potential owners and heirs, there is no basis for believing that an attorney prosecuting a mortgage-style foreclosure will be any more diligent in a title search than will a paralegal or other tax office employee pursuing a in rem foreclosure. The reverse in fact may be true. An attorney working on a fixed-fee arrangement for local tax foreclosures has a disincentive to spend any more time than the bare minimum on a title search—that attorney is not getting paid more if she spends more time on the case. And as is true of service issues, judges do not routinely investigate the adequacy of a title search in a mortgage-style foreclosure. Nearly all mortgage-style foreclosures are uncontested and resolved without trial or other substantive inquiry from a judge. The properties that get to foreclosure are almost always properties that the owners have essentially abandoned.

Regardless, it’s clear that title insurers have concerns about in rem foreclosure property. But do those concerns lead to lower sale prices and decreases in local governments’ tax bases? The evidence suggests otherwise.

First, tax collectors often see repeat buyers at their foreclosure sales. If these buyers were having trouble insuring or re-selling in rem properties, they would not continue to buy them.

Second, appraisers generally do not take forced sales such as foreclosure sales into account when assigning tax values. Even if the in rem sale price is less than the property would have produced at a voluntary, arms-length transaction, it should not have an effect on the property’s tax appraisal.

Third, the properties that actually make to foreclosure sale are almost always low-value properties on which taxes have not been paid in years. Even if a property’s tax appraisal decreased after an in rem sale, the net effect on the local government’s tax revenue will still be positive if the new owner is more diligent about paying taxes on the property than the old owner.

Fourth, and most importantly, very few in rem foreclosures actually make it to sale. Case in point: Valerie Curry has overseen many hundreds of in rem foreclosures for Orange County and she reports that over 80% of those foreclosures are terminated due to payment prior to sale. Markus Kinrade sees similar results in Wake County.

Much of an in rem foreclosure program's value lies in its ability to produce payment from delinquent taxpayers with just the threat of a sale, not the actual sale. All of the objections to in rem foreclosures deal with post-sale issues. That's a concern for something less than twenty percent of all in rem foreclosures. The small minority of properties that do make it to sale have such low ownership interest and low values that judicial challenges and title problems are unlikely to have any substantive impact on the local government down the road.

Critics of the in rem process argue that local governments should always use the mortgage-style foreclosure process (G.S. 105-374) rather than in rem because they can collect the related attorneys' fees from the sale proceeds. That argument ignores two important problems.

First, attorney fees may be charged to the taxpayer in a mortgage-style foreclosure only if the complaint is filed. If the taxpayer pays the delinquent taxes before the complaint is filed (as often happens once the taxpayer realizes foreclosure is likely), then the local government will be stuck with the tab for the attorney's title search and other pre-complaint work. See this post for more on when attorneys' fees may be charged.

Second, many of the properties that make it to foreclosure sale won't produce enough sale proceeds to cover both the delinquent taxes and the attorneys' fees. Once again, the local government will be stuck with the attorneys' tab.

While I don't advise local governments to abandon the use of in rem foreclosure, I do think they can take steps in the in rem process to lessen concerns about these properties. The first and most important step is to work very hard to identify all potential owners and to serve those potential owners with notice of the foreclosure. The second step is to insist that the clerk of court open a file for the in rem proceeding and include in that file all relevant title search and service documentation provided by the local government. From what I hear, often there are no court files for in rem foreclosures available for review by title insurance companies. This lack of documentation concerning the tax office's effort to locate and serve all property owners contributes greatly to title insurers' worries about in rem properties. Making sure that a well-documented file exists at the courthouse may help convince title insurers that the property is not a major insurance risk.

[Many thanks to the many property tax officials across the state who responded to my inquiries about the in rem process.]

Links

- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-375
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