Coates' Canons Blog: Tax Foreclosure and Redevelopment

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Carolina County has been working with its largest municipality, Tar Heel Town, to redevelop one of Tar Heel Town's more dilapidated neighborhoods. Many of the properties in this neighborhood are owned by absentee landlords who fail to maintain them properly. Not surprisingly, many of these properties are also subject to liens for thousands of dollars of delinquent property taxes and minimum housing ordinance repair costs.

A local community development corporation (CDC) hopes to acquire and redevelop some of these properties into affordable housing, but the CDC has had difficulty convincing the absentee landlords to sell. Now the CDC is pushing the city and county to foreclose on the delinquent properties in the neighborhood—and then, with the liens cleared, the CDC hopes to buy some of the properties out of foreclosure at a substantial discount. The town council is supportive of the proposal, because it sees it as a way to accomplish some of its goals for the neighborhoods. Is the CDC's proposal realistic? How could it be implemented?

In short, the CDC's proposal is realistic, but the city and county would need to proceed carefully…

Property taxes on real property may be collected using foreclosure, of course. And as my colleague Tyler Mulligan explains here, so too may housing ordinance repair costs. Thanks to G.S. 153A-140 and G.S. 160A-193, foreclosure is also a remedy for nuisance abatement costs such trash removal and grass cutting that is often required when landlords fail to maintain their properties.

I provide a detailed description of property tax foreclosures in this post. For our purposes, the most important point to remember is that the property tax foreclosure process requires a public auction of the property in question, which must be sold to the highest bidder free and clear of all tax and other liens. The local government conducting the foreclosure may not set restrictions on the selling price, on the bidders, or on the deed to the property.

Price: While the relevant statutes do not permit a local government to set a minimum bid for the property being sold at foreclosure, it can accomplish much the same by submitting its own bid for the property. G.S. 105-376(a).

In most tax foreclosures, the foreclosing government will submit an initial bid at the amount of taxes, fees, costs, and interest owed on the property. By doing so, the government ensures that it will be made whole if a third party tops that bid and buys the property. If nobody tops the government's initial bid, then the government becomes the proud owner of the foreclosed property.   (More on how this strategy might help with redevelopment efforts in a moment . . .)

If the government does not submit an initial bid, then any bid of any amount will be sufficient to buy the property, regardless of the amount of taxes and other costs owed on the property.

Bidders: A local government cannot play favorites by excluding certain parties from the bidding. Even the current owner who is being foreclosed upon is eligible to bid on and buy the property at the foreclosure. And if the government does not submit an initial bid at the amount of taxes and costs owed on the property, then the current owner could buy back the property for as little as $1 with all of the tax and other liens extinguished.

Deed: The property must be sold in "fee simple, free and clear of all interests, rights claims and liens . . . " G.S. 105-374(k) . In other words, a local government may not place restrictions on the foreclosure deed requiring the property be used as affordable housing or otherwise limiting the owner's use of the property. The winning bidder must receive the same ownership rights in the property as were held by the owner who was foreclosed upon. See this post for more details.

Given these limitations, how could a local government use the tax foreclosure process to assist with redevelopment efforts in the neighborhood?

Local governments' authority to purchase properties on which they are foreclosing essentially gives them the power to keep the properties out of the hands of undesirable owners—assuming, of course, that the governments are willing to outbid these third parties. Sometimes simply an initial bid of taxes and costs owed will be sufficient to deter other bidders. But a local government is not limited to this initial bid; it may raise its bid to whatever level it desires if it wants to make sure that the property remains under its control.

A local government could wait until after the initial auction to submit a higher bid. Under the "upset bid" process, potential buyers (including the foreclosing government) have 10 days after the initial sale to submit a new bid that exceeds the current high bid by at least 5% or $750, whichever is larger. If an upset bid is submitted, a new 10-day window for additional upset bids begins. The foreclosure sale does not finally end until no new upset bids are submitted for 10 days. G.S. 1-339.25, as incorporated by G.S. 105-374(m).

If a local government is the ultimate high bidder, it will not be required to make good on its entire bid in cash. The government must pay only the portion of its bid that would not be used to satisfy taxes and other government obligations owed on the property. G.S. 105-376(b).

For example, assume Carolina County is the high bidder for a property foreclosed upon jointly by the county and Tar Heel Town. The city and county were owed $10,000 in taxes and costs. If the county's winning bid was exactly $10,000, it would not need to pay any funds other than whatever it owed to its attorney and to the court for foreclosure costs.

But if the county's winning bid were $15,000, then it would have to pay the $5,000 in excess of the taxes and costs owed on the property to the clerk of court for distribution to the property's former owner or to junior lienholders.

Either way, the county would hold the property for the benefit of itself and the city. If the county later sells the property, it must use the proceeds to satisfy the taxes and costs for which the property was foreclosed. G.S. 105-376(b). But it is not required to sell the property. The purchasing government may use the property or dispose of it in any manner otherwise permitted. Tyler Mulligan discusses methods of disposal for redevelopment purposes here.

Another option, if the county wanted the property to be redeveloped into affordable housing, would be to convey the property to the CDC pursuant to G.S. 153A-378, provided the CDC agreed to use the property to construct affordable housing. The CDC would take the property free from all previously existing tax liens, which were extinguished by the foreclosure.

If the county chose this option, or chose to hold the property for a park or other public use, it would be expected to negotiate with the city as to what payment, if any, the county would owe the city for the city taxes and costs included in the foreclosure. G.S 105-376(b). In my example, I assume Tar Heel Town would be thrilled with the transfer to the CDC and would not demand any payment for the lost taxes.

Links

- ced.sog.unc.edu/?p=854
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=153a-140
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=160A-193
- canons.sog.unc.edu/?p=4747
- canons.sog.unc.edu/?p=5089
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-376
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-374
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