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Summary.

Real Estate, Construction Law and Title Insurance

Real Estate Settlements Face Disruption

A buyer must be a party to the foreclosure to redeem the tax lien or risk losing title

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It would be a fair wager to say that the average person does not spend much time thinking about tax sale certificates. Perhaps you've given them a passing thought at midnight, when an infomercial promises that you could earn enough to retire without taking off your smoking jackets. (Do people still own smoking jackets?)

All that changed on January 29 when the New Jersey Supreme Court issued three companion decisions in the cases of *Simon v. Rando*, *Simon v. Cronecker*, and *Malinowski v. Jacobs*. (A motion for reconsideration was filed Feb. 7). The holdings in these three cases have already affected a sea change in the tax lien industry. That change, however, is interesting only to the ten attorneys in the State of New Jersey who practice in this arena. The more far-reaching impact will be on the parties to real estate transactions, their attorneys, title companies and underwriters who insure those transactions. Anyone who falls into that category, and who participates in a transaction where there is an ongoing tax lien foreclosure, must be aware of the new requirements that these cases impose.

The three cases address a question that has been the subject of considerable litigation in the Chancery and Appellate Divisions. The question was whether a defendant in a tax lien foreclosure, who is in jeopardy of losing his property, can sell that property to a third party. One might question why this was ever an issue. After all, if the property owner still owns the property, what would prevent it from being sold to pay off the taxes and generate some equity?

This self-evident right of a defendant-property owner to sell has been challenged by the holders of the tax sale certificates who are in the process of foreclosing the property. Many tax sale certificate owners are in the business to obtain title to real property. When one prosecutes a tax foreclosure, unlike a mortgage foreclosure, there is no sheriff's sale. The entry of final judgment vests title in the holder of the certificate. While this happens in a relatively small percentage of the cases, when it does, it is (generally) a significant return for the

tax sale certificate holder. Many would argue that the prospect of obtaining title is the engine that drives the tax lien investment industry and the reason why it is such a successful source of revenue for the municipalities in this state. When property owners sell their property to third parties to prevent the loss of the property at foreclosure, they thwart the efforts of the tax lien investor to obtain title. Needless to say, this makes the tax lien investor very unhappy.

Beginning in the early 1960s, the first of the so called "heir hunter" cases arose out of our Supreme Court. These cases involved parties who sought out heirs to properties, so as to acquire interests for little or no consideration and redeem the taxes. To protect owners of property from these societal pariahs, New Jersey law began to limit the rights of parties to dispose of their property once a foreclosure had commenced. In 1967, the legislature, in an attempt to deal with the perceived scourge of the heir hunter (or "title raider," to use a more modern pejorative) enacted a statute that provided once a tax foreclosure had commenced, a third party (other than a family member) could not acquire a property and redeem the taxes unless the property was acquired for more than "nominal consideration." In addition, both the statutes and court rules contain provisions that require that any redemption of a tax sale certificate be "in the cause."

Until recently, there were two major questions raised by these statutes and court rules. What does it mean to be "in the cause"? And how do you determine whether property was purchased for more than nominal consideration? Although trial courts and appellate panels took various stabs at answering these questions, it was not until the cases just decided by the Supreme Court that a clear set of guidelines were established. However, in establishing those guidelines, the Court created significant peril for the real estate professional.

First, on the issue of "nominal consideration," the Supreme Court held that "more than nominal consideration under N.J.S.A. 54:5-89.1 means consideration that is not insubstantial under all of the circumstances; it is an amount, given the nature of the transaction, that is not unconscionable." *Simon v. Cronecker*, slip op. at page 41. In reaching this conclusion, the Court rejected all the proposed formulas that required some preset percentage of the speculative value of the property be paid for the consideration not to be deemed "nominal." The practical effect is that trial courts will approve arm's length transactions that appear reasonable, if the seller will walk away with some proceeds after satisfaction of the taxes.

Now for the bombshell. No one purchasing a property from the defendant/property owner in a tax foreclosure can redeem the taxes without being admitted "in the cause." Under *Simon v. Rando*, this is defined as being a named party in the foreclosure action and filing a motion to intervene if one is not. The Supreme Court has decided it is the buyer of property who is redeeming the taxes.

This may not appeal to one's intuitive sense, or knowledge of New Jersey real estate contracts. Virtually every one of these contracts has a clause that permits the seller to clear title by utilizing the sale proceeds to satisfy liens at the closing. Since the seller, who is a defendant in the foreclosure, is already "in the cause" one would think that the seller would be free to redeem the taxes using the proceeds of the sale. Not so.

Once a buyer becomes aware of the existence of a tax lien, and a recorded *lis pendens* (most likely on review of the title report), the buyer *must* become a party to the foreclosure to redeem the tax lien. If the buyer does not file a motion to intervene, the holder of the tax sale certificate can reject the redemption funds that have been sent to the tax collector, refuse to return the tax sale certificate endorsed for cancellation, and continue with the foreclosure. If unchecked by a court, this will result in both the seller and buyer of the property being divested of title. It is arguable that this loss of title cannot be reversed, even by the exercise of equitable powers by a Chancery judge, based upon the rather strict language used by the Court in *Simon v. Rando*.

Obviously, this result must be avoided. When a closing attorney or title company is presented with evidence that there might be a tax foreclosure in process, immediate action is required. First, counsel for the plaintiff must be contacted to determine if there is an active foreclosure. (Recall that *lis pendens* and tax sale certificates often remain of record even after taxes are redeemed.) If there is an active foreclosure, two questions must be answered. How much time is remaining before the entry of final judgment? Under New Jersey law, a tax sale certificate can be redeemed (but only by a party who has the right to redeem) up until the day the final judgment is entered. Second, inquire as to whether the certificate holder will allow redemption without the necessity of the buyer filing a motion to intervene. Although there is little practical experience with this request, there has been some indication that the holders of tax sale certificates will not insist upon the filing of a motion in every instance, and will accept redemption funds from a real estate sale.

If the closing attorney takes these steps, determines that there is an active foreclosure and perhaps a redemption deadline has been set, and consent cannot be obtained for redemption, a motion to intervene must be filed immediately. If there has already been an Order Setting Time, Place and Amount for Redemption, there may only be a short period of time left. Care must be taken to insure the motion is returnable prior to the redemption deadline, or that a request for emergent relief is made in the motion to extend the redemption deadline until after the motion is heard. The motion to intervene will have to include proofs, most likely from both the seller of the property and the buyer/proposed intervenor that the transaction is for more than nominal consideration. (Guidance on this

particular question is beyond the scope of this article. However, I would suggest reading the *Simon v. Cronecker* decision.)

There is one additional step that should be taken. Although the Supreme Court did not specifically address the question, N.J.S.A. 54:5-89.1 states that “a party who is seeking to intervene must have recorded their interest in the real estate.” Since the statute is quite specific, it would appear that either the agreement of sale, or a memorandum of the agreement, will have to be recorded prior to the filing of the motion to intervene. I question whether the Court intended to clutter the real estate records in this manner, not to mention the fact that many real estate contracts prohibit the recording of the contract or a memorandum of the contract. Nonetheless, out of an abundance of caution, I would strongly suggest recording prior to filing.

The results of these decisions have the potential of creating a considerable additional motion practice for counsel, as well as for Chancery judges of this State. However, considering the Draconian results of the failure to be admitted in the cause, and the loss of title when redemption funds from a party not in the cause are lawfully rejected by a tax lien holder, it is not only the prudent course, it is the only course that one can take.