

TO: MEMBERS OF THE COMMITTEE ON REVENUE/ URBAN AFFAIRS
FROM: GEORGE KILPATRICK, REVENUE COMMITTEE COUNSEL
RE: LR 375, LAND REUTILIZATION COMMISSION, SPECIAL
ASSESSMENTS AND URBAN REDEVELOPMENT
DATE: OCTOBER 21, 2008

Introduction - This study arose from three bills brought before the two standing committees in 2008: (1) LB 899, which called for transferring the Douglas County Land Reutilization Commission to become a function of the Omaha city planning department; (2) LB 989, which would have elevated the status of special assessment liens, like demolition liens to parity with the levy for general taxes; and (3) LB 710, which would have required notice to adjacent landowners before a land reutilization authority sells property. LR 375 seeks to examine these issues in a broader context of delinquent taxes and special assessments.

Background – When a Land Reutilization Commission receives and hopefully, sells a property, this is the very end of a long series of actions and processes dealing with delinquent taxes. The Land Reutilization Commission receives property at least four years after taxes have become delinquent and after many other persons and entities have had some control over the rights to the property.

The beginning of this process is most familiar to the Revenue Committee. When property taxes first become delinquent, the taxes plus 14 percent interest are paid to the levying governments through the sale of tax sale certificates. This tax sale certificate process essentially allocates delinquent property taxes among qualified bidders, or “investors” on a rotating basis. The winning bidders pay the amount of taxes and interest due on the property and receive a certificate. Usually, the investors are seeking the fourteen percent interest rate on delinquent taxes. This is seen by some as a “windfall” for the investors, many of whom are out-of state.

Many times counties themselves have asked to change the process, both to allow the county to own the certificates and collect the high interest rate or to increase the fee the county charges for issuing the tax sale certificate from \$10 to \$20 or more.

Under NEB.REV.STAT., SECTION 77-1801, all real property which has been assessed taxes that are delinquent shall be subject to sale on the first Monday in March. Public notice of the sale is given and the land is “sold” to whoever is willing to pay the taxes and the interest that has accumulated thereon. While the statute calls this tax sale process an auction, there is no “auction” as we normally think of it because the price has already been set. Effectively, the delinquent tax list properties are taken up in order and qualified bidders whose number comes up can either buy the certificate or pass that opportunity to the next bidder. Investors typically buy these for the opportunity to earn 14 percent interest on the delinquent amount, not because they want the property.

The county must buy the certificates for all those properties that are unsold at the auction. Often those are the ones where the owner is least likely to “redeem” the property by paying all the taxes and interest and therefore retaining ownership of the property.

Despite all the language in the statutes about “purchase” and “land sold for taxes” these transactions are not sales of land and the purchaser does not get the property, at least not immediately. Tax sale certificates are publicly recorded liens which have priority over all other liens on the property. At this stage, delinquent special assessments are paid by the purchasers at the tax sale certificate auction. Special assessments that have not yet been levied are not included in the tax sale. These assessments were the subject of LB 989 (2008).

The owner of the property may redeem the property by paying all taxes and interest that were paid by the purchaser of the certificate, plus additional interest accumulating at 14 percent per year. The owner has three years from the time of sale to redeem the property under the statute (NEB. REV. STAT., section 77-1837). Under Article VIII, section 3 of the Nebraska Constitution, the redemption period cannot be less than two years.

Holders of tax sale certificates may obtain a deed after the three year redemption period. Most, however, foreclose on the certificate. This means that the sheriff sells the property to the highest bidder. If the proceeds from the sale are less than the taxes due and accumulated interest, the certificate holder is out the difference. Any excess received over the taxes and interest is returned to the property owner. If the property fails to sell, the deed is taken by the county which is to dispose of it. Counties may replace this duty with an entity called a land reutilization authority, but only Douglas County has seen fit to do so.

This year, an investor, Aeon Financial, LLC. challenged Sarpy County’s round robin sale process as inconsistent with the tax sale certificate requirements of section 77-1807. Aeon, apparently sought to purchase a majority of the certificates for sale in Sarpy County but was only able to acquire those that came up for sale at its turn in the round robin format. NEB. REV. STAT., section 77-1807 allows any “person who offers to pay the amount of taxes due on any real property for the smallest portion of the same shall be the purchaser, . . .” Aeon argued that this was an auction to the highest bidder with the “highest” meaning the bidder that would pay the full amount of delinquent taxes while accepting a lien on *less* than the entire property. The smallest share of the property encumbered then is the highest bidder.

The district court on June 3rd held that the round-robin procedure indeed violated the statute, but refused to enjoin or reverse the sale. Essentially, the court instructed the Sarpy County Treasurer to comply with the statute next year, but gave no instructions on how to do that. Therefore, one issue the Committee could consider is the conduct of the auction itself. The Sarpy County Attorney has asked for legislation granting counties more authority regarding the conduct of the sale, including conducting a real auction with the certificate going to the highest bidder. In states where this is the practice, any bid of more than the taxes and interest would function like a discounting of the interest rate.

LR 307 in 2004 called for the Revenue Committee to study the entire tax sale certificate process and alternatives thereto. Among the findings from the research done at that time was that about one third of states use a tax sale certificate process to collect delinquent taxes. Therefore, it is less than a majority. Most of the rest commence the collection process with a judicial foreclosure. There is always a redemption period, averaging approximately two years before the land can actually be sold to collect taxes. Some are shorter, however.

A few states use an administrative process. This is usually much faster. For example, in Massachusetts, land that has delinquent taxes pending is sold by the town at a public auction to the highest bidder. The town takes the title to any property that is unsold and any purchaser receives a deed to the property. This deed may be foreclosed upon after six months.

On August 19th, the staff of the Revenue Committee and the Urban Affairs Committee met with members and staff of the Douglas County Land Reutilization Commission, and a deputy city attorney for Omaha to discuss the issues raised in LR 375. The purpose of this series of meetings was to gather different perspectives on the “whys” of the legislation that was proposed last session. What is the fundamental problem or problems that these bills were designed to correct? If there is more than one problem, can they be pursued simultaneously and comprehensively?

The problems – All people that we met with indicated that the fundamental issue was budgetary. In recent years the Douglas County Land Reutilization Commission has received fewer properties to resell so the budget for the agency has become hard to manage. Under the statute (section 77-3211) The Land Reutilization Commission must purchase all properties that are foreclosed which cannot be sold to another person or entity. The number of properties falling to the Land Reutilization Authority has decreased in recent years and seems unlikely to rebound.

Proceeds from the sale of these properties are supposed to recover the costs of the Commission (usually unpaid taxes and interest) and the administrative costs of operating the Commission. The Commission has only one employee. Recently, in order to cover the costs, the Commission began charging \$25,000 each to the city of Omaha, Douglas County, and the Omaha Public Schools District. The Douglas County payment has been made through in-kind services. The Commission has also contracted to perform this service for Sarpy and Otoe Counties, but these contracts have resulted in few properties to sell and little additional revenue. Estimates provided by the Douglas County Land Reutilization Commission projects that its cash balance will decline from \$38,250 at the end of 2008 to -\$5,750 at the end of 2010.

LB 899 was introduced to dissolve the one Commission employee into the planning department thereby providing administrative support within current resources. Both the county and the school district, of course, support performing this function in some way

without paying the \$25,000. The Douglas County representative on the Land Reutilization Commission expressed concern about this approach if a situation arises where the property involved is in the county but outside of the city of Omaha, but currently, there are no such properties.

LB 989 also reflects a response to a fiscal problem. Special assessments levied by the city for all purposes are inferior to the liens for regular taxes. However, liens for demolition create a unique problem because they can be larger than the value of the property in and of themselves and because they are far more likely to be delinquent. According to figures provided by the Omaha City Attorney's office, nearly 75 percent of Omaha's special assessments for demolition are delinquent while for most other kinds of special assessments, the delinquency rates are 10 -15 percent. Other high percentages are for weed removal - 28 percent; and litter removal – 26 percent. Not surprisingly, nuisance abatement assessments are delinquent far more than special assessments to build sidewalks or otherwise improve the neighborhood.

Understandably, other governments are concerned that large nuisance abatement assessments could overwhelm ordinary taxes and take most of the proceeds of a foreclosure sale if these liens are elevated to be at parity with liens for regular taxes.

LB 710 had a different focus. That bill would have required the Land Reutilization Commission to notify adjacent landowners when property will come up for sale. Essentially, the thought was that neighbors should have the first opportunity to say no.

A solution – One way to address, if not resolve all of these problems might be to allow public officials to act earlier in the delinquent property tax system to minimize costs and maximize opportunities for redevelopment and cost recovery. If a public entity, instead of acquiring only those properties that no one will buy at foreclosure could select properties that may become troublesome and those nearby, costs could be spread over more properties and sales of properties could be packaged together to increase the purchase price.

Such intervention could occur as early as the tax sale certificate process. Currently, under section 77-1807, properties for which property taxes are delinquent are sold to anyone willing to pay the delinquent taxes and interest that has accrued up to the date of the sale in March.

What developed during our meetings with the interested parties was an idea that the city/ Land Reutilization Commission/city planning department be allowed to acquire tax sale certificates before the public auction in certain limited circumstances. These limitations on that right to “cherry pick” the tax sale certificates could require the city to only purchase certificates for properties that were located within city limits *and* meet one of the following five criteria:

- a. The city has in place a special assessment for demolition, weed removal, or litter removal,

b. The property is on the city's schedule for demolition, weed removal, or litter removal, but the work has not yet been done and the assessment has not been made. (Perhaps properties which have received more than one citation demanding that the property be cleaned up would be appropriate.)

c. The property is within the same city block as another property or certificate for a property being purchased by the city under a, or b.

d. The property has been determined to be blighted and substandard and is therefore within a redevelopment district, *or*

e. The property is within an area of declining valuation.

If LB 899 were adopted largely as it was introduced, the city government and city planning department would be the entity that would have the first pick of delinquent properties and have control over the redevelopment of the area in which it lies. This change in the law could both help fund the costs of the land reutilization function and help plan and redevelop distressed areas. Given the concern expressed by the county board member, the legislation could provide that if a city planning department ends up with property outside the city, it cannot be sold without the permission of the county board. These would only be properties that fall to the planning department because there are no other bidders at foreclosure, a fairly rare event.

The Committee may want to extend the coverage of this legislation beyond Omaha. While it is true that Douglas County is the only one with a Land Reutilization Commission currently, other cities may have the desire to protect demolition and clean up liens and plan redevelopment if a proposal like this were enacted. One possibility would be that any city of the metropolitan, primary, and first class be permitted to use this power and authority. Or the Committee could allow any city to have this power.

While this proposal would not elevate that status of demolition and clean up assessments, it would enable the city to consider demolition and clean up in a larger redevelopment context. The Committee could consider allowing other liens, such as for sidewalks and paving to be elevated to parity with the liens for general taxes, and could also consider the notice for sales of property to neighbors.

Recommendations