

MUNICIPAL TAXES, TAX SALE CERTIFICATES, AND THE MATTER OF PRINCETON OFFICE PARK – (Part 1 of 4) – The Need for Municipalities to Sell Tax Liens

by Joel R. Glucksman on March 2, 2012

PART I

The Need For Municipalities To Sell Tax Liens

In New Jersey, unpaid real estate taxes are a “continuous lien” on land, N.J.S.A. § 54:5-6. However, it is often not easy for municipalities to realize a sufficient financial return on these liens. To enable municipalities to fund their operating budgets, New Jersey therefore lets them sell these tax liens. See N.J.S.A. §§ 54:5-1. Moreover, because these liens carry the same statutory 18% interest rate which a property owner must pay the municipality on real estate tax claims, the sale process has worked well for years, generating sufficient numbers of buyers. Indeed, an industry has grown up of tax certificate buyers who inject liquidity into the municipality finance system by purchasing outstanding tax liens.

Unfortunately, in 2010 this system was thrown into chaos by a bankruptcy court ruling in the matter of *In re Princeton Office Park, L.P.*, 423 B.R. 795 (Bkrtcy. D.N.J. 2010), *aff’d*, Civil No. 10-3021 (D.N.J. filed September 14, 2010). This opinion declared that a bankruptcy court could arbitrarily change the statutory 18% interest rate paid on tax liens, even well after the liens had been purchased in the open market, thus effectively overturning the careful financial calculations that tax certificate buyers make in deciding to purchase liens. For nearly two years, while this ruling has wended its way up the appeal ladder, it has cast a pall over municipal finances and chilled the purchasing of tax liens. This blog post, and several others that will follow, will explore this ruling and its impact on municipal finances in New Jersey.

Unpaid property taxes severely hamper the proper functioning of municipalities. Even under normal circumstances, unpaid property taxes impede the ability of municipalities to fulfill their responsibilities to their citizenry. Municipalities cannot cease providing basic municipal services, such as police and fire protection, road maintenance, and public libraries. Municipalities are thus “involuntary banker[s]” to taxpayers who fail timely to remit tax payments. *East Orange v. Palmer*, 52 N.J. 329, 334 (1968).

Today, we are four years into the nation's worst economic contraction since 1929. Due to the effects of the recession — such as higher unemployment and the general fall-off in business cash-flow — governments at all levels are being strangled financially by the double curse of falling tax revenues and rising costs. Needless to say, the lessened willingness of both the federal and state governments to assist cash-strapped municipalities only adds to the budgetary constraints on local governments. In this toxic environment, municipalities accordingly need not only to ensure timely and regular payment of realty taxes by their solvent citizens but must also convert unpaid real estate tax claims into spendable dollars.

Fortunately, New Jersey law has long provided a remedy – the sale of a municipality's tax liens through the sale of tax certificates. The proper functioning of the tax certificate process under the New Jersey Tax Sale Law, N.J.S.A. §§ 54:5-1, et seq. (2011) (the "Tax Sale Law"), is therefore critical to New Jersey municipalities' ability properly to maintain their cash flow needs. As the New Jersey Legislature found in 2003, in passing the Tax Lien Financing Corporation Act, N.J.S.A. §§ 52:27BBB-66, et seq. (2011)(emphasis added):

"It is hereby further declared that qualified municipalities are owed millions of dollars annually in unpaid property taxes, and that such uncollected taxes adversely impact qualified municipalities' ability to timely collect the moneys necessary to meet their operating expenditures (sic) and provide for the delivery of necessary government services, amplifying the risk of future real property tax increases and negatively impacting those taxpayers who timely remit payment. It is hereby further declared that limited means exist for qualified municipalities to expedite the collection of delinquent taxes, that as a result, such delinquencies often remain unpaid, and that the assignment sale of the tax liens related to such delinquent taxes will enable qualified municipalities to expedite the receipt of anticipated revenues and provide a funding source that will enable such qualified municipalities to more effectively carry out their public purposes."

In the case of *In re Henry*, 173 B.R. 878, 883 (Bankr. D.N.J. 1993), the court noted (emphasis added):

"Furthermore, the court also recognizes that municipalities are given special treatment for their real estate tax liens, not only under New Jersey state law, but also under the administrative priority provisions of the bankruptcy code. This special treatment is a result of lawmakers' awareness of the crucial importance of real estate taxes to the overall functioning of municipal government."

In our next blog post, we'll discuss further the critical importance that the tax certificate sale process has to municipal finances.