POLICY BRIEF

Tyler v. Hennepin County

Analysis and Policy Reform Options for State and Local Governments

On May 25, 2023, the United States Supreme Court released its opinion in ***Tyler v. Hennepin County***, making a rare but significant incursion into the realm of property tax law and, more specifically, the state and local government practice of property tax foreclosure.

About a dozen states will be most directly impacted by this decision and will need to closely review their property tax statutes and practices.[1] However, the *Tyler* decision has also renewed attention to longstanding inequities in the property tax system, from assessment to collection to enforcement and foreclosure. It presents all states and local governments with an unprecedented opportunity to create more equitable, efficient, and effective property tax systems.

While the focus of the Center for Community Progress has long been enhancing and coordinating a range of legal and policy tools—like property tax foreclosure—to help communities address vacant, abandoned, and deteriorated (VAD) properties, the *Tyler* decision has far more wide-ranging implications.

This is a key moment to engage lawmakers to advance reforms that maximize equity and fairness for individuals while still protecting a community's ability to address vacancy and disinvestment, conditions that disproportionately impact Black and Brown neighborhoods.

This brief provides state and local government leaders with our perspective and analysis of the *Tyler* case by identifying and answering, to the best of our ability, key questions left unanswered by the Court. We also suggest high-level policy reforms state and

Key Terms*

Property tax foreclosure, or foreclosure: The range of judicial, non-judicial, and other processes across the country used to extinguish an owner's and other interested parties' rights to real property and where the property is ultimately transferred to a new owner to satisfy the total amount of unpaid taxes and other public debts. The transfer may be accomplished by a "foreclosure sale," or a "strict foreclosure."

Foreclosure sale: A public auction held at the conclusion of the foreclosure where the property is offered for sale, the minimum bid reflects the total public debt owed, and the winning bidder is willing to pay the highest amount above the minimum bid.

Strict foreclosure: Where the foreclosing entity in a tax foreclosure, either the local government or a tax lien holder, takes direct title to the property in full satisfaction of the public debt. There is no public auction or sale.

**The terms defined above are solely for convenience and use in this policy brief.*

[1] States that are likely impacted most include, but are not limited to, Minnesota, Massachusetts, Maine, Nebraska, Illinois, New Jersey, New York, Michigan, Ohio, and Wisconsin. These are states where the property tax foreclosure processes allows for strict foreclosure, or allows strict foreclosure on some smaller subset of tax-delinquent properties (e.g., vacant and abandoned properties).

local lawmakers should consider as they review their property tax systems and practices to comply with *Tyler*, and urge them to see the property tax system and property tax foreclosure, as critical tools to build more equitable, resilient communities.[2]

Summary and Analysis

The *Tyler* decision essentially posits that tax foreclosure is solely a debt collection tool, and that local governments can recover only what they are owed in a tax foreclosure and no more.[3] This narrow interpretation means if the government—or a private tax lien holder—takes title to property worth more than the amount the government is seeking in the foreclosure (including unpaid taxes, interest, fees, costs, and other public liens), the former owner or interested party should have an opportunity to recover any cash generated from the foreclosure that exceeds the amount owed. According to the Court, the failure of the state or local government to provide the former owner or other interested party an opportunity to obtain this "surplus," if any exists, violates the "Takings Clause" of the 5th Amendment of the U.S. Constitution.

Thus, we know one thing for sure: Local governments retain the ability to foreclose upon or otherwise transfer tax-delinquent property to satisfy the unpaid tax debt, **but they must also provide an opportunity for property owners to recover any value in the property that exceeds the amount owed**.

Unfortunately, the Court declined to provide much clarity beyond this point, leaving states and local governments seeking to comply with *Tyler* with many unanswered questions. Below, we have identified five important questions for state and local governments to consider, and our best attempt at some preliminary answers.

Critically, there are hundreds of different property tax foreclosure processes across the country and these answers are subject to guidance from local attorneys. A careful analysis of your jurisdiction's property tax foreclosure process is essential to answering these questions for your community.

1. What mechanism(s) can state and local governments use to value tax-delinquent property for the purposes of determining whether a surplus exists, and if so, how much?

The decision strongly suggested that value established through a foreclosure sale—i.e., a public auction of the title to the property—at the conclusion of the tax foreclosure is permissible, so long as there is also a mechanism to return any surplus generated from the sale to the former owner or interested parties.

The Court did not expressly impose any other limitations on how tax-delinquent property may be valued for purposes of determining whether a surplus exists outside of a foreclosure sale, but any such valuation methods (e.g., an appraisal by the foreclosing local government) carry additional risk that the mechanism could be challenged by former owners or interested parties post-*Tyler*.

2. When should this valuation take place?

The date of the "taking" of the surplus in the property appears most likely to be the date that (a) the property was sold or transferred, or (b) the former owners' right to redeem the property and prevent the foreclosure were extinguished, whichever one happens last. We therefore believe the valuation of the tax-delinquent property should take place on or as reasonably close as possible to that date.

3. If there is a surplus, how should it be distributed and to whom?

In most jurisdictions, mortgage foreclosure statutes already offer one option for how to distribute surplus, if any is generated from a public auction or some other mechanism (e.g., an appraisal and transfer to a local government entity). While the Court in *Tyler* seemed to suggest the owner is the one with the right to the surplus, most experts tend to agree that former owners and other parties with an interest in the property (e.g., mortgage or other lien holders) should be able to claim surplus. Local governments should

2 This analysis is intended to be prospective in nature, focused on how states and local governments could limit future liability and design a more equitable, efficient, and effective property tax system moving forward. The issue of retroactive liability is certainly of critical importance for many states and local governments that have not historically been in compliance with *Tyler*, but this is an issue we do not attempt to address in this analysis.

3 For a summary of the facts, a link to the decision, and more about Community Progress' initial impressions of the *Tyler* decision, please see: **https://communityprogress.org/blog/tyler-hennepin-future-property-tax-foreclosure**.

explore whether the unclaimed surplus can be put in an escrow account for a defined period, after which those amounts default to the local government if no claim has been made.

Whatever the process, it is critical states and local governments ensure vulnerable owner-occupants know and can readily exercise the ability to claim any surplus.

4. Can states or local governments require property owners or other interested parties to claim an interest in future surplus prior to the public auction or transfer of the property—or risk losing the ability to do so?

Possibly, but there is risk in relying on such an interpretation. In its analysis, the Court discussed and did not overrule a 1956 Supreme Court decision, *Nelson v. City of New York*, where the Court found an ordinance requiring a property owner to file a timely answer in a foreclosure proceeding for unpaid water bills or risk forfeiting the right to future surplus did not amount to an unconstitutional taking.[4] Specifically, the Court stated:

> "New York City's ordinance…permitted the owner to recover the surplus but required that the owner have 'filed a timely answer in [the] foreclosure proceeding, asserting his property had a value substantially exceeding the tax due.' *Ibid*. (citing *New York v. Chapman Docks Co*., 1 App. Div. 2d 895, 149 N. Y. S. 2d 679 (1956)). Had the owners challenging the ordinance done so, 'a separate sale' could have taken place 'so that [they] might receive the surplus.' 352 U. S., at 110. The owners did not take advantage of this procedure, so they forfeited their right to the surplus. Because the New York City ordinance did not 'absolutely preclud[e] an owner from obtaining the surplus proceeds of a judicial sale,' but instead simply defined the process through which the owner could claim the surplus, we found no Takings Clause violation. *Ibid*."[5]

We believe the discussion of *Nelson* leaves open the possibility that a state statute or local ordinance requiring property owners or interested parties to request a public auction in the foreclosure action, or otherwise make a claim for surplus, prior to the transfer of the property (or risk losing that right) may be permissible post-*Tyler*.

However, local practitioners and their attorneys should be aware that this interpretation may be risky. After all, the Court in *Tyler* did not assess the adequacy of the New York City ordinance in question in *Nelson*. It merely distinguished the ordinance from the Minnesota statute, where the Court found there was no opportunity for owners to claim surplus. It is unclear how the Court, or lower courts, would assess the adequacy of a "request sale" requirement in the future if a former owner or interested party failed to make such a request and the local government or new owner later sold the property for an amount exceeding the total of the unpaid taxes and other charges.

5. Several states, including Illinois and New Jersey, sell tax liens or tax certificates to private buyers who, after the expiration of the owner's redemption rights, can convert the lien or certificate into a deed to the property without a public sale of the property. Are these private buyers subject to claims from former owners after *Tyler*?

The answer appears to be yes.[6] When a private tax lien or tax certificate buyer purchases the property tax debt and then converts that debt to a deed to the property without a mechanism to value the property and return any surplus to the former owner or other interested parties, the claim that an unconstitutional taking has occurred is still valid. While former owners will likely name—at least—both the local government and the private tax buyer in their suit to recover a surplus, there is no reason to think that the tax buyer who acquired the title (and, presumably, the surplus) will be immune from liability for failure to provide the former owner just compensation.

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4 *Nelson*, 352 U.S. 103 (1956).

5 *Id*.

6 See, for example, the ScotusBlog summary of *Nieveen v. Tax 106 et al*. Case No. 22-237 (petition for Writ of Certiorari granted, judgment of the Nebraska Supreme Court vacated, and case remanded for further consideration in light of *Tyler v. Hennepin County*, 598 U. S. ___ (2023).) **https://www.scotusblog.com/case-files/cases/nieveen-v-tax-106**.

Reimagining Delinquent Property Tax Enforcement Policy

Property tax systems, from assessment to collection to foreclosure, **need reform**. This includes reforms to better address VAD property and to help vulnerable owners preserve and protect their homes and home values. While the *Tyler* decision leaves unanswered questions for many communities and upends some critical tools communities have used to address VAD properties, it also creates an unprecedented opportunity for local leaders and advocates to reimagine their entire property tax system.

We encourage local leaders to seize this opportunity and work with lawmakers to update antiqued tax foreclosure systems, secure reforms to help local communities prevent and better address VAD properties, and create **more equitable, efficient, and effective delinquent tax enforcement systems**. A property tax system is:

Equitable if it provides meaningful protections to vulnerable owners to help ensure they can afford the taxes, avoid foreclosure and the loss of their home, or, if all else fails, mitigate the harmful impacts of foreclosure as best as possible.

Efficient if either compliance is achieved or the foreclosure/transfer occurs in the shortest amount of time possible, at either the lowest public cost or in a way that will reduce potential future public costs.

Effective if it properly incentivizes property owners to pay their taxes to fund essential public services and if an owner fails to pay, seeks to compel the transfer of property to a new, responsible owner with insurable title.

The following local- and state-level reforms are aligned with these principles and may be achievable post-*Tyler*. These are broad policy reforms that do not apply to any one state. The extent to which each policy may be realistic or could be adapted to help reform the property tax system in your state will require a deeper analysis of your state's existing laws and political landscape.

As policymakers in your state or local government craft legislative responses to *Tyler*, we encourage you to consider the following to create better systems.

1. Help vulnerable property owners avoid property tax foreclosure and preserve home equity.

The policy argument in favor of the outcome in *Tyler* is strong in the context of a vulnerable homeowner who may or may not have known about resources to avoid foreclosure. Community Progress has consistently advocated for interventions that protect vulnerable homeowners facing property tax foreclosure from displacement or loss of family wealth, which are also critical to preventing future vacant properties. However, the most effective way to make the property tax system fairer and more equitable is to adopt upstream protections to help owners avoid tax delinquency in the first place.

Such policies should:

A. Ensure property tax assessments are fair, accurate, and sensitive to market realities and historical context. All systems should provide an accessible path to contest assessments.

B. Increase property tax exemptions, especially homeowner exemptions for senior, disabled, or legacy (e.g., lived in same home for 15 years or more) homeowners to limit the possibility of the local government foreclosing on a lower-income owner-occupied home.

C. Adopt readily accessible circuit breakers to reduce the tax burden for low-income homeowners. These could include complete exemptions for households that earn less than locally established poverty rates or partial exemptions for low- and moderate-income households.

The most effective way to make the property tax system fairer and more equitable is to adopt upstream protections to help owners avoid tax delinquency in the first place.

D. Allow payment plans to ensure owners can spread out property tax payments over months or even years, especially those owners whose property taxes are not paid through an escrow account connected with their mortgage.[7]

E. Allow heirs of deceased property owners living in the subject property to qualify for the same exemptions, circuit breakers, and payment plans as owners on the title to the property.

F. Reduce the interest rates charged on delinquent property taxes to make it easier for property owners to redeem and reduce opportunities for tax lien investor speculation.[8]

2. Eliminate the sale of tax liens, especially for VAD properties.

States should use the sale or transfer of the property as the primary method to enforce unpaid property taxes, as opposed to the sale of tax liens to private investors. This is most important in the context of VAD properties where the most effective intervention is to transfer the property to new responsible owner with insurable title as opposed to selling the debt and waiting for a private investor who may or, in many cases, may not choose to acquire title, leaving the property cycling through an inefficient system year after year.

Many state statutes that authorize the sale of tax liens also do not have a process in place, like a foreclosure sale, to generate surplus proceeds or for a former owner or interested party to claim such proceeds.

Local governments, not private investors, should be responsible for enforcing and foreclosing on unpaid tax debts. WIth a system of judicial foreclosure, especially one where the period of redemption is placed before the foreclosure event (see 3D), local governments may have more flexibility to design or expand interventions to prevent the foreclosure. Local governments may also be better equipped to administer a process that provides insurable title to a new owner. Moreover, this positions the state or local governments as the only appropriate party to defend a *Tyler* claim, as opposed to a private tax lien investor.

Insurable Title is a Policy Decision

A key factor influencing prospective homebuyers or investors in vacant property is whether a title insurer will be willing to issue a policy to protect the new owner from potential future claims to ownership or title. Title insurance is also needed in most cases to secure financing for acquisition, repairs, or construction. To obtain such a policy to tax foreclosed property, insurers need to have confidence that the notice of the foreclosure met minimum standards for due process.

For many local governments, providing this level of notice will be a costly, time-consuming endeavor. These communities are left with a policy choice. Bear the upfront costs (and add them to the cost of redeeming the property or to the minimum bid/sale price) or reduce the pool of interested and qualified purchasers and, therefore, increase the likelihood that the property could become tax delinquent again in the future. Such a tool also has the added benefit of offering emerging or newer neighborhood developers a better opportunity to access tax foreclosure inventory by reducing acquisition and holding costs associated with acquiring tax-delinquent VAD properties.

3. Create a judicial property tax foreclosure system designed to produce insurable title.

States should create delinquent property tax enforcement systems that ensure property owners and interest holders receive constitutionally adequate notice of the foreclosure and produce insurable title at the conclusion of the foreclosure. Such systems increase the likelihood that owners will learn about the foreclosure and redeem the property and, if they do not, that the property will be transferred to a new, responsible owner with clean title. If exemptions, circuit breakers, or payment plans failed to keep the owner out of this foreclosure process, states or local governments could also establish a minimum threshold

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7 For a detailed overview of exemption, circuit breaker, and payment plan programs see Adam H. Langley and Joan Youngman, *Property Tax Relief for Homeowners*, Lincoln Institute of Land Policy, November 2021, **https://www.lincolninst.edu/publications/policy-focus-reports/property-tax-relief-homeowners** and John Rao, *The Other Foreclosure Crisis: Property Tax Lien Sales*, National Consumer Law Center, July 2012, **https://www.nclc.org/wp-content/uploads/2022/09/tax-lien-sales-report.pdf**.

8 SB 1675, which passed the Illinois legislature in 2023, reduces the penalty to be charged by Cook County on property tax certificates held by the County from 18 percent to 9 percent per year.

(e.g., $2,000) that must be met before pursing judicial foreclosure on properties with a homestead exemption.

Key features of such a system would include:

A. **Judicial oversight, which includes a hearing where any interested party can appear and be heard**. Oversight helps ensure the process meets due process requirements and the hearing provides an opportunity for owners and interested parties to connect with local government and, potentially, social services.

B. **Full constitutional notice of the foreclosure and sale and the expiration of the owners' redemption rights provided once, by mail**. The government should conduct a comprehensive title examination, provide notice to all individuals identified, publish notice of the foreclosure, and take further practical steps if they have knowledge that the mailed notice was not received.[9] To comply with *Tyler*, this notice should also include information about any opportunity afforded to the owner or interested party to seek any generated surplus.

C. **All unpaid amounts due to the government should be included in the foreclosure judgment**. This includes, at a minimum: all unpaid taxes including taxes that became due during the foreclosure; any interest, fees, and costs of foreclosure; the costs of conducting any subsequent sales; and all public liens that reflect unpaid costs the local government incurred enforcing housing and building code violations at the property. This amount should serve as the minimum bid for a foreclosure sale. This is the best and last chance for a local government to be fully compensated for the total public cost of mitigating the harm of VAD property, and the authority to do so must be clear in state law.

D. **The redemption rights of all owners and interested parties are extinguished on the date the sale or transfer of the property is finalized**. First, while owners should be given every opportunity to redeem, the placement of redemption rights before the foreclosure sale, as opposed to after, as in states like Texas (about two years post-sale) and Tennessee (generally one year post-sale), likely expands the market of potential bidders at the sale and increases the purchase price—and the potential surplus. Second, for purposes of complying with *Tyler*, the valuation of the property (e.g., foreclosure sale) should occur as close to this date as possible. Third, the pre-sale redemption period for owners or interested parties should differ based on property type. For example, owner-occupants should get more time to redeem (two or more years) than vacant property owners (one year or less).

E. **With certain exceptions (see #5 below), property not redeemed during the foreclosure action should be sold at public auction**. A public auction is likely the most defensible mechanism post-*Tyler* to determine if a surplus exists. Local governments and land banks should retain the option of acquiring any properties that do not receive a minimum bid at the public auction by submitting a credit bid in an amount equal to the minimum bid. They may also retain the option to compete with private bidders but must pay cash when their winning bid exceeds the minimum bid.

F. **The presiding court should issue a final order and decree approving the transfer of the property**. This order should clarify that all subordinate liens and matters are disposed of, and it should order the distribution of surplus, if any. This court order is an important step to increase the likelihood that a title insurer will be willing to issue a title policy.

4. Publicly clarify procedures to distribute any surplus after the sale or transfer.

State statutes could specify that any surplus generated at the public auction shall be distributed according to that state's mortgage foreclosure laws. If surplus is generated at the public auction but no claims have been made during or immediately after the foreclosure action is completed, consider the following practices:

A. The surplus should be held in escrow, likely through the court, and distributed to the owner and other interested parties upon receipt of a claim.

B. The local government must make the process to claim surplus accessible to all claimants, especially vulnerable, low-income households. This may include providing notice at all points of enforcement,

[9] See *Mennonite Bd. Of Missions v. Adams*, 462 U.S. 791 (1983); *Jones v. Flowers*, 547 U.S. 220 (2006); *Mullane v. Central Hanover Bank & Trust Co*., 339 U.S. 306 (1950).

making sure the notice is easy to understand and available in different languages, ensuring heirs or family members of deceased owners have a path to claim proceeds, and other tactics.

C. If the property tax foreclosure involves a nonjudicial proceeding, the local government could initiate a suit with the court—called an interpleader action—between all parties and file the surplus with the court for distribution. If the foreclosure is a judicial proceeding, the surplus should be paid into the court to be distributed to the appropriate parties.

D. Assuming the local government properly provided notice of the ways in which the owner or interested parties could claim surplus proceeds, explore whether it is possible to cap how long such money should remain in "escrow" from the date of sale (e.g., two years). Though there is little law supporting a specific term or statute of limitations in this type of matter, a state or local government considering this approach could explore ways to automatically transfer unclaimed funds at the end of the period to a fund that helps property owners avoid tax foreclosure, a fund that addresses vacant properties, or the local government's general fund.

5. Create specific procedures to address VAD properties.

Creating an equitable, effective, and efficient property tax system as outlined above will help communities better address VAD properties. Such a system reduces the time properties linger in the property tax foreclosure process, expands the pool of end users able to acquire and reuse VAD by providing clear title, and increases the recovery of public costs incurred to address VAD properties (e.g., code enforcement costs recovered through redemption or purchase at foreclosure sale).

A key concern among our local partners is that properties exposed to foreclosure sales, as discussed above, will be purchased by speculators or unscrupulous investors who will not bring these properties up to code, maintain them, and perhaps even not pay future taxes, continuing the cycle of decline. Unfortunately, the *Tyler* decision limits or impacts the ways in which many states and local governments have used strict foreclosure to address this problem, including programs like "right of first refusal" which allow local governments to directly acquire tax-delinquent VAD properties and responsibly steward them to new owners in a manner that prioritizes local goals. While many practitioners were encouraged that *Tyler* decision seemingly left open some possible paths for local governments using these mechanisms to explore (see discussion of *Nelson* in previous section), the use of such tools is not without risk and will likely be much more expensive.

The minimum bid for all properties should include all costs the local government incurred in addressing harmful conditions at the property.

Cities can consider developing additional strategies to address VAD properties by prioritizing the following:

A. If the government asserts the property is vacant and abandoned during the foreclosure, at a minimum, state law should prescribe a shorter (one year or less) redemption period than for occupied property.

B. As discussed in 3C, the minimum bid for all properties—especially for VAD properties—should include all costs the local government incurred in addressing harmful conditions at the property, including costs related to code enforcement, securing the property, and responding to calls for public safety. If this is done properly, either the government is fully reimbursed for its costs, or the increased price of the minimum bid discourages speculative bidders. Then, the government or a land bank can intervene and direct the property to a new owner in a manner aligned with community needs and priorities.

C. For states that conduct a foreclosure sale at the conclusion of the foreclosure, the local government or a land bank should have the ability to submit a default or credit bid in the amount of the minimum bid and gain title to the property if no other bidders bid more than the minimum. Local governments and land banks should also be able to compete with private bidders at the foreclosure sale, though they should pay cash for any difference between the final price and the minimum bid.

The above strategies appear most likely to withstand potential *Tyler* challenges.

Many practitioners also believe that the Court's discussion of *Nelson* provides local governments with an opportunity to continue to use strict foreclosure and right-of-first-refusal practices to acquire tax-delinquent VAD properties so long as the former owner or interested party fails to make an affirmative claim for surplus at some point in the foreclosure process. As discussed earlier, this reliance on *Nelson* is risky. Should *Nelson* be overruled or further distinguished by federal courts or the Supreme Court in the future, local governments engaging in these practices could be liable for the difference between what was owed in the foreclosure and the fair market value of the property.

If states or local governments are willing to assume this risk, some components to consider could include:

- At the conclusion of a property tax foreclosure for property certified as vacant and abandoned, the judge may grant title to the property directly to the local government so long as:
    - The local government has certified that the property is vacant and abandoned in the foreclosure notice, or otherwise certified and provided notice of this decision to the owner and interested parties during the foreclosure; and
    - The owner or interested party has had an opportunity to contest the finding that the property is vacant and abandoned; and
    - The owner or interested party has not filed a motion or claim in the foreclosure action requesting the property be sold via foreclosure sale.

Local governments interested in exploring this last option might consider how to hedge for the possibility that a court may not find this type of "request sale" requirement to be constitutionally adequate in a future claim for surplus. The local government could conduct an appraisal, or some other approximation of fair market value, of the property and only proceed with properties where the value is less than the total public debt owed. This practice should be well documented, though it certainly will not eliminate the risk of such a claim being made nor the willingness of the court to side with the plaintiff's valuation in future litigation.

Conclusion

For nearly fifteen years, Community Progress has worked closely with state and local leaders and community advocates to reform state laws and practices to address VAD properties—including reforms related to property tax systems and code enforcement systems. We are leaders in the land bank movement and have helped in varying degrees with almost every state land bank law. We encourage you to reach out to us to see how we can help you respond to *Tyler* and reform your property tax system.

For questions, please reach out to Matt Kreis, General Counsel, at **mkreis@communtyprogress.org**.

About the Center for Community Progress

The Center for Community Progress helps people to transform vacant spaces into vibrant places. Since 2010, their team of experts has provided urban, suburban, and rural communities battling systemic vacancy with the policies, tools, and resources needed to address the full cycle of property revitalization. As the only national nonprofit dedicated to tackling vacant properties, Community Progress drives change by uncovering and disrupting the unjust, racist systems that perpetuate entrenched vacancy and property deterioration. Community Progress has delivered customized, expert guidance to leaders in over 300 communities and provided hundreds of hours of free educational resources as well as leadership programming to help policymakers, practitioners, and community members across the country return properties to productive use. To learn more and get help for your community, visit communityprogress.org.

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