Memorandum

To: Commission
From: John JA Burke
Date: January 16, 2002
Re: Distressed Property Act

In June 2002, A2539 was introduced to the New Jersey Assembly and S1676, an identical bill, was introduced to the New Jersey Senate.[1] The bills revise New Jersey receivership statutes to preserve affordable housing and eliminate neighborhood blight. Each has substantial membership support.

On October 21, 2002, the Assembly Housing and Local Government Committee reported amendments and referred the reprint of the bill to the Assembly Appropriations Committee. S1676 was referred to the Senate Community and Urban Affairs Committee.

The Statement of October 21, 2002 describes the purposes of the bill and the main deficiencies of existing receivership statutes. It provides:

> This bill, as amended by the committee, would revise the receivership statutes in order to make receivership a more workable tool for the improvement and preservation of affordable housing and the elimination of neighborhood blight. Receivership refers to the intervention of third parties to maintain and improve properties when the owner of record fails to do so.

The bill would repeal three existing receivership statutes: 2A:42-79, 40:48-2.12h and 54:5-53.1. Enacted in 1962, 40:48-2.12h was part of an "Act concerning municipalities in relation to the regulation of buildings and structures and their use and occupancy, and supplementing Title 40 of the Revised Statutes."[2] The statute authorizes a public officer of a municipality to bring an action in the Superior Court to be appointed receiver *ex officio* to collect rents and income to conform the building to legal standards.

Enacted in 1966, 2A:42:79 authorizes a public officer to bring an action in the Superior Court to be appointed receiver *ex officio* if the owner of a multiple dwelling fails to correct violations of housing codes. Rental receipts are applied first against the cost of repairs, second against the costs and expenses of receivership and then against fines and penalties. 2A:42-79 is virtually identical to 40:48-2.12h except that the former applies to substandard residential housing while the latter applies to all buildings within the competence of municipal jurisdiction.

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[1] A2539 was introduced on June 17, 2002. S1676 was introduced June 20, 2002. Bonnie Watson Coleman and Jerry Green are the primary sponsors of A2539; Nilsa Cruz-Perez, Mims Hackett, John F. McKeon and Joan M. Quigley are co-sponsors. Richard J. Codey and Robert W. Singer are the primary sponsors of S1676; Ronald L. Rice, Sharpe James and Shirley K. Turner are co-sponsors.

[2] 40:48-2.12h applies to all buildings unlike 2A:42-79 which applies to substandard residential housing.

Enacted in 1942, and subsequently amended in 1943, 1975 and 1977, 54:5-31.1 authorizes a municipality that has taken possession of property by a tax sale to collect rents and profits from the building and apply them to the amount due upon the certificate of tax sale, and for subsequent taxes and other charges. The municipality may use the revenue to correct code violations and to render the property safe and habitable.

The "Statement" to A2539 correctly notes, "Underlying these laws was the assumption that the remediation of specific, previously identified code violations would be adequate to restore a building to sound and habitable status." With respect to municipal ownership by tax sale, the "Statement" points out, "The existing statutes also assume that once the code violation is remediated or back taxes paid, the right to collect rents on a property reverts to the owner."

A2539 and S1676 propose to change the nature of receivership to achieve a long-term solution to distressed residential properties. The bill entitled the "Multifamily Housing Preservation and Receivership Act" consists of 33 sections and would repeal the three existing laws on receivership. The salient features are: (1) the supply of financing through a state agency, (2) the definitions of "code violation" and "party in interest," (3) the delineation of the receiver's duties and powers, (4) the receiver's authority to create a "super" priority to obtain financing, (5) the option of municipalities to forgive tax obligations, (6) the judicial option to approve a sale of the property at below market value, and (7) the delineation of an owner's right of return.

The two bills are designed to permit non-profit organizations experienced in the management and rehabilitation of distressed properties to get control of residential buildings. A party in interest may bring a receivership petition if there is a violation of any code requirement affecting the health and safety of the tenants existing at the time of filing the petition and provided the violation has persisted for 90 days. The word "code" applies to: "any housing, property maintenance, fire or other public safety code applicable to a residential building, whether enforced by the municipality or by a State agency." A "party in interest" includes a tenant, lien holder, municipal officer and "any non-profit corporation carrying out community development activities within the municipality in which the building is located."

After the petition is filed and the hearing requirements satisfied, the court may appoint the receiver and grant any appropriate relief.[3] That relief includes approving the plan to operate, manage and improve the building to remedy all conditions constituting the grounds for receivership. The receiver has the statutory authority to contract for repair without advertisement or bidding, to borrow money and incur debt and to apply for loans from the "Receivership Loan Revolving Fund" that would be created for the purpose of financing the statutory scheme.

The receiver may apply to the court to sell the property and may propose the manner of sale. The bill mentions four non-exclusive alternatives: (1) sale at market, (2) negotiated price to a non-profit organization qualified to own and operate

[3] The petitioner must notice the owner, lienholders, mortgage holders and the municipal officer. The court would normally appoint the receiver named in the petition.

multifamily rental property, (3) conversion to cooperative or condominium ownership, or (4) sale to a tenant in the case of a one to four family building. The court may order the sale free and clear of all liens. The bill sets the order of priority for distribution of the proceeds of sale. The bill also specifies the conditions under which the building may be returned to the owner.

A2539 and S1676 improve existing receivership statutes that appoint municipal officers as receivers *ex officio* and emphasize correction of isolated code violations or the collection of unpaid taxes. The bills appear to embody the ideas proposed by Alan Mallach and establish a system for professional non-profit community development corporations to take control of problem properties and attempt to fix them. The bills contain a comprehensive scheme for the transfer of residential property from owners to "parties in interest." The bills also squarely place the statute within the jurisdiction of the Department of Community Affairs.

If enacted, A2539 and S1676 would provide a legal framework for receivership actions in the context of declining residential investment property. Unlike existing law, the bills allow broadly defined groups to petition the court to appoint a receiver. Although a causal link cannot be established between existing receivership statutes and distressed properties, the bills nevertheless open the process to private organizations committed to community development and urban renewal. Therefore, the revised law in this area would substantially improve the New Jersey receivership statutes.

However, the bills fall short of a comprehensive revision of New Jersey law and distressed properties. They do not apply to commercial, vacant or incompletely developed property. They also are heavily weighted in favor of receivership rather than sale to a market buyer. While the remedy of receivership may be an appropriate response to certain residential investment properties, it may be completely unfit in cases of commercial, vacant and incompletely developed properties. A transfer of ownership may provide the best solution to distressed properties of the latter sort. In addition, the bills do not consolidate, re-compile or repeal related law on the subject of substandard buildings.

New Jersey is no stranger to dilapidated properties and to the production of legislation to solve this problem. In a Memorandum dated May 7, 2001, the staff of this Commission identified several legislative attempts to correct blight through law; the memorandum described merely the tip of the iceberg. The New Jersey statutes are replete with laws governing unfit buildings, public housing, and repair of housing, demolition and urban homesteading. The laws are found in various titles, such as 2A, 40, 55, to name a few.[4] A revision of New Jersey law requires consolidation and re-compilation in this area.

[4] *E.g.*, 2A:42-79 (appointment of receiver for substandard multiple dwelling); 2A:42-82 (receivership procedure for substandard multiple dwelling); 20:3-1 *et seq*. and 40:14B-34 (Eminent domain); 40:48-1 *et seq*. (Unfit Building Act and demolition authority); 40:48-2.14 (Removing brush, weeds and debris); 40:55-21.1 *et seq.* (Blighted Area Act); 54:5-31.1 (municipal possession of tax delinquent property); 40A:12A-23 *et seq.* (Local Redevelopment and Housing Law); 40A:12-31 (Urban Homesteading Act); 55:14K-2 *et seq.* (New Jersey Housing Finance Agency); and 55:19-22 *et seq.* (New Jersey Urban Development Corporation).

A2539 does not address the problems of unoccupied property and hence leaves a gap. The following example illustrates the problem. On July 17, 2001, The Star-Ledger reported a story entitled "A Relic Comes Down: Apartments fall to wrecking ball." The apartments were the Washington Apartments in East Orange built in 1912. They were luxury apartment buildings that were home to "business executives, car dealership owners, and stockbrokers." The article stated that, during the 1970s, the apartments "started getting dilapidated, was (sic) boarded up and eventually began to attract prostitutes, drug addicts and homeless people." An East Orange employee remarked, "It's very melancholy to see the building come down. It's a real bit of history of East Orange falling victim to the wrecking ball."

The article failed to explain why public officials allowed the building over a period of thirty years to fall into "such a deplorable condition that it had to come down" given the available and abundant legal resources. The article also did not explain the lack of police enforcement regarding prostitutes, drug addicts and homeless people going in and out of the buildings. The history of these apartments demonstrates two points. New Jersey is electing to destroy its housing stock, even property of arguable historical value, rather than invent novel methods of private market solution. A2539/S1676 would not be useful to restore or rehabilitate vacant residential property.

The Commission's proposed Distressed Property Act (DPA) is compatible with A2539/S1676. The DPA is broader in scope, covering both commercial and residential property, as well as vacant and incompletely developed property. The DPA provides for receivership but favors sale of property. The DPA allows any person with a sound plan and qualified financing to petition the Superior Court to sell the distressed property. The separate law revision approaches can stand together. They do not compete but offer different solutions to similar problems.

Conclusion

A2539 and S1676 are worthy of support. However, they do not address the problem that the Commission intended to solve when it undertook the distressed property act project. Given the morass of statutes that has developed over the past 60 or 70 years, it would be appropriate to revise the statutes dealing with declining properties, no matter which public policy approach the Legislature elects to take.