International Municipal Lawyers Association
2015 Code Enforcement Program
Las Vegas, Nevada

Receiverships for the Tough Problems

Sunday, October 4, 2015

Presentation
by

Gregory P. Priamos and Kevin K. Randolph
County Counsel Shareholder
Riverside, CA Gresham Savage
San Bernardino, CA

©2015 International Municipal Lawyers Association. This is an informational and educational report distributed by the International Municipal Lawyers Association during its 2015 Code Enforcement Program, held October 3-4, 2015 in Las Vegas, NV. IMLA assumes no responsibility for the policies or positions presented in the report or for the presentation of its contents.

RECEIVERSHIPS FOR THE TOUGH PROBLEMS

By: Gregory P. Priamos and Kevin K. Randolph

Introduction

Long before the foreclosure fallout from the Great Recession of 2007-2009, California legislators adopted a statutory framework that specifically targeted blighted properties and their attendant ills. This statutory scheme, found in California Health & Safety Code section 17980.7, enlarged the already significant powers held by local enforcement agencies by allowing the agencies to petition a court to appoint a receiver over seriously substandard properties.

Many states have similar (and not-so-similar) statutory schemes intended to address the very real and substantial impacts related to substandard homes and commercial structures. And receivership is by no means the only tool available to communities to redress the problems caused by vacant, abandoned structures. Traditional remedies – such as civil injunction and criminal prosecution – continue to serve as bolts in the code enforcement quiver. Yet receivership often-times brings a level of control over the property that other remedies cannot. The receiver, although not taking actual title to the property in most instances, exercises dominion over the property to the exclusion of all others, including the owner and existing lienholders. And although a receiver's authority will vary from state-to-state and court-to-court, the following are some of the more commonly-held powers:

- to assume exclusive possession and control of the property
- to secure the property against further intrusion
- to displace and relocate any occupants if needed to carry out the rehabilitation
- to insure the property
- to prepare a rehabilitation plan and obtain super-priority private financing to pay for the costs
- to sell the property and distribute proceeds as directed by the court.

The Scope of Potential Code Enforcement Receivership Cases

Depending upon the jurisdiction, receivership can address a host of different problems and types of properties. In California, as one example, the authors – one a former city attorney and current county counsel and the other a receiver – have tackled many different types of problem properties through the receivership process. Although a majority of those cases involved single and multi-family residential properties, the remedy has also been very successfully applied to commercial properties and other non-residential uses. The following examples demonstrate the breadth of the receivership remedy:

- a single-family home that served as a pipe bomb-making factory and in which the owner confined his bedridden mother in a rear bedroom. The city became involved when the owner, after a few too many beers, stepped out into the front yard and began firing a handgun into the air.
- a former gas station whose shuttered mini-mart was being used by a transient population as a party spot. The receivership was complicated by a pre-existing regulatory order and agreement arising from the presence of leaking underground storage tanks.
- a rural lot with three abandoned homes that were being used by the locals for impromptu raves. The city took action after one of the partygoers killed another in a dispute over a drug debt.
- an abandoned trailer located on property contiguous to a national forest. The owner, who had been convicted of child molestation based on acts occurring on the property, actively participated in the proceedings from prison.
- a property located in a commercial retail area that served as a storefront medical marijuana dispensary. The city's land use ordinances prohibited the use of property for medical marijuana clinics and, under California law, an illegal land use can serve as the basis for the appointment of a receiver.

Brief Overview of Select Code Enforcement Receivership Laws in the United States

Being California-based lawyers, the authors are most familiar with that state's version of code enforcement receiverships. But California is by no means the only state with a code enforcement receivership statute. In addition to the California framework, we have set out below (in necessarily-brief detail) key points from code enforcement receivership (or receivership-like) statutory schemes from Illinois; Massachusetts; Michigan; Missouri, New Jersey; Ohio; Pennsylvania; and Texas.

1. California (Health & Safety Code § 17980.7)

- Requires seriously substandard properties (as defined by statute).
- Properties include any property used for human occupancy, including single-and multi-family residential and commercial structures.
- Owner must be given a due process opportunity for self-correction within a "reasonable time."
- Process:
    - Municipality issues notices of violation and abatement orders.
    - Non-compliance is referred to legal counsel for preparation of complaint and receivership petition.

- Counsel files litigation and requests the court to appoint a receiver, who is nominated by the municipality and who must demonstrate the ability to complete the repairs. May be an individual, most corporations, or a tenant/housing entity.
- Receiver relocates occupants (if any) if needed.

- The receiver is nominated by the municipality but approved, appointed, and supervised by the court.
- The receiver is not the agent or representative of either the municipality or the owner. The receiver acts independently and with the court's approval as to all major actions.
- The receiver is paid from proceeds of property's sale or by the owner or lenders. Technically, the municipality may be held accountable for shortfalls but this rarely occurs.
- Three primary approaches to rehabilitation:
  - The receiver prepares rehabilitation scope of work, borrows funds, and contracts for the work. Unless the owner or lender elects to redeem the property following completion of the rehabilitation, the receiver markets and sells the property.
  - The receiver sells to a qualified investor buyer, who uses their own funds and contractors to complete the work; receiver supervises the work's progression.
  - The owner or lender funds and/or uses its contractors to perform the work; receiver supervises the work's progression.
- From the sales proceeds, receiver pays:
  - taxes;
  - the rehabilitation loan;
  - escrow costs and sales commission;
  - municipality's administrative fees and legal fees;
  - the receiver's fees and expenses; and
  - the balance to lender and owner.

2. Illinois (65 Ill. Comp. Stat. Ann. 5/11-31-1 – 31-2.3)

- Used as a very last resort.
- Process:
  - The municipality may petition the court to have a receiver appointed for a property that violates the minimum standards of health and safety under the applicable municipal ordinances.

        - The law allows other entities such as non-profits or community development corporations to bring receivership actions but the law gives more flexibility to municipalities.
        - A receiver may be appointed even if the property is in foreclosure.
    - The municipality must provide notice of the petition to the owner.
    - The judge decides if a receiver is needed.
    - Once appointed, the receiver is given broad authority to make necessary repairs.
    - To pay for the repairs, the receiver can obtain loans evidenced by a receiver's certificate. The lender certificates are repaid at an interest rate fixed by the court.
    - If the owner does not pay off the certificate, the certificate becomes a first lien on the property and is superior to all other encumbrances, except taxes.

- **Chicago Troubled Building Initiative (TBI)**
    - In addition to other methods, Chicago uses receivership to prevent the deterioration and loss of housing stock.
    - Chicago authorized Community Investment Corporation (CIC), a nonprofit, to administer the TBI and to act as a receiver for troubled buildings.
    - Chicago and CIC work together to identify deteriorated buildings that are public health and safety risks.

3. Massachusetts Receivership

- The State Attorney General's Office (AGO) implements the state's Abandoned Housing Initiative (AHI).
- The AGO seeks out delinquent owners of abandoned residential property and encourages them to voluntarily repair their properties and make them secure.
- If the owners refuse, then the AGO petitions the court to appoint a receiver.
- Process:
    - Municipalities share residential property addresses with the AGO.
    - The AGO notifies the real parties in interest to make repairs.
    - The AGO requires documentation that the owner can finance the repairs and will use a licensed contractor; if not, a receivership petition may be brought (under the State Sanitary Code) by either the AGO or the municipality.

- The receiver is appointed by the court.
- The receiver may lien the property for costs incurred.
- Once repairs are completed, the owner may reimburse the receiver for costs and clear the lien.
- If the owner cannot or will not pay the costs, then the receiver may foreclose on the lien and the property sold at auction to the highest bidder.

4. Michigan (Mich. Comp. Laws Ann. § 125.535)

- Receivership may be used when an owner or occupant fails to correct a violation that creates an imminent danger to the health and safety of the occupants or the public.
- When the court finds that there are adequate grounds for the appointment of a receiver, it will appoint the municipality, a local agency or officer or other competent person as receiver.
- The receiver repairs, renovates and rehabilitates the premises as needed and, where ordered by the court, may demolish a building.
- When payment for receivership expenses are not otherwise paid for by another party, the court may enter an order approving the receiver's expenses and permitting the receiver to lien the property for payment.
  - The court may establish the lien as a senior lien, except as to tax and assessment liens and a recorded mortgage of first priority. The court may also order the time and manner for foreclosure if the lien is not satisfied.
- **Detroit's Nuisance Abatement Program**
  - Detroit Land Bank (Bank) identifies nuisance properties within target neighborhoods.
  - The Bank posts highly visible 3 foot by 4 foot posters on substandard buildings to give notice that it will seize the property if owners do not respond within 72 hours.
  - If the owner contacts the Bank, the Bank and the owner attempt to enter into a rehabilitation agreement by which the owner pledges to complete repairs within 30 days.
  - If owner doesn't contact the Bank within the 72 hours, or if the owner agrees to repair but doesn't complete, the Bank may file a nuisance lawsuit.
  - If the owners do not respond to the nuisance complaint within 28 days, the Bank may seek a default judgement to give the Bank title to the property. The owner loses all rights and interest in the property.

5. Missouri (Missouri Revised Statutes 441.510-441.645)

- A complaint seeking the appointment of a receiver may be brought by any county, municipality, local housing corporation or neighborhood association.
- The property must be in violation of building or housing codes and threaten public health and safety.
- Process:
    - Entity files application for appointment of a receiver and gives written notice to interested parties of its intent to file the application.
    - If, following the application for appointment of a receiver, the interested parties elect to correct the property's substandard conditions, the interested parties must post security for the completion of the repairs.
    - If no interested party elects to correct the property's conditions, the court may make a determination that the property is in an unsafe or unsanitary condition and appoint a receiver to complete the rehabilitation.
    - The receiver may lien the property if necessary to recover receivership costs and expenses for rehabilitation of the property.
        - The lien is superior to all other liens, except taxes, assessments, receiver's certificates, and mortgages recorded prior to October 13, 1969.

6. New Jersey (NJSA 55:19-84 through 97)

- Abandoned Properties Rehabilitation Act.
    - Applies to property that has not been legally occupied in the previous six months.
- Process:
    - Identify property.
    - The municipality either brings the action or designates a representative to bring the action.
    - The municipality/representative identifies parties in interest (owners and lenders) and files complaint.
    - Owner/lender submits/doesn't submit rehabilitation plan.
    - If no party submits an acceptable rehabilitation plan, then the municipality/representative submits its own rehabilitation plan.
    - Court awards possession to the municipality/representative and the municipality/representative rehabilitates the property.

- The owner may petition the court for reinstatement of control and possession but no later than 30 days after the municipality has filed a notice of completion with the court.
    - The petition for reinstatement must include a plan for completion and reuse of the property.
    - Provide legally binding assurances that the owner will comply with all conditions of any grant or loan secured by the municipality or repay them in full.
    - The petition must be accomplished by payment of all liens and costs incurred.
- The municipality/representative takes title and sells the property if owner isn't reinstated.
- The proceeds of sale are distributed as follows:
    - Costs and expenses of sale;
    - Other governmental liens;
    - Repayment of principal and interest on any borrowing or indebtedness incurred by the municipality/representative and granted priority lien status;
    - A reasonable development fee to the municipality/representative consistent with the standards for development fees established for rehabilitation programs by the New Jersey Department of Community Affairs or the New Jersey Housing and Mortgage Finance Agency; and
    - Other valid liens and security interests, in accordance with their priority.

7. Ohio (Ohio Rev. Code Ann. § 3767.41)

- A receivership may be used to enforce any local building, housing, air pollution, sanitation, health, fire, zoning, or safety code regulation. A receivership petition may be brought by a municipality, neighbor, tenant or a nonprofit organization.
- The entity that brings the action is not liable for the costs, expenses, and fees of any receiver.
- If the property includes subsidized housing, the entity must give written notice to the landlord regarding the defective conditions and the landlord has 60 days to remedy the conditions.
- For all other properties, the complaint and a notice of the hearing must be served on the property owners.
- The court must conduct a hearing within 28 days after service.

- If the court finds that the owner had a reasonable opportunity to repair the conditions but refused or failed to do so, the judge will offer the mortgagee, lienholder or other interested party associated with the property, in order of priority of interest in title, the opportunity to undertake the work.
- If the judge finds no interested party willing or able to undertake the work, only then will a receiver be appointed.
- The rehabilitation costs constitute a first priority lien on the building.

8. Pennsylvania (68 P.S. § 1101- 1111): Blighted & Abandoned Property Conservatorship Act

- Four Conditions Necessary:
    - Property not legally occupied for 12 months;
    - Property not actively marketed for sale for previous 60 days;
    - Property not subject to existing foreclosure action; and
    - Property owned by current owner for 6 months.
- The property must exhibit three of the following conditions:
    - public nuisance;
    - attractive nuisance to children;
    - attractive nuisance for illicit purposes;
    - substantial rehabilitation is needed and no rehabilitation has taken place within the previous 12 months;
    - the property is unfit for human habitation, occupancy or use;
    - the property condition and vacancy creates a material risk of fire;
    - the property is subject to unauthorized entry leading to potential health and safety hazards;
    - the presence of vermin, debris, uncut vegetation or physical deterioration creates health and safety hazards; or
    - the property's dilapidated appearance negatively affects nearby properties.
- Process:
    - A party in interest (lienholder, resident or business within 500 feet, nonprofit, redevelopment agency, municipality, or school district) files a petition for a conservator over the property.
    - The court appoints a conservator, who takes possession and control of the property.

- The conservator's rehabilitation plan is submitted and approved by the court.
- The conservator implements the plan and submits status reports.
- The conservatorship is terminated upon the completion of the rehabilitation plan, when a party in interest redeems the property, or when the property is sold.
- Distribution of sale proceeds.
    - All court costs.
    - Liens of the Commonwealth, liens for unpaid property taxes and properly recorded municipal liens.
    - Costs and expenses of sale.
    - Principal and interest on any borrowing or other indebtedness granted priority over pre-existing liens and security interests.
        - The court may grant priority status to a lien given to secure payment of conservator's expenses if the conservator first sought financing from senior, nongovernmental lienholder but the lienholder declined and the lien priority is necessary to induce another lender to provide financing.
    - Costs incurred by the petitioner in preparing and filing the petition.
    - Costs of rehabilitation and any fees and expenses incurred by the conservator in connection with the sale or the safeguarding of the property for which the lien authorized.
    - Other valid liens and security interests in accordance with their priority.
    - Any unpaid obligations of the conservator.
    - The owner.

9. Texas (Tex. Loc. Gov't Code Ann. § 214.003)

- A home-rule municipality may bring an action against a property owner whose property is not in substantial compliance with fire protection, structural integrity, zoning or trash disposal ordinances.
    - Texas has general law cities and home-rule cities. A home-rule city is a city with more than 5,000 people and where the citizens adopted a home-rule charter. A home-rule city can pass any regulations or laws it deems necessary unless in conflict with state law.

- After notice and hearing, the court may appoint a receiver.
    - The receiver may be a non-profit corporation or an individual with demonstrated abilities.
    - A lienholder may request to be appointed as a receiver.
    - A receiver cannot be appointed for owner-occupied, single family residences.
- After restoration of the property, the receiver must file an accounting of costs and expenses, including reasonable costs for labor and supervision, income received from the property and (at the receivers discretion) a receivership fee of 10 percent of those costs and expenses.
- If the total of the rehabilitation costs and expenses and the receivership fee exceeds the income received during the receivership, the receiver may maintain control of the property and lien the property for the amount of the unrecovered costs.
- The receiver may petition the court to sell the property if the receiver has been in control of the property for more than one year and the owner has failed to pay the receiver's costs and expenses.
- The order of distribution of proceeds is:
    - court costs;
    - municipal costs and expenses,
    - any lien held by the receiver; and
    - other valid liens.

Summary of Code Enforcement Receivership (or Similar) Laws Under the 9 States Surveyed

1. **All 9 states require some level of violation of a health, safety, or welfare code or regulation.**
    - Pennsylvania is more specific than most.
2. **In all 9 states, a petition may be brought by the municipality.**
    - Massachusetts allows the Attorney General to also file.
    - Illinois, Missouri, Ohio, and Pennsylvania allow a non-profit or other community housing corporation to file.
    - New Jersey, Ohio, and Pennsylvania allow other interested parties to file.

3. **First Priority Lien.**

    - Illinois, Massachusetts, Texas, Ohio, and California.

    - In Michigan, the court may establish the receiver's lien as a senior lien, except as to tax and assessment liens and recorded mortgages of first priority.

    - Missouri allows receiver's liens to be superior to all other liens except for taxes, assessments, receiver's certificates, and mortgages recorded prior to October 13, 1969.

    - New Jersey has an order of priority with costs and expenses of sale first in line, then other governmental liens, then repayment of principal and interest on any borrowing or indebtedness incurred by the municipality to fund the receivership.

    - Pennsylvania has on order of priority with court costs first, then state tax or municipal liens, then principal and interest on any rehabilitation indebtedness. Rehabilitation costs are 6th out of 9 places in order of priority.

4. **Some states have specific rules regarding properties in foreclosure.**

    - In Pennsylvania and Missouri, no receivership may be allowed if property is in foreclosure.

Benefits, Drawbacks, and Conclusion

Code enforcement receiverships can be a useful tool for communities that are grappling with vacant, abandoned, or dilapidated structures. In many cases, a receivership enjoys certain advantages over other forms of abatement actions, such as criminal prosecution and civil injunctive relief. Receivership can be a speedier remedy than a civil injunction and more certain, since a third party (the receiver) assumes control over the property and is motivated to move forward with the repair work quickly. Receivership can also avoid the unnecessary use of law enforcement staff (who often view code enforcement as a low priority) and a criminal justice system that is often impacted. A receivership is self-funding and does not constitute the drain on public finances that other remedies can.

Yet code enforcement receiverships are, like any other approach, not suitable in every instance. Structures that are severely damaged may not be repairable and must be demolished; although a receiver usually has the power to abate through demolition, it is often quicker and less expensive for the municipality to demolish. Perhaps the most frequently-encountered hurdle is extraordinarily low resale values for homes that require an extraordinarily high level of repair. In those cases, unless the property is generating significant income, the receiver may not be able to obtain financing for the repairs. In some of these types of cases, a

receiver can approach the rehabilitation from a different angle. However, in a few cases, some remedy other than receivership must be employed.

In sum, code enforcement receiverships can and are used to great effect in situations where more traditional enforcement avenues have proven to be a dead end. Once the court confirms the receiver's appointment, the municipality's day-to-day involvement is greatly diminished. In those jurisdictions that allow it, the municipality can recover its attorneys' fees and administrative enforcement costs. Most importantly, a successfully-implemented code enforcement receivership can serve as a catalyst to encourage other stakeholders to invest in and improve the community in which they live and work.

Acknowledgment: The authors wish to acknowledge the efforts of Tempestt Garland, who helped research and draft this paper.