PROPERTY

Restraining 'Theft by the State'

In its 2023 decision on home equity theft, the Supreme Court showed property rights aren't only for the rich.

BY JONATHAN KLICK AND GIDEON PARCHOMOVSKY

Geraldine Tyler, a Black grandmother in her 80s, had her Minneapolis condo seized and sold by Hennepin County authorities for her failure to pay a property tax bill. By the time of the 2015 foreclosure, the $2,300 in back taxes had accrued another $13,200 in interest, fines, and penalties that were more than satisfied by the $40,000 price the county received in the sheriff's sale. The nearly $25,000 left over after the taxes and associated fees—Tyler's home equity—became a windfall to the county because Minnesota law made no provision to return surplus equity to homeowners after foreclosure. Instead, according to the state's forfeiture statute, those funds were to be used to develop memorial forests or acquire and maintain county parks, with any residual funds to be distributed to the local town, county, and school district.

Tyler sued Hennepin County, claiming her loss of home equity amounted to a government taking, which requires just compensation under the Fifth Amendment. She also claimed the fines imposed for failing to pay her taxes were excessive and therefore prohibited under the Eighth Amendment of the US Constitution.

The Minnesota federal district court dismissed her suit, stating there is no property interest in excess equity unless a provision in the US or state constitution, a federal or state statute, or municipal code creates such a property right. While noting that some states have laws expressly creating such rights, the district court found that Minnesota did not and that its statute expressly denied such a right by allocating any surplus equity to other public uses. As the court put it:

> In short, nothing in the constitutions of the United States or Minnesota, nothing in any federal or state statute, and nothing in federal or state common law gives the former owner of a piece of property that has been lawfully forfeited to the state and then sold to pay delinquent taxes a right to any surplus. Without such a right, Tyler does not have a viable takings claim, and thus her takings claims are dismissed.

Regarding Tyler's excessive fine argument, the district court found that the $13,200 in interest and penalties plus the $24,500 in forfeited equity did not constitute a fine for Eighth Amendment purposes because the charges were not a punitive action by the government but were merely remedial, compensating the government for losses associated with the unpaid taxes. In summary, the court's opinion held:

> Minnesota's tax-forfeiture scheme bears none of the hallmarks of punishment. It is a debt-collection system whose primary purpose is plainly remedial: assisting the government in collecting past-due property taxes and compensating the government for the losses caused by the non-payment of property taxes. The Court therefore finds that the statute does not impose a "fine" within the meaning of the Excessive Fines Clause of either the United States or Minnesota Constitution. Tyler's excessive-fines claims are dismissed.

That is, the implied interest rate (based on the interest, fees, penalties, and forfeited equity) of about 60 percent annually on the original $2,300 in property taxes only served as reasonable compensation to Hennepin County and in no way punished Tyler. Interestingly, this implicit rate substantially exceeds the rates specified as permissible under Minnesota's

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statute regulating interest rates on loans entered into without an explicit written contract.

On appeal, the Eighth Circuit affirmed the district court's motion to dismiss. In its discussion, the court noted that while Minnesota had recognized a common law property right to surplus equity, that right was abolished with the state's passage of a 1935 tax forfeiture statute, continuing:

> Thus, even assuming Tyler had a property interest in surplus equity under Minnesota common law as of 1884, she has no such property interest under Minnesota law today. Where state law recognizes no property interest in surplus proceeds from a tax-foreclosure sale conducted after adequate notice to the owner, there is no unconstitutional taking.

In support of its decision, the appeals court noted that the US Supreme Court had previously blessed New York City's decision to keep all the proceeds from a $7,000 foreclosure sale of property for the failure to pay $65 in water bills (an implicit interest rate well in excess of 100 percent per year). In *Nelson v. City of New York* (1956), the Court held that whether such retention of surplus equity amounts to a taking depends on the language of the underlying statute, specifically whether the law requires that the excess equity be returned. In the case against the City of New York, the relevant legal provision contained no such requirement (though it did not preclude the return of the excess funds).

NOT JUST MINNESOTA

In the course of the litigation, arguments on Tyler's behalf noted that while the majority of states recognized a property right to excess equity either by statute or in common law, at least a dozen states did not. According to research by the Pacific Legal Foundation (PLF, which represented Tyler in her litigation), during the period 2014–2023 localities foreclosed on at least 860 homes, putting almost $800 million in lost surplus equity into government coffers. One case they unearthed involved foreclosure for a debt of $8.41 that was satisfied by a forced sale yielding $24,000 in government revenue.

In its research, PLF found what it dubbed "home equity theft" occurring not just in Minnesota. State laws also allowed for it in Alabama, Arizona, Colorado, the District of Columbia, Illinois, Maine, Massachusetts, Nebraska, New Jersey, New York, Oregon, and South Dakota. Practices in these states differed, with some places like DC and Illinois largely exempting owners of single-family residences and Maine exempting senior citizens. Also, shortly before Tyler's litigation, an Alabama state court severely constrained the ability of governments in the state to retain surplus equity. PLF also found more subtle practical differences with, for example, many governments in Massachusetts simply waiting until interest and fees had wiped out any surplus equity before initiating foreclosure procedures.

ANDREYPOPOV / GETTY IMAGES (THIEF), URFINGUSS / GETTY IMAGES (HOUSE)

These states differed from the rest of the country, where there are various procedures for compensating homeowners. Some states require the homeowner to actively seek reimbursement, while others appear to provide the funds automatically after the forced sale. PLF, however, did note some loopholes even within the states with legal protections against home equity theft. For example, Idaho law allows the county satisfying its tax debt to gift the land to any federal or Idaho state entity; by foregoing a sale, there is no excess equity. Similar transfers to government entities without sales are possible in Nevada, Ohio, Rhode Island, and Wisconsin. Montana, while protecting surplus equity in residential properties, provides no similar protection for non-residential properties.

On the interest and fines front, states vary widely in how they regulate the fees attached to tax bills. Georgia, for example, levies a monthly interest rate equal to the prime rate plus 3 percent in addition to other penalties. Double-digit annual interest rates are common throughout the states, as are substantial delinquency and redemption penalties.

It is interesting to note that the practices of withholding surplus funds and the charging of such high interest rates are largely prohibited for non-governmental parties. For example, the Uniform Commercial Code requires that secured lenders maximize the proceeds from the sale of any collateral, and it requires that surplus funds be returned to the debtor. Also, as indicated above, various states have limits on the interest rates charged in settings outside of formal written loan contracts.

PROPERTY RIGHTS FOR THE POOR

As a practical matter, the incidence of home equity theft will fall primarily on individuals of lower socio-economic status. Relatively lower-income folks will be more likely to have liquidity problems that hamper their ability to pay their taxes. Further, access to legal advice and representation is more limited for poorer individuals. Just navigating the foreclosure process is complicated and often beyond the ability of individuals without the assistance of counsel. Any legal challenge almost necessarily will require a lawyer.

Although there is no systematic research about the characteristics of the individuals subject to home equity theft, it is reasonable to assume most people losing their surplus equity will be relatively low-income and have limited wealth because of these issues. Given the demographic characteristics at the lower ends of the income and wealth distributions, it is likely that the individuals losing their home equity will disproportionately belong to minority groups as well. Further, the very groups likely harmed by these foreclosure practices have limited ability to lobby against the practices on the political front. This leaves poor homeowners with little protection from the predations of state and local governments.

This is not a new story. Years of study of the related practice of eminent domain (where the government takes private property for some public use, paying market prices as compensation) show that those most likely to have their properties taken by the government are the poor, and individuals from minority communities are targeted especially. While compensation is paid in those instances, the measure is market value, which may not completely cover an individual's idiosyncratic subjective valuation, meaning those whose properties are taken are systematically under-compensated. Just as in the case of home equity theft, poorer individuals are less able legally and politically to fight for their rights. At least in the eminent domain context there is some compensation, even if it is inadequate. Victims of home equity theft, like Tyler, are left with nothing.

Tyler's cause, however, was taken up by the US Supreme Court in 2023. Writing for a unanimous Court, Chief Justice John Roberts found that Hennepin County's practices (and, by extension, those of many other state and local governments) did indeed violate the Fifth Amendment's protection against government takings without just compensation. Effectively, the Court decided that surplus equity must be returned to homeowners delinquent on their taxes and that laws like Minnesota's that distribute excess funds to public entities are constitutionally prohibited.

Roberts noted that allowing states to hide behind statutes that effectively declare property rights not to exist is inconsistent with the Fifth Amendment's central purpose. That is, if a government could simply declare that property rights are only valid when it says so, government can opportunistically define property rights in a way that allows it to take property whenever it wants without the need for compensation.

A concurrence penned by Neil Gorsuch and joined by Ketanji Brown Jackson takes up Tyler's excessive fines claims. Although this Eighth Amendment–based argument was not addressed in the majority opinion, Gorsuch argued the lower courts erred in their dismissals of it. The concurrence stresses that sanctions that bear no relationship to the government's actual costs constitute a fine under the US Constitution and therefore cannot be excessive; they must be proportionate. Although Gorsuch expressed no explicit opinion regarding the reasonableness of the interest, penalties, and fees applied to Tyler's unpaid property taxes, as noted above many states apply interest rates that exceed market rates substantially. Often the applied rates would be legally suspect if charged by non-governmental entities in situations without written contracts that include explicit disclosure.

THE REAL-WORLD EFFECTS OF TYLER'S VICTORY

The decision in *Tyler v. Hennepin County* strengthened the property rights of homeowners who previously risked being stripped of their home equity in the event of falling behind on their property taxes. On the other hand, as argued by Hennepin County and other jurisdictions that engaged in home equity theft, the prospect of losing one's home equity presumably deters individuals from falling behind on their taxes, improving the fiscal standing of communities, to say nothing of the revenues created by the seized equity. These windfalls, in principle, could improve the ability of local governments to provide more services without raising additional taxes. That is, conceptually there is a tradeoff between strengthening residents' property rights and improved government capacity, which presumably makes a community more attractive.

To analyze the practical effects of the Supreme Court's decision prohibiting states from keeping surplus equity, we examined the sales prices of homes in the states that had engaged in the practice before and after the May 2023 decision. To account for background trends in home prices that could otherwise confound any changes caused by the *Tyler* decision, we compared the changes in the home equity theft states to changes occurring in other states at the same time. To further refine our analysis and address the concern that trends in states like Minnesota and New York might be different than trends in states like Wisconsin and Pennsylvania, we leveraged the insight that *Tyler*'s protections are mostly important for properties on the low end of the value distribution because wealthy homeowners are unlikely to have their properties foreclosed and sold. This allowed us to compare the effects of *Tyler* on low-valued properties relative to what was happening contemporaneously to higher-end homes in the same county. Thus, if coincidentally at the same time as *Tyler* was being decided other factors were affecting home values in a given state or county, the high-end homes allow us to control for those non-*Tyler* effects.

Using Zillow indexes by county, we found the *Tyler* decision led to a 4 percent increase on average in the sales prices of low-value homes relative to higher-value homes in those states that had previously engaged in home equity theft. This amount is net of any changes in the relative prices of low- and high-value homes happening nationwide. This figure is substantial, amounting to roughly a $7,000 price increase on average, and the effect is unlikely to have arisen by mere chance based on tests for statistical significance. Breaking down the analysis state-by-state, it turns out the effect was even bigger in Oregon and Maine, where prices rose by 7 and 8 percent respectively.

These amounts are important in practical terms, as they represent material changes in homeowner wealth. Relative to the median household in 2022, these effects imply an increase of almost 5 percent in terms of net worth. Even if we restrict attention to just homeowners, this wealth appreciation amounts to 2 percent. Economic research suggests that growth in home equity is an especially important component of wealth among the relatively poor, and home values (as well as homeownership in general) might even have significant effects on intergenerational wealth. Relative to existing research on the effect of homeownership on wealth, the *Tyler*-induced increase we estimate is the equivalent of gaining an additional year of home ownership for the average low-income household. It seems that property rights matter, and they may be especially important for the less well-off, at least when it comes to protecting against the predations of the state.

A MORE ROBUST NOTION OF PROPERTY

Prior to the *Tyler* opinion, many courts assumed that property rights were defined by the government and, therefore, could largely be modified or even abolished by a state statute—perhaps even by a municipal code. However, as the Roberts decision notes:

> The Takings Clause does not itself define property. For that, the Court draws on "existing rules or understandings" about property rights. State law is one important source. But state law cannot be the only source. Otherwise, a State could "sidestep the Takings Clause by disavowing traditional property interests" in assets it wishes to appropriate.

Continuing the thought, the decision goes on to say: "The County had the power to sell Tyler's home to recover the unpaid property taxes. But it could not use the toehold of the tax debt to confiscate more property than was due." That is, property rights provide an internal protection against opportunistic predations of the government that must endure beyond government say-so if they are to have any real protective effect.

This decision has subtly altered the conventional thinking about government takings in the United States. Historically, property law scholars recognized three general categories of government takings, each with its associated level of protection in terms of how likely it is that compensation will be required. Physical seizures, as in eminent domain cases, virtually always require compensation. Regulatory takings (i.e., losses of value or even use rights of property because of changing regulations) usually do not lead to compensation. However, loss of property associated with government taxation was believed to never require compensation—until *Tyler*, that is. Although the decision does not limit the government's ability to tax property, it clearly indicates that property rights provide limits on how those taxes may be collected. Also, if subsequent courts pick up on Gorsuch's reasoning in the concurrence, fines used to coerce the payment of taxes may be subject to limitations as well.

Invoking tradition going back to the very foundations of Anglo-American law, the *Tyler* decision notes that the government may have its due but no more than its due. Wrote Roberts:

> The principle that a government may not take more from a taxpayer than she owes can trace its origins at least as far back as Runnymeade in 1215, where King John swore in the Magna Carta that when his sheriff or bailiff came to collect any debts owed him from a dead man, they could remove property "until the debt which is evident shall be fully paid to us; and the residue shall be left to the executors to fulfil the will of the deceased."

This principle took root, as the decision notes:

> As Blackstone explained, the common law demanded the same: If a tax collector seized a taxpayer's property, he was "bound by an implied contract in law to restore [the property] on payment of the debt, duty, and expenses, before the time of sale; or, when sold, to render back the overplus."

Socialist Pierre-Joseph Proudhon famously declared that "all property is theft," but Geraldine Tyler (with assists from PLF and the US Supreme Court) showed that sometimes property rights protect against theft by the state. R