SCOTUS: “Home Equity Theft” Violates the Takings Clause

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Why Lienholders and Loan Servicers Should Care

In a unanimous decision, the Supreme Court held in *Tyler v. Hennepin County* that a county’s process of retaining the equity in a homeowner’s property constitutes a violation of the Takings Clause of the Fifth Amendment. This decision has important repercussions for not only homeowners but lienholders and loan servicers as well.

For most people, their homes are their most valuable asset. This is due in large part to the equity homeowners build up over the years (that is, the difference between a home’s value and the balance on any remaining mortgage). Home equity is incredibly valuable to homeowners. They can borrow against it in the form of a home equity loan or a line of credit. They can also turn the equity into cash when the home is sold. In fact, even if the borrower defaults on their mortgage, surplus sale proceeds usually exist post-foreclosure sale if there was equity in the property.

But what happens when local governments commence a foreclosure action as a result of unpaid taxes? In more than a dozen states, local governments are not only able to recoup their losses through confiscating the property, but are also entitled to the equity the homeowner has accrued in the property as well. This can, and often does, result in a significant windfall to local governments. For instance, one study found that in Minnesota, homeowners subject to the state’s foreclosure-forfeiture scheme lost, on average, homes worth $207,000 to satisfy debts of $17,000.[1] In another study, New Jersey homeowners lost approximately 92% of the value of their homes, or $219,000 above the tax debt that was owed, which averaged $16,800.[2]

Take the case of 93-year-old Geraldine Tyler. Ms. Tyler owed approximately $2,300 in delinquent property taxes and almost $13,000 in accrued interest, penalties, and costs. Hennepin County, Minnesota foreclosed on Ms. Tyler’s condo, selling it for $40,000. Consistent with Minnesota law, Hennepin County not only kept the proceeds needed to satisfy the delinquent taxes but also the surplus of more than $25,000 which represented Ms. Tyler’s equity in the condo.

In response, Ms. Tyler commenced a putative class action against the county alleging that the taking of her home equity amounted to uncompensated takings, imposition of excessive fines, and violation of substantive due process under both the United States and Minnesota Constitutions. The U.S. District Court for the District of Minnesota dismissed Ms. Tyler’s complaint and, on appeal, the Eighth Circuit Court of Appeals affirmed. In so ruling, the court rejected Ms. Tyler’s argument that the Takings Clause protects her home equity. It likewise rejected Ms. Tyler’s excessive fines argument, even though the county had conceded that Minnesota’s forfeiture statute was, at least in part, designed to serve as a “deterrent to those taxpayers considering tax delinquency.”

Ms. Tyler then filed a Petition for Writ of Certiorari with the U.S. Supreme Court in August 2022. Ms. Tyler argued, among other things, that taking more property than necessary to pay a tax debt violates deeply rooted English property rights, that the Eighth Circuit's decision conflicts with various Takings decisions by the Supreme Court, and that significant conflicts exist among state and federal courts regarding whether the government must pay compensation when it takes property to collect a debt and keeps the surplus. In late January 2023, the Supreme Court agreed to accept Ms. Tyler's petition and, on May 25, 2023, unanimously ruled in her favor that Hennepin County's actions violated the Takings Clause of the U.S. Constitution.

Chief Justice Roberts, writing for the Court, first looked at the lengthy history prohibiting the government from taking more from a taxpayer than she owed. He noted that unlike Minnesota's statute at issue, most states require excessive value to be returned to the taxpayer when real property is sold to satisfy an outstanding debt. Notably, the Chief Justice found that in other circumstances Minnesota law recognizes that such equity belongs to the taxpayer and "Minnesota may not extinguish a property interest that it recognizes everywhere else to avoid paying just compensation when the State does the taking."

He further rejected the county's argument that Ms. Tyler has no property interest in the excess funds because she had abandoned the same due to non-payment of her taxes, finding that the purpose of Minnesota's forfeiture law is not concerned about "the taxpayer's use or abandonment of the property, only her failure to pay taxes. The County cannot frame that failure as abandonment to avoid the demands of the Takings Clause." Ultimately, the Chief Justice found:

> *"The Takings Clause 'was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.' A taxpayer who loses her $40,000 house to the State to fulfill a $15,000 tax debt has made a far greater contribution to the public fisc than she owed. The taxpayer must render unto Caesar what is Caesar's, but no more."*

While this decision obviously provides a huge win for taxpayers and homeowners in the thirteen states where "equity theft" had been permitted, it also impacts lienholders and mortgage servicers as well. Indeed, in most cases a tax lien has priority over a mortgage or deed of trust, even if the instrument was recorded prior to the tax lien. Moreover, many of these forfeiture statutes extinguish valid liens encumbering the forfeited property and do not require payment on the corresponding note or debt. *See, e.g.* Minn. Stat. § 281.23. In other words, prior to the Court's decision in *Tyler*, lienholders would have no automatic right to excess sale proceeds to satisfy all or part of the underlying debt like they would be entitled to in a judicial foreclosure action.

Because of that possibility, prior to this ruling, many lienholders and loan servicers were faced with a decision as to whether they should advance the amounts owed to the county (sometimes tens of thousands of dollars) to avoid a tax foreclosure where the mortgage lien could be released leaving them unsecured. Today's opinion makes such a decision much easier as now, at minimum, a mortgagee would appear to have a valid argument that any excess sale proceeds should go to pay outstanding obligations owed by the taxpayer, not to the county's coffers.

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[1] See Park, Carol & Deerson, David J., *Looking Up*, Pacific Legal Foundation (2021), (visited March 15, 2023).

[2] Angela C. Erickson, *The size and scope of home equity theft: Shining a spotlight on New Jersey* (Nov. 15, 2021)

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