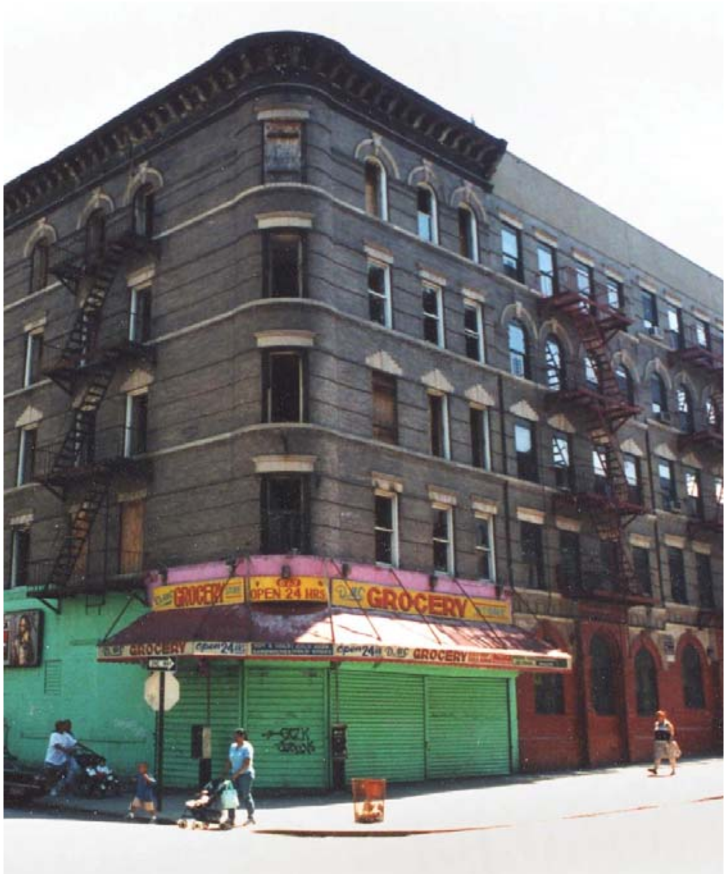

THE INVISIBLE TRANSFORMATION

TURNING DEBT INTO REVENUE

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THE INVISIBLE TRANSFORMATION: Turning Debt Into Revenue

By

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All of CHPC's work relies on the expertise of our many Board members. The ad hoc committee formed for this report provided invaluable insights and critical review of our work and as always we are grateful for their help.

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Major funding for the report was provided by Enterprise Community Partners, Inc.

Additional funding was provided by **Community Preservation Corporation**, the **Estate of William R. Ginsberg** and the **Ginsberg Family**, and the **Estate of Marian R. Naumburg**.

ACKNOWLEDGEMENTS

Because there are few publically published works that analyze tax lien securitizations carried out by taxing jurisdictions in the U.S., we were reliant on our colleagues to help us understand how they worked, how they didn't work, and most importantly why. We are grateful for their time, their expertise, and their patience.

The New York City Department of Housing Preservation and Development (HPD) under the leadership of Commissioner Rafael Cestero provided us with access to their key staff, data, and insights into this complex issue. In particular, HPD's former and current Deputy Commissioners for Budget, Fiscal, and Performance Analysis, Diane Lipset and Molly Park, provided cost data for rehabilitation of Third Party Transfer properties. Assistant Commissioner for Neighborhood Preservation, Bill Carbine, made available critical data on the history of HPD's review of tax liens and the results of *in rem* foreclosure proceedings.

Chandra Ganesh, Deputy Assistant Director at New York City's Office of Management and Budget (OMB), provided audit reports, private placement memoranda, and other data and assistance, without which our understanding of the results of the City's tax lien securitizations would not have been possible. Michael Dardia, Deputy Director of OMB, generously gave his time to review our work and provided invaluable feedback.

Howard Liggett, Executive Director of the National Tax Lien Association, helped us to understand the nature of tax lien sales in other jurisdictions. Priscilla Almodovar, former President and Chief Executive Officer of NYHomes, and Arlo Chase, Senior Vice President for Policy Initiatives at NYHomes, discussed with us in detail the tax lien securitization carried out in upstate New York. At Neighborhood Restore, HDFC, Executive Director Sal D'Avola and his staff provided data concerning the number of buildings and units that had passed through the Third Party Transfer Program. John Warren, formerly the First Deputy Commissioner at HPD, who played a key role in the inception and implementation of the new strategies, read an early draft and remind us of what we had omitted.

Work of this kind requires financial support to ensure that we can devote the time and resources to carry it out. For that we must thank every member of our Board of Directors who unwaveringly support our efforts, and especially Michael Lappin and John McCarthy of the Community Preservation Corporation who support our research work with a generous annual contribution that we rely on in good times and bad. Extraordinary gifts from the Estate of Marian R. Naumburg and from our former Board member William R. Ginsberg and his family allowed us to build an infrastructure of people and resources that make research like this possible.

For this report in particular we must acknowledge and thank CHPC Board member Abby Jo Sigal, Vice President and Impact Market Leader, New York Office of Enterprise Community Partners, Inc., for the generous grant that we received from Enterprise Community Partners, Inc. Without their financial support this work would not have been possible.

THE INVISIBLE TRANSFORMATION:
Turning Debt Into Revenue

The Impact of In Rem Foreclosure and the Third Party Transfer Program on Tax Lien Securitization

REPORT ABSTRACT

This report examines changes in NYC's tax foreclosure and housing policy that occurred between 1978 and 1996. It provides an overview of the conditions in the 1970s and '80s, the significant changes in housing and tax policy in New York City in relation to *in rem* foreclosure that have been in effect now for more than a decade, and strategies for residential tax collection in other cities. It also presents an analysis of the Third Party Transfer Program, which is designed to address the most distressed buildings, and its impact on the securitization of uncollected tax liens.

The report finds that the City's securitization of tax delinquent liens on residential property has been a success in terms of increasing revenue, improving tax collection, and improving distressed housing. Significantly, it finds that a critical component of this success has been its investment in the most distressed residential properties.

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DISCLOSURE

The authors wish to disclose that this report's two principal writers have had significant involvement in the development and implementation of the Third Party Transfer Program and its related strategies.

Both Jerilyn Perine and Harold Shultz worked at the Department of Housing Preservation and Development (HPD) during the period that these new policies were designed, enacted, and implemented. During this period (approximately 1995 through 1997), Jerilyn Perine served as the Assistant Commissioner for the Division of Alternative Management and was responsible for much of the Third Party Transfer Program's operation. Harold Shultz, as Deputy Commissioner for the Office of Housing Preservation, was involved in the creation of the original legislation. In addition, Mr. Shultz now serves as Chair of the Board of Directors of Neighborhood Restore, which administers the program for HPD.

Both authors have had long careers in NYC government, most notably at HPD. Their involvement in these programs accounts for just one aspect of their work. We believe that this report provides an unbiased analysis, but it is important to acknowledge this prior involvement.

OVERVIEW

more than 100,000 units of deteriorated occupied and vacant housing were renovated and returned to private ownership

Between 1997 and 2008, the City of New York rescued and financed the rehabilitation of 4,600 units of distressed housing, saw real estate tax collection increase approximately 1.5%, and raised more than $1.2 billion[1] in revenue from the securitization of real estate tax liens–with a public investment of only $395 million. This nearly invisible transformation of debt into revenue occurred as a result of two dramatic public policy strategies undertaken by the City of New York which would rely on innovative uses of *in rem* foreclosure of tax delinquent residential properties.

The first innovation would use *in rem* foreclosure to wrestle direct ownership and control from bad owners and transfer it to the City itself. The second innovation would build on that success by using *in rem* foreclosure to transfer property from bad owners directly to new private ownership. The former would require foreclosure on all delinquent liens and the City assuming responsibility for whatever properties remained in the foreclosure. The latter permits a more strategic response, foreclosing on only those properties in need of housing assistance, and securitizing for sale the majority of liens which creates revenue for the City.

The first innovation was a historic intervention designed to save a troubled tax delinquent residential property inventory that developed largely in the 1970s and 1980s. The City's efforts included interim City management, long term investment in capital improvement, and turning a significant market failure into a resource for housing preservation and community development. An early pioneer in land banking, the City of New York, largely through the work of its Department of Housing Preservation and Development (HPD), would utilize an abandoned, tax foreclosed property inventory to rebuild neighborhoods. This strategy also led to the creation of an affordable housing industry which could then be relied on to maintain private investment and responsible management when market conditions improved.

[1]This represents the initial revenues received by the City from 13 tax lien securitizations for the period 1996 through 2008. In fact the City has actually received millions more from continued collections after the satisfaction of the bonds. See the example for the 2004 tax lien trust later in this document.

HPD continued to oversee the cycle of renovating *in rem* buildings and returning them to private ownership through a series of innovative programs, while at the same time taking in new *in rem* properties annually which would become the City's management and maintenance responsibility. It would be the largest, most sustained public investment in low income rental housing made in an effort to mitigate private market failure anywhere in the United States. Through these efforts more than 100,000 units of deteriorated occupied and vacant housing, previously in City ownership, were renovated and returned to private ownership and management.[2]

Shell of an in rem building at 2136 Crotona Parkway in the Bronx.
Photo: © Larry Racioppo, NYC/HPD.

2136 Crotona Parkway after City rehabilitation.
Photo: © Larry Racioppo, NYC/HPD.

The second and more recent innovation required the passage of legislation in 1996 that would substantially reshape the City's housing and real estate tax policies. The new legislation would permit the city to use its *in rem* foreclosure process to transfer residential property directly to a new owner rather than take the property into City ownership first. The companion legislation would permit the City to sell real estate tax liens to a trust, paving the way for the securitization of tax liens. It was anticipated that these changes would improve the overall real estate tax

[2] This number was derived from estimating the number of units in City owned *in rem* properties that started construction through HPD programs which relied on the *in rem* stock. It includes programs that renovated occupied and vacant City owned *in rem* buildings between FY 1978 and the first half of FY 2010 and relies on unpublished HPD charts. HPD's records of construction starts by program improve dramatically beginning in FY 1987. Between FY 1978 and FY 1986 the records are less reliable. For additional information please contact CHPC.

collection rate, generate revenue through the securitization of the liens, and end the cycle of City ownership of tax foreclosed residential properties by transferring the most troubled residential buildings directly to new owners with financial support sufficient to ensure their renovation and long term viability.

This report provides an overview of the conditions that preceded the change in direction in 1996, the significant changes in housing and tax policy in New York City in relation to *in rem* foreclosure that have been in effect now for more than a decade, and an overview of residential tax collection strategies in other cities. It also presents an analysis of the Third Party Transfer Program which is designed to address the most distressed buildings and its impact on the securitization of uncollected tax liens. The report does not undertake a review of the outcomes for buildings that were subject to the tax lien securitization sale and were either returned to their original owners upon satisfaction of the lien, or transferred to a third party servicer for management and subsequent disposition.

this report finds that the City's securitization of tax delinquent liens on residential property has been a success

In summary, this report finds that New York City's securitization of tax delinquent liens on residential property has been a success in terms of increasing revenue, improving tax collection, and improving distressed housing. In addition, it finds that a critical component of this success has been its investment in the most distressed residential properties. This relatively modest investment has ensured that the most troubled residential buildings were improved and turned over to responsible management. Additionally, the removal of such troubled properties, and therefore the worst tax liens, has ensured that the tax liens that are sold through securitization have sufficient value to repay investors and provide a reasonable return to the City. The City's successful application of innovative use of *in rem* foreclosure and tax lien securitization has been largely the result of both an integrated public policy approach that addresses the need for strong tax collection systems that generate revenue and ensure enforcement, and the City's long term and well established commitment to preserving its critical stock of affordable rental housing.

1978: THE FIRST IN REM INNOVATION

1978 was a bad year for housing in New York City. The arson and abandonment that had been sweeping through the City's low and moderate income neighborhoods had reached crisis proportions, exacerbated by the devastation of the 1977 blackout. Of the 351,000 housing units lost between 1970 and 1981, the three years between 1975 and 1978 would be the worst.

1978 was a bad year for housing in New York City

Tax delinquent property that was taken by the City through *in rem* foreclosure would generally be sold at auction by the NYC Department of General Services (DGS). However, since most of the properties had little real value, they were typically sold at public auction for less than half their assessed value.[3] Even worse, at such low values some purchasers only intended to collect a year's rent roll from the tenants, provide little service delivery or maintenance, and withhold real estate taxes. Such properties would often go through the foreclosure process again, as conditions for tenants further deteriorated.

Housing and community activists were clamoring for the City to act, yet with its finances in shambles there were real concerns about the City's ability to take on a significant obligation of a deteriorated housing stock, already abandoned by the private sector, half of which was occupied with tenants in dire need of services.

The South Bronx, 1988. Photo: © Larry Racioppo, NYC/HPD.

In 1976 the City Council passed Local Law 45, which authorized *in rem* foreclosure actions against property after only one year of

[3] Gliedman, Anthony and Elstein, Barbara "Real Estate Tax Payment Patterns of Multiple Dwellings Taken by the City for Non-Payment of Taxes and Resold From January 1972 to December 1974", (Unpublished study, NYC Housing and Development Administration, December 31, 1975)

delinquency in its real estate taxes. By changing the law to permit *in rem* foreclosure after only one year of tax delinquency instead of three years, it was hoped that residential buildings could be taken into City ownership and saved from the cycle of maintenance decline, arson, and loss. It was also expected at the time that owners would be encouraged, through tougher tax collection efforts, to pay their taxes and avoid *in rem* foreclosure altogether. The former would prove to be correct, the latter did not.

Then in 1978 the City Council passed Local Law 3, which would transfer title and management obligations of residential properties to HPD from DGS, though commercial property remained with DGS to be auctioned as quickly as possible. On September 1, 1978, the day the new law took effect, HPD became owner and property manager for more than 100,000 units of abandoned and poorly maintained residential properties in more than 10,000 buildings located throughout the City's poorest communities.[4]

NYC HPD's Crisis Management Office. Photos: © Larry Racioppo, NYC/HPD.

[4]The actual number of *in rem* units in HPD management in 1978 would always be an estimated number. According to NYC HPD's chart "Department of Property Management Workload FY 1979-2009", the inventory in FY 1979 was 100,995 units in 8,953 buildings. However, it is important to note that units in vacant buildings (48,851 units in 4,606 buildings) could only be estimated, and an accurate count of units in occupied buildings was dependent on HPD staff conducting roof to cellar inspections, which were not all completed in the first year of management.

However the costs were high and there was almost constant criticism that the City's interim management and maintenance efforts, particularly of the occupied *in rem* buildings, were inadequately funded. In the first year of HPD's management, September 1978 through August 1979, they would receive an allocation of $54 million from HUD's Community Development Block Grant (CDBG) program.[5] By the early 1990s the City's "interim" management of the *in rem* stock would become the largest user of New York's CDBG funds received from the federal government, utilizing about $200 million a year.

HPD became owner and property manager for more than 100,000 units of abandoned and poorly maintained residential properties

These early efforts did pioneer innovative programs to return this troubled stock to responsible for profit and not for profit organizations, as well as to tenant cooperatives. These efforts would lay the groundwork for the creation of the most experienced and diverse affordable housing industry in the U.S.

With the implementation of the Ten Year Plan in 1987, the residential *in rem* stock would get an allocation of capital funding that allowed the vacant building inventory, which had extensive capital needs, as well as a significant portion of the occupied stock to be renovated and returned to the private sector. This massive investment had significant benefits to the City's low income communities—including the preservation of an extensive inventory of affordable housing and the expansion of an affordable housing industry which relied on this stock for its pipeline of projects. Entire neighborhoods were saved from abandonment and depopulation.

As a result of the increasing cost of maintenance and management of this stock, and the never ending cycle of additional in rem takings, a moratorium on new *in rem* foreclosures was established in 1993.[6] This kept the inventory of City owned deteriorated properties and their accompanying maintenance and renovation cost from increasing. However, deteriorated buildings simply remained with irresponsible owners who in turn continued to owe taxes and maintain poor living conditions for their buildings' occupants.

As neighborhoods and their housing markets improved, the roles of government and the private sector in affordable housing were being challenged and rethought. Government

[5] NYC Department of Housing Preservation and Development, "In Rem Housing First Annual Report" (City of New York October 1979), p.4

[6] Braconi, Frank "In re In Rem: Innovation and Expediency in New York's Housing Policy", in Housing and Community Development in New York City, Facing the Future, ed. Schill, Michael (Albany, State University of New York Press, 1999), pp. 93-118.

The Bradhurst Apartments at West 148th Street and Frederick Douglass Boulevard as it was brought into the in rem program. and when the rehabilitation was complete. Photos: © Larry Racioppo, NYC/HPD.

ownership of this stock, so critical since 1978, was now seen by some as a potential obstacle to private investment. What had begun as interim emergency management by the City when the private sector had walked away, could now be viewed as a large bureaucracy devoted to long term government ownership and management which was often inefficient and slow to respond to a changing marketplace.

A result of the reluctance to process *in rem* foreclosures was that by 1995 there was a growing backlog of buildings that met the legal standard for *in rem* foreclosure but instead were languishing in poor private management. At the same time, the buildings left in City management were increasingly those with special needs. Programs designed to renovate and sell *in rem* properties which had worked so well in the past were not so well suited to the inventory that remained. Most were occupied, in need of full gut renovation (and therefore tenant relocation), or had a unique "story", like the squatter-occupied building in the Bronx with a cherry tree growing in the middle of its interior.

Entire neighborhoods were saved from abandonment and depopulation

In addition, there was growing concern that tax collections on both residential and commercial buildings were not being adequately pursued and as a result real estate tax collection was in decline. Between 1993 and 1996 the City was collecting only 91.17% of the real estate taxes due to it in the first year after billing. With revenue from real estate taxes representing the largest component of the City's tax revenue, the effectiveness of real estate tax collection was, and still is, critical to the City's financial health.

1996: THE SECOND IN REM INNOVATION

HPD's Tenant Interim Lease building files.
Photo: © Larry Racioppo, NYC/HPD.

In 1995 HPD commissioned a study of the cost of its residential *in rem* ownership and management. The results were startling. A typical building that had been seized for $36,000 of unpaid taxes cost the City $2.2 million to own, maintain, and prepare for sale. Perhaps even more surprising was that the buildings remained in City ownership on average for 19 years before being moved into private ownership.[7] The investment in the *in rem* stock that was such a critical component of the reclamation of the City's most troubled communities from 1978 forward, and indeed had successfully transformed many low income neighborhoods, was no longer having the same effect. By 1995 conditions in these same communities had materially changed and a new approach to tax delinquency and *in rem* foreclosure was sorely needed.

Once a decision was reached that the existing system of *in rem* foreclosure should change, HPD was charged with the task of reshaping both the sale and renovation of its remaining inventory of *in rem* properties, which at the time was 44,033 housing units in 4,755 buildings.[8] In addition, HPD would have to reshape the disposition strategy for housing that would face *in rem* foreclosure in the future to ensure that troubled buildings didn't simply recycle through the system. At the same time, the Department of Finance (DOF) along with the Office of Management and Budget (OMB) set out to devise a system that would maximize real estate tax collection overall, and ensure that the City obtained fair value for delinquent tax liens. The securitization of real estate tax liens (popularly referred to as "tax lien sale") was determined to be the most promising strategy.[9]

Both the tax planners and the housing planners recognized that within any group of tax delinquent residential properties, some would require direct government intervention rather than the securitization of their delinquent liens to ensure their long term economic and physical improvement. However they disagreed on how much discretion HPD should have in excluding properties from the lien sale. Tax planners were concerned that too many liens would be excluded, while housing planners worried that no quantifiable criteria would fully capture all of the problem buildings that should be excluded.

[7]Andersen Consulting, "Breaking the Cycle: Developing an Effective Intervention Strategy for Dealing with New York City's In Rem Housing Problem" (Study report, unpublished, Andersen Consulting, 1994)

[8]New York City Department of Housing Preservation and Development, "HPD STARTS, COMPLETIONS, SALES and CAPITAL COMMITMENT HISTORY; HPD Historical chart, Central Management Inventory by Fiscal Year" (HPD report, unpublished, 1994)

[9]Reform of real estate tax collection encompassed both commercial and residential properties. While it was always New York City's policy to auction off commercial properties, the costs of HPD's management of residential properties impacted the City's ability to conduct *in rem* foreclosures for both commercial and residential properties. Where we are referring only to residential properties or tax liens, we will identify such properties or liens as "residential".

A compromise was reached with two broad subsets of buildings identified for exclusion from any securitization plan: Those with extreme tax delinquency (defined as those with delinquent taxes that exceeded 15% of the property's assessed value) and those with severe housing deterioration.

a new approach to tax delinquency and in rem foreclosure was sorely needed

For the tax planners, the former subset represented property owners who would likely never pay on their lien. For the housing planners, both groups represented buildings that needed more than just a possible sale to a new owner to address their problems. Housing planners also wanted to include some flexibility to withhold properties from the securitization pool which had been involved in prior government programs or required a more in depth analysis.[10]

Housing planners also understood very well that extremely troubled buildings, without clear government intervention, were likely headed toward further deterioration, making future remedies that much more costly. For poorly maintained residential buildings the impact on tenants, the loss of an affordable housing resource, and the higher subsequent renovation costs were all factors that argued for a program to intercept such buildings before their condition worsened.

The tax planners understood that while they were concerned that as many properties as possible should be subject to lien securitization, extremely troubled properties would decrease the value of the pool of liens that would only result in less revenue for the City over time.

Apartment conditions before and after HPD rehabilitation at 751 Dawson Street, Bronx. Photos: © Larry Racioppo, NYC/HPD.

[10]For example, since the Housing Code Violation system in NYC is largely dependent on tenant complaints, it is possible for buildings in poor physical condition to have few violations if the tenants for whatever reason do not call to complain about them. Conversely, buildings with violations on record may actually have corrected them but failed to take the actions necessary to have them removed from the public record. In either case it was important for the housing planners to have the flexibility to devote the time needed to determine actual building conditions.

AN INTEGRATED TAX COLLECTION AND HOUSING POLICY

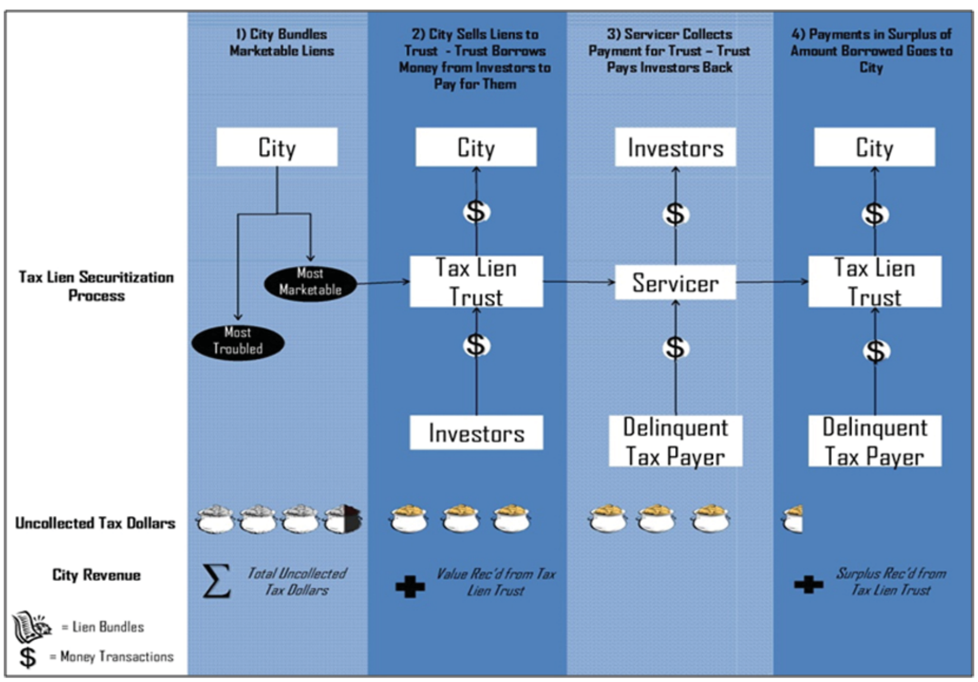
An integrated program was created that would deal with the needs of both tax collection and housing preservation with two core components. The program's structure, established in the new legislation, is summarized below.

1. TAX LIEN SECURITIZATION

The City would identify tax liens that it could reasonably expect would be paid if a private servicer would devote effort to its collection. In general these are tax liens that are worth less than 15% of the value of the property. The City would sell those liens to a trust that would hire a servicer to do the collections. The trust would pay the City, up front, for the liens using privately borrowed money. As the trust collected on the tax liens, it would pay off its lenders. If any collections were made after the lenders were paid, the trust would continue to collect funds and remit the collections to the City. Chart 1 illustrates the structure of a tax lien trust.

Chart 1

Structure of a Tax Lien Trust



Source: New York City Tax Lien 2008-A Trust, "Private Placement Memorandum" June 24, 2008

2. THIRD PARTY TRANSFER PROGRAM

The excluded properties, as defined in the new legislation, would be subject to the *in rem* foreclosure process. They would also require public sector financial assistance and the identification of a responsible new owner to ensure that renovation and a financial restructuring would occur.

That foreclosure process itself would no longer result in the City taking title, although it retained the legal right to do so. It would also not be possible to transfer the property directly to a new owner because it was projected to take up to two years on average from initial title transfer to the completion of a scope of rehabilitation work and financial package required before the property could be conveyed to its permanent owner.

Instead, the *in rem* foreclosure would result in title being transferred directly to a not for profit intermediary, which would become responsible for interim maintenance and operation and ultimately for transfer of the property to a new permanent owner with the necessary financing to renovate it. Neighborhood Restore Housing Development Fund Corporation was that intermediary.

The process of identifying the properties to be excluded from the residential tax lien securitization and subject to *in rem* foreclosure can be described as follows:

HPD first determines if any properties must be excluded from the tax lien sale because they meet the statutory definition of distressed as established by Local Law 37 of 1996. Statutorily distressed properties are defined as those with

- 15 percent or more tax lien-to-market value ratio, ***and***
- 5 or more hazardous (Class B) or immediately hazardous (Class C) Housing Maintenance Code violations per dwelling unit; ***or***
- $1,000 or more in HPD Emergency Repair Program liens per building.

The legislation also provided HPD with discretionary authority to exclude from the tax lien sales properties it considers distressed that don't meet the statutory definition. Finally, HPD may exclude properties that are already the subject of other government intervention, rehabilitation efforts, or that are ineligible for other reasons.[11]

The creation of the new programs was met with some skepticism. Tenant advocates wanted to ensure that existing tenants would be protected from displacement and unaffordable rent increases, and would have an opportunity to form a tenant owned cooperative if desired. Affordable housing developers were concerned that the scope of work and funding for the

[11]Allred, Christopher and Weinstein, Robin "Breaking the Cycle of Abandonment" (Boston: Pioneer Institute, http://www.pioneerinstitute.org/pdf/bgc_2000.pdf)

renovation could be insufficient to meet the needs of the buildings and ensure their long term survival. They were also concerned that the properties should be owned with minimal long-term restrictions.

Ultimately, the legislation would provide for tenant protection, adequate notice provisions, and the opportunity to advance a tenant owned cooperative. The Third Party Transfer Program would establish a scope of work and source of funding to meet the needs of the buildings, and insure that the buildings were transferred to responsible new owners.

IMPACT OF TAX LIEN SECURITIZATION AND THIRD PARTY TRANSFER

The legislative changes initiated in 1996 were intended broadly to:

- Increase real estate tax collection,
- Raise revenue from the securitization of real estate tax liens, and
- Save and improve the most distressed tax delinquent housing.

By examining the impact of the implementation of the legislation over the last decade, this report provides an analysis of the impact of the legislative changes on those three key areas.

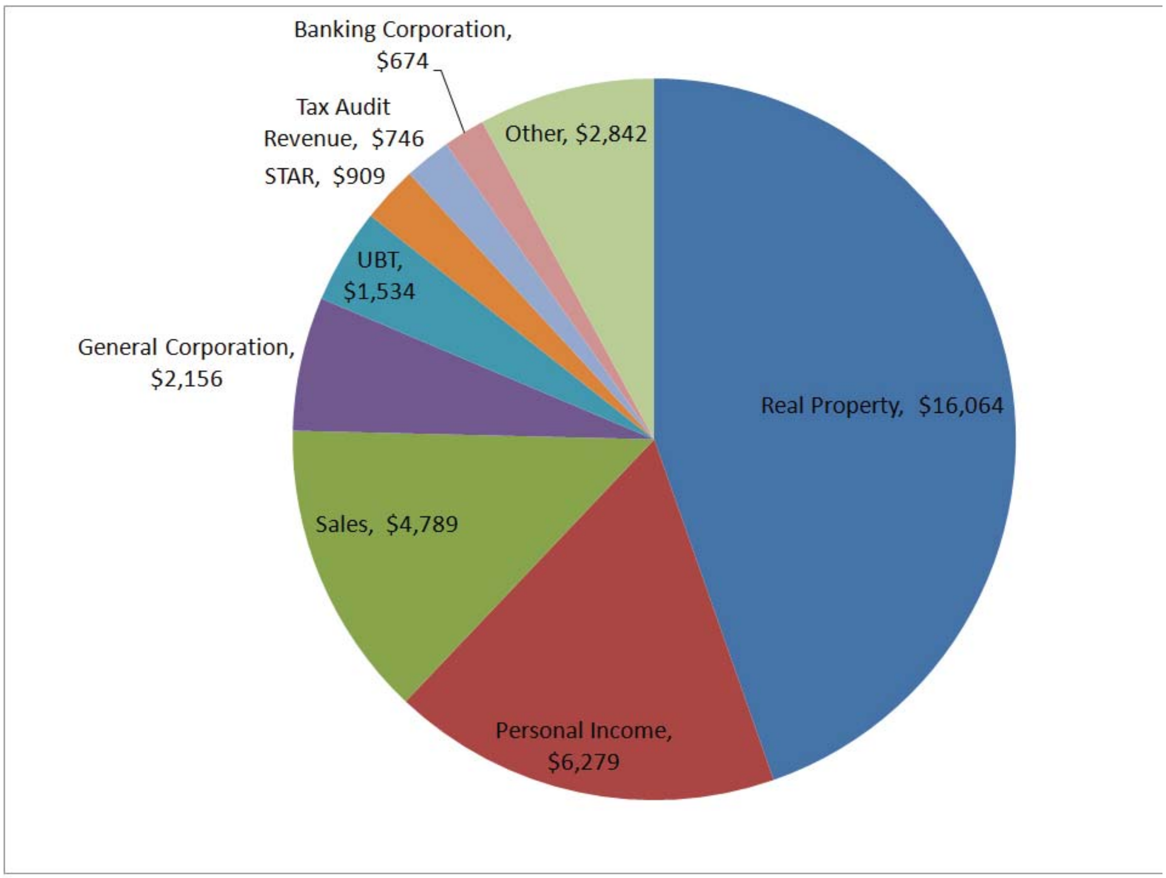
REAL ESTATE TAX COLLECTION

New York City derives revenues from a variety of sources. In FY 2010 all taxes levied by the City are projected to account for about $36 billion, or 59%, of the City's projected $61.1 billion in revenue. State and Federal grants account for about $19 billion of revenue and miscellaneous sources account for the remaining $6 billion in revenue.

Chart 2 indicates the amount of tax collection contributed by each of the various City taxes. The real property tax is, by far, the most significant portion of the City's revenue collection.[12] In 2010 it was projected to account for 44.6% of all tax revenue, more than two and half times more than the next largest source of revenue, the personal income tax. Thus the ability to effectively collect the real property tax in a timely manner is extremely important to the City's ability to provide services to its citizens and balance the budget. Real estate tax collection is also an important measure of the health of the City's housing stock, as decreasing collection is closely correlated with a drop in maintenance and building conditions.

[12] The "Other" category includes taxes, such as commercial rent tax, real property transfer tax, mortgage recording tax, utility taxes, cigarette taxes, and hotel taxes.

Chart 2
Projected NYC Tax Collection, FY 2010
In Millions



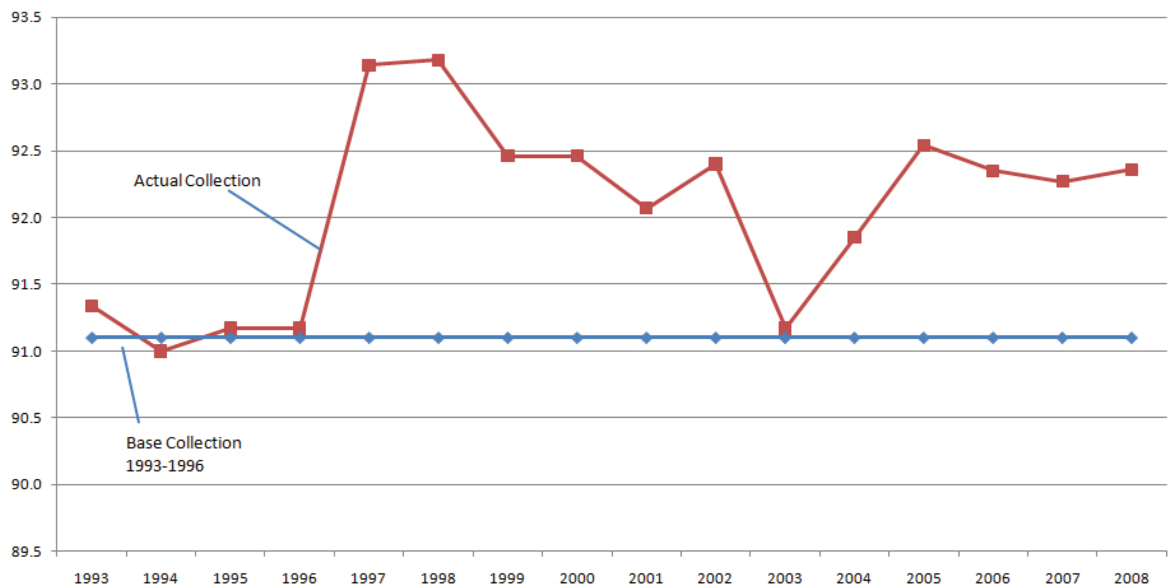
Source: NYC Office of Management and Budget, November 2009 Financial Plan: Revenue.

Following the implementation of the tax lien securitization sale and the new *in rem* foreclosure system, real estate tax collection improved. As Chart 3 indicates, the real estate tax collection rate increased to 93% after remaining largely flat at about 91.1% from 1993-1996. Thereafter, the rate remained around 92.5% (an average increase of about 1.4%) with the notable exception of 2003. In 2003 the city imposed a large real estate tax increase which resulted in a 16.7% increase in the amount of taxes due.

In the first year of the program's implementation, real estate taxes collected within the first year of billing increased by 2.14%.[13] As Chart 4 shows, this resulted in $160 million in additional real estate tax collections for the City in 1997. Over the 12 year period of 1997 to

[13] Real estate taxes are sometimes paid late. These figures reflect payments received within the first twelve months of the initial billing. Improving such first year tax collections are important to the City to ensure that payments are made in a timely way.

Chart 3
Improved Real Estate Tax Collection in First Year Of Billing 1993-2008
In Millions



Source: William Thompson, Comprehensive Annual Financial Report of The Comptroller for the Fiscal Year Ended June 30, 2008, and 2003.

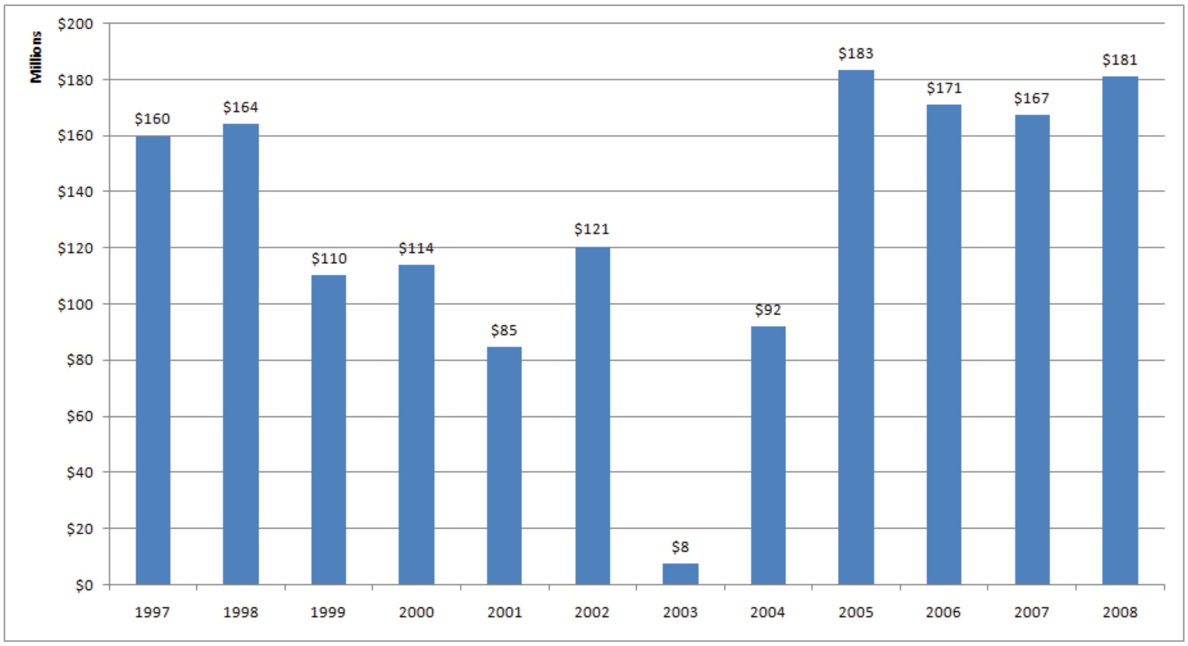
2008, the difference between the pre-1996 real estate tax collection rates (had they remained unchanged) and the actual real estate tax collection rate resulted in an additional $1.55 billion collected. While tax collection rates are affected by many factors, it is reasonable to presume that a consistent enforcement strategy has a significant impact on the collection of real estate taxes.

RAISING REVENUE FROM LIEN SECURITIZATION

An obvious goal of the securitization of tax liens is to raise revenue. As previously noted, overall these securitizations have generated $1.008 billion in real estate tax revenue for the City. This figure includes both upfront payments the City receives when it securitizes the lien and funds paid over time received after the tax lien trust has paid off its lenders.

In order to illustrate this process a single trust was examined in more detail. The following section describes the process of a single trust created in 2004 which has subsequently repaid its borrowers and paid additional funds to the City of New York.

Chart 4
Additional First Year Real Estate Tax Collection 1997-2008



Source: William Thompson, Comprehensive Annual Financial Report of The Comptroller for the Fiscal Year Ended June 30, 2008, and 2003.

The New York City Tax Lien 2004-A Trust (NYCTL 2004-A Trust) was created in September 2004.[14] (See Chart 5, page 16) The City sold the Trust $54,682,860 of tax liens for a discounted price of $50,035,000. The Trust, in turn sold bonds to investors worth $50,035,000. The difference in the value of the bonds and the value of the tax liens represents additional assurance to the lenders that there will be enough funds collected to repay their investment. The discounted value is subject to a variety of market conditions.

The City immediately obtained the bulk of the $50,035,000, though some was retained by the Trust to pay for expenses such as hiring a servicer and creating a reserve fund.

The Trust repaid the full $50,035,000 to all its bond holders by March 2007 with interest. However, over $12 million of tax liens still owned by the Trust remained uncollected. Through the end of fiscal year 2008, the Trust collected a portion of those liens and paid to the City another $5.5 million. Additional liens may still be collected over time.

Therefore, from a lien pool initially valued at $54,682,860, the City has already received more than $56.5 million in revenue, with the potential for more in the future.

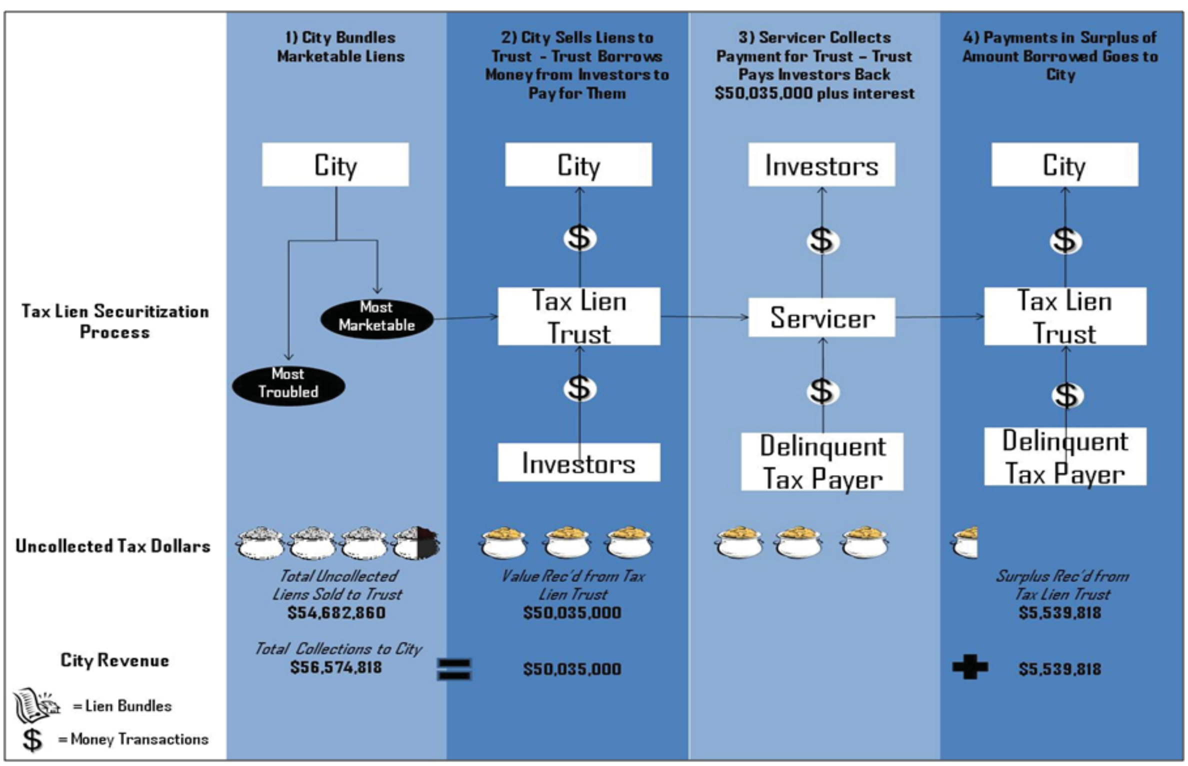
[14] A tax lien trust contains not only real estate taxes, but also water and sewer liens and a variety of other liens. While we have talked solely about real estate tax liens so far, this example will lump together all the liens in this Trust.

Over the period 1996 through 2008, the City has conducted thirteen tax lien securitizations. Of the thirteen trusts created between 1996 and 2008, eleven have repaid their lenders in full and the two most recent trusts are projected to do the same.

Since 1996 the City has securitized and sold approximately $1.25 billion in real estate tax liens. The thirteen trusts initially paid the City $918.9 million for those liens. Through 2008, the City has collected $1.008 billion on those liens. The difference of $89.3 million represents surplus collections received following repayment of the bondholders.

An important factor in maximizing the revenue to the City from the tax lien securitization is to ensure that the pool of liens excludes those that will devalue the pool as a whole. The exclusion of such liens from the lien pool is a critical function that is provided for in the legislation and is largely carried out by HPD.[15]

Chart 5
Revenue Collected by NYCTL 2004-A Trust For the Years 2004-2008



Source: New York City Tax Lien 2008-A Trust, "Private Placement Memorandum" June 24, 2008 and NYCTL 2004-A Trust Financial Statements June 30, 2008 and 2007.

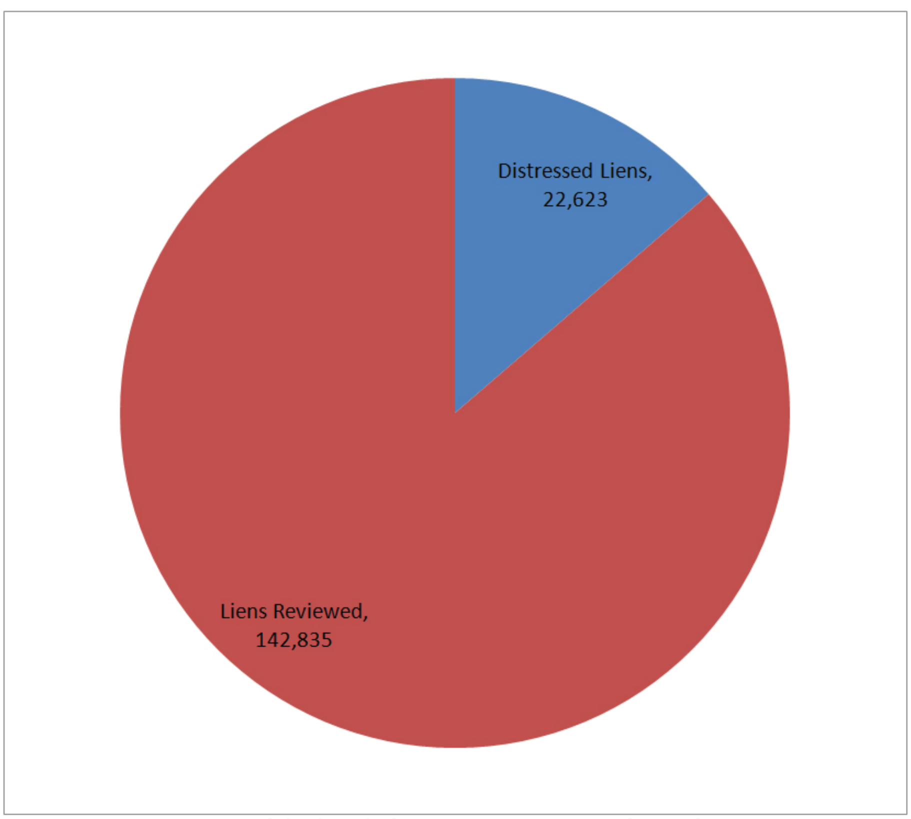
[15] Other agencies may remove liens from the securitization, such as water and sewer liens. Usually this is done when the agency finds errors in the underlying billing.

Between 1996 and 2008, HPD reviewed 142,835 tax liens and recommended that 85% or 120,212 liens be included in the securitization pool for sale. It has excluded 22,623 liens from securitization and sale.

As previously described, residential properties with uncollected real estate tax liens are rejected for securitization for a variety of reasons. Chart 7 shows how most tax liens rejected for lien securitization meet one of the statutory standards specified in the legislation. HPD also reviews the tax liens for administrative errors, such as properties eligible for real estate tax abatements that are in process but are not yet reflected in the tax records, or buildings that are or were subject to government housing intervention and require closer inspection. Housing Development Fund Corporation low income tenant cooperatives were also typically removed since HPD had other remedies to address their tax delinquency problems. HPD also identifies buildings as distressed and therefore in need of housing intervention, even if such buildings do not strictly meet statutory standards.

Through this system of exclusions, properties that require more direct intervention to ensure that the buildings' conditions are improved are removed from the tax lien securitization pool.

Chart 6
Liens Reviewed



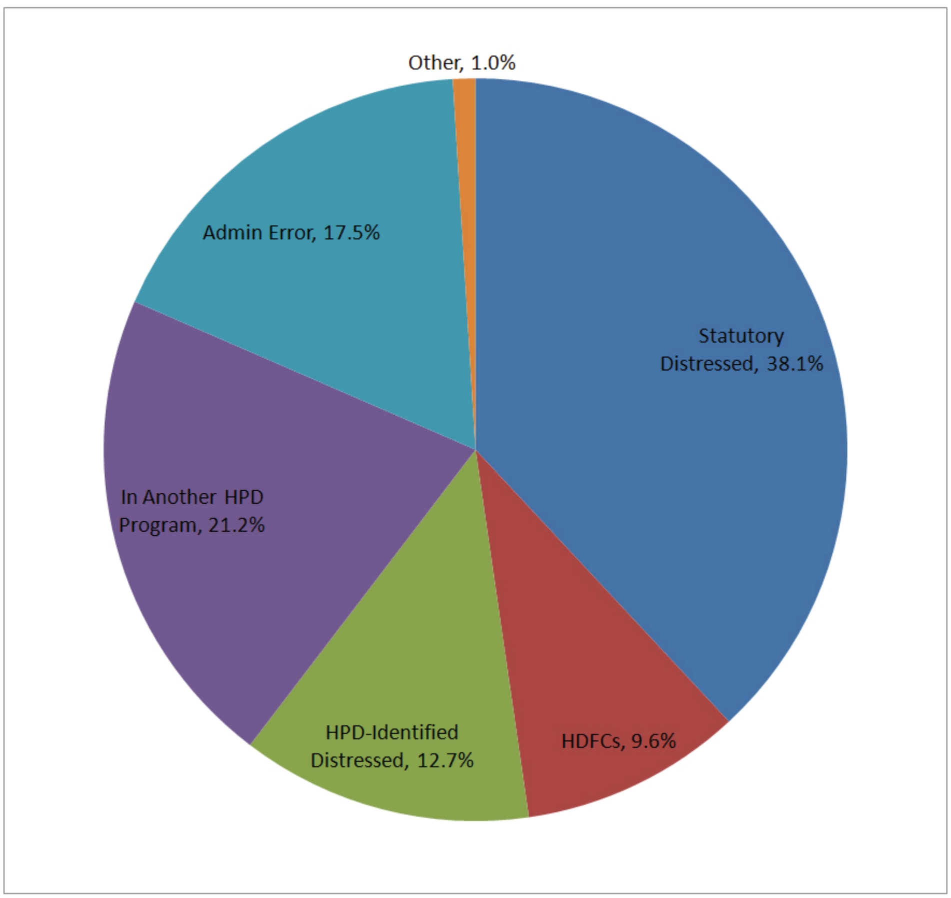
Source: HPD unpublished data on reviewed tax liens.

This system has the added value of excluding buildings from securitization that are less likely to pay their taxes, creating a pool of liens with greater overall value.

Between 1996 and 2008 HPD excluded 22,623 liens from the tax lien securitization. Of the 22,623 tax liens excluded from the sale, 2,295 buildings were ultimately subject to *in rem* foreclosure proceedings.

There are a variety of reasons for the difference between the number of liens and the number of buildings subjected to *in rem* foreclosure. First, one building may have multiple liens. Second, those buildings which were included due to administrative errors, or for which HPD is pursuing other remedies, will be resolved without commencing foreclosure. Many parcel owners will also pay their taxes once they are aware that foreclosure is possible.

Chart 7
Reasons for Rejection of Tax Liens for Securitization



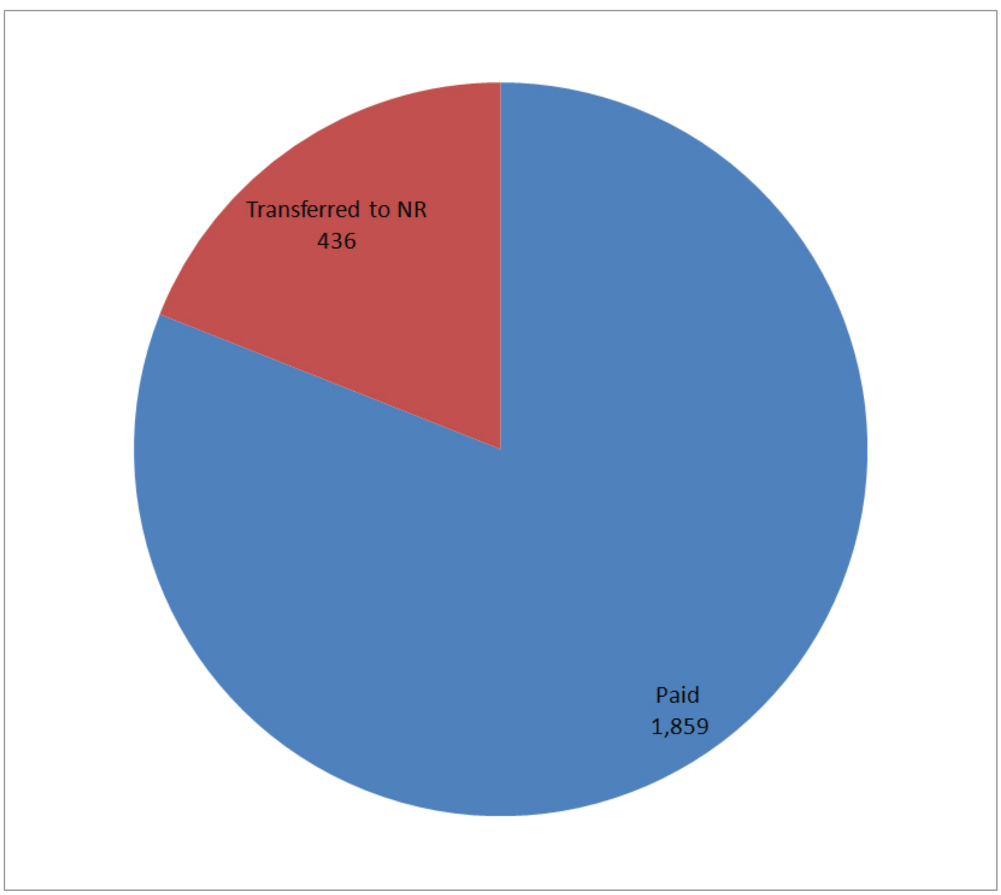
Source: HPD unpublished data on reviewed tax liens. Tax liens for 1996 are not included since detailed data on those liens is not available.

The most common outcome for a foreclosure action is the payment of taxes by the owner. Of the 2,295 properties that entered foreclosure, 1,859 paid prior to completion. Those owners paid $317.8 million in taxes. Only 436 parcels remained that actually completed foreclosure and entered the Third Party Transfer Program.

Thus tax lien securitization and the Third Party Transfer Program together have improved the tax collection process and generated additional revenue from the securitization of tax liens by:

- Increasing first year timely tax collections by $1.55 billion,
- Providing an efficient and simple method of promptly collecting $1.008 billion in delinquent real estate taxes, and
- Collecting an additional $317.8 million in taxes during the in rem foreclosure process.

Chart 8
Foreclosure Results



Source: HPD unpublished data on *in rem* foreclosures.

SAVING AND IMPROVING DISTRESSED HOUSING

While the exclusion of distressed housing from the pool of securitized liens has had a positive effect on revenue from the sale for the City of New York, it has also had a significant impact on saving and improving some of the City's most distressed critical housing resources.

The new *in rem* legislation provided for the transfer of *in rem* foreclosed properties to an intermediary not for profit, which in turn would transfer property to a new owner when renovation scope and financing were in place. Neighborhood Restore (NR), an independent Housing Development Fund Corporation funded through the City of New York, was established for this purpose.

Between 1996 and 2008, 436 properties were subject to the Third Party Transfer Program

At the conclusion of the *in rem* tax foreclosure process, NR assumes title to the properties. Along with title, NR assumes interim management obligations, and works with HPD to identify an appropriate new owner, establish the scope of renovation work, and to secure necessary financing. New owners may be either for profit or not for profit organizations deemed eligible to participate in the program by HPD.[16] In addition, tenants interested in future conversion to low-income tenant owned cooperative ownership can work with a not for profit partner to carry out the renovation.

Between 1996 and 2008, 436 properties were subject to the Third Party Transfer Program. Neighborhood Restore transferred ownership of 363 properties with 4,600 units of housing to new qualified owners with rehabilitation financing.

Based on the City Capital Budget commitment from FY 2000 thru 2009, the average per unit cost for the City was approximately $74,000. This estimate included federal funds such as HOME,[17] which is reflected in the City's Capital Budget. This public investment also leveraged additional funding such as private financing, owners equity, and Low Income Housing Tax Credit funds which can, on average, account for an additional $40,000 to $50,000 per unit. Thus the ten year cost to the City is estimated to be approximately $340.5 million for rehabilitation of this distressed building stock, or approximately $34 million per year.

[16] New owners are identified from a pre-qualified list maintained by HPD and which is periodically opened to allow new participants to qualify.

[17] HOME is a federal block grant program to create affordable housing. HPD uses such funds as capital funds in its loan programs.

Mixed use building at 613 East 141st Street in the Bronx before and after going through the Third Party Transfer program. Photos: © Neighborhood Restore.

While most of these buildings pay no or limited taxes after their rehabilitation,[18] they do contribute to improving their neighborhoods and increasing real estate tax assessment and collection.[19]

TAX LIEN SALES AND SECURITIZATION IN OTHER CITIES

For this report, twenty of the largest cities in the U.S., excluding NYC, were surveyed to determine what method they utilized to collect delinquent tax liens. In addition, tax lien securitization sales carried out in seven other cities were examined to determine their outcomes. Since no single source was found that provided a compilation of strategies employed by all taxing jurisdictions, it is possible that these examples are incomplete.

Communities throughout the U.S. primarily use one of two methods to collect delinquent real estate taxes. They either foreclose on properties without taking title or they sell the tax liens or deeds to another entity which then has the right to collect the unpaid lien.

Foreclosure is a long and technical legal proceeding. Taxes may or may not be collected by the taxing jurisdiction while the proceeding is pending, which can take a year or more. Worse for many municipalities and counties, if no payment is made the jurisdiction may become the owner of the property at the end of the process. While this may be desirable for land banking, it requires an ability to take on the financial and organizational burden of interim (and perhaps long term) management and maintenance of what invariably are distressed properties.

As an alternative, many taxing jurisdictions instead sell individual tax liens. In this method a municipality auctions off tax liens to private buyers. Private buyers can be individuals but are

[18] Buildings transferred to not for profit owners which also receive LIHTC are eligible for tax exemptions through 420(c) and those transferred to for profit owners or not for profit owners without LIHTC are eligible for J-51 or other tax benefits.

[19] Gould Ellen, Ingrid and Voicu, Ioan "NonProfit Housing and Neighborhood Spillover", (Working Paper, Furman Center for Real Estate and Urban Policy, 2005).

frequently large financial entities that are seeking to make a profit from the difference between the discounted purchase price of the lien and what they can collect. A variation of this technique is the bulk lien sale in which a municipality offers a group of liens for sale to a single purchaser.

The obvious attractiveness of any lien sale is that the taxing authority obtains immediate cash for the liens without a complicated and long drawn out collection process and without assuming title of an inventory which may be difficult to dispose of.

Unlike New York City, which has sought to connect tax collection and housing objectives in its tax enforcement process, these cities have employed strategies that are almost solely geared to tax collection. That is not to say that housing preservation and intervention strategies are not also applied, but rather that the focus on tax delinquency has been on collection rather than as a tool for housing intervention. In most of these cities that separation in objectives is reinforced by a separation in authority. Typically counties are responsible for tax collection and cities are responsible for housing and community development. Such structures make integration of the two policies more difficult to achieve.

Abandoned buildings in Detroit.

There are a few exceptions worthy of note. Detroit, with many properties that have deteriorated for decades and thus do not sell at any price, has most recently tried to create a land bank of its abandoned properties. Memphis has proposed the creation of a land bank and the alteration of state law to allow the city to give more properties to community development groups. Baltimore has created a land bank for its abandoned vacant property. Other cities such as Cleveland, Ohio; Flint, Michigan; and Atlanta, Georgia have also created land banks. For the most part, these land banking schemes are dependent on a sale which will not attract viable bidders either because of the property's poor value or by structuring a sale that discourages bidders and instead provides for a default purchase by the government.

The following summarizes the tax collection strategy applied to uncollected tax liens in the 20 largest cities in the U.S., exclusive of New York City. Please note that the sale of the tax deed involves the sale of the property following a foreclosure process, but without the taxing jurisdiction ever taking title to the property. The sale of the tax lien directly to a purchaser requires additional proceedings to obtain title to the property.

20 Largest cities (excluding NYC) by Descending Population 2008

1. Los Angeles, California
Sells tax deeds for property in tax default for 5 years. (See California Property Tax: An Overview, Publication: August 29, 2009)

2. Chicago, Illinois
Tax liens are sold at auction. Buyer may seek a tax deed in court if payment is not made. (See http://tiny.cc/8llg4 and Illinois Code 35 ILCS 200/21-205.)

3. Houston, Texas
County sells tax deeds, subject to owner's right of redemption. (See http://tiny.cc/6xitz)

4. Philadelphia, Pennsylvania
City sells tax deeds at auction. Used tax lien securitization once but no longer does. (See http://tiny.cc/rxsic and Pennsylvania Statutes Title 53. Municipal and Quasi-Municipal Corporations Part II. Cities of The First Class Chapter 43. Taxation Article IV. Enforcement of Tax Liability)

5. Phoenix, Arizona
County sells tax liens. Purchaser may foreclose them in court. (See http://tiny.cc/tyus0)

6. San Antonio, Texas
County sells tax deeds, subject to owner's right of redemption. (See http://tiny.cc/epnvw)

7. San Diego, California
Sells tax deeds for property in tax default for 5 years. (See California Property Tax: An Overview, Publication: August 29, 2009)

8. Dallas, Texas
County sells tax deeds, subject to owner's right of redemption. (See http://tiny.cc/f5m5i)

9. San Jose, California
Sells tax deeds for property in tax default for 5 years. (California Property Tax: An Overview, Publication: August 29, 2009)

10. Detroit, Michigan
County sells tax foreclosed property after expedited tax foreclosure. (See http://tiny.cc/hl826)

11. Indianapolis, Indiana
County sells tax liens. (See http://tiny.cc/9941r and http://tiny.cc/8kd9f)

12. Jacksonville, Florida
County sells tax liens. Deed may be issued to tax lien holder after lien is unpaid for two years. (See http://tiny.cc/hrjtn)

13. San Francisco, California
Sells tax deeds for property in tax default for 5 years. (California Property Tax: An Overview, Publication: August 29, 2009)

14. Hempstead, New York
County sells tax liens. (See http://tiny.cc/21gnp)

15. Columbus, Ohio
County sells tax liens to private buyers who may foreclose. Liens are sold in bulk rather than individually. (See http://tiny.cc/3kmk1)

16. Austin, Texas
County sells tax deeds, subject to owner's right of redemption.
(See http://tiny.cc/aff4i and http://tiny.cc/h5hjj)

17. Memphis, Tennessee
City sells tax deeds after court proceeding.
(See http://tiny.cc/pdlbm)

18. Baltimore, Maryland
City sells tax liens. Purchaser of tax lien then has right to foreclose. (See http://tiny.cc/kcjlc)

19. Fort Worth, Texas
County sells tax deeds, subject to owner's right of redemption. (See http://tiny.cc/gffjx and http://tiny.cc/ryykz)

20. Charlotte, North Carolina
City sells tax deeds at public auction after expedited foreclosure process. (See http://tiny.cc/u1zl2)

THREE CASE STUDIES IN TAX LIEN SECURITIZATION

While tax lien securitization has been a success in New York City, its record is not nearly so positive in other places. Overall, most taxing jurisdictions sell tax liens directly without securitization.

This report has determined that few taxing jurisdictions utilize tax lien securitization. This research found only five other jurisdictions where tax lien securitization was carried out: New Haven, Philadelphia, Jersey City, Puerto Rico, and upstate New York (a combined effort that included Syracuse, Buffalo, Binghamton, and Plattsburgh). In fact, Jersey City had been the model for the program developed in New York City.

No substantive data on the New Haven and Puerto Rico experiences were uncovered. While New Haven and Puerto Rico each did one tax lien securitization in the late 1990s, no evidence was found that they had done a second one, making it unlikely that their initial attempts were particularly successful.

Information obtained for the remaining three cities indicated that all three (note that Jersey City carried out two tax lien securitizations) were failures since lenders did not receive full repayment of their bonds and thus lost money. Jersey City became enmeshed in litigation which was eventually settled, while Philadelphia and upstate New York made settlement payments to lenders to avoid litigation. In all three cases no further tax lien securitizations were done.

Philadelphia, Pennsylvania

In 1997 the City of Philadelphia and the Philadelphia School District conducted a securitized tax lien sale from approximately 33,600 parcels.[20] The City and the Philadelphia School District sold approximately $106.3 million in tax liens to a trust for $75.5 million. The Philadelphia Authority for Industrial Development in

Abandoned property in Philadelphia.

[20] Audit of the Philadelphia Industrial Development Corporation conducted by Philadelphia City Comptroller, April 2000

turn sold bonds in the amount of $75.5 million. After fees, expenses, and reserves, the City and the Philadelphia School District received $70 million.

At the time an audit was completed, three years into the securitization, the servicer had only collected about $22 million out of the total uncollected lien amount of $106.3 million. The audit projected that of the $75.5 million of bond principle only about $33.3 million would be repaid from collecting on the tax liens. To make up the difference, the City of Philadelphia had been substituting new tax liens for the ones that were not paid. In fact Philadelphia defaulted on $46.3 million of bonds in 2004.[21]

By way of comparison, New York City's tax lien trusts have usually fully paid their bond holders within four years.

The audit noted that a primary reason for failure of the securitization was the inability of the servicer to collect on the taxes that were due. The audit specifically noted the poor quality of the tax liens as a core reason for the inability to collect on the liens. One third of the value of the lien pool was represented by properties whose lien to value ratio exceeded 50%. While the audit noted other administrative obstacles to foreclosure enforcement, it appears that the initial screening of the lien pool and the necessary exclusion of liens likely to fail was insufficient.

Jersey City, New Jersey

In 1993 and 1994 Jersey City conducted two of the earliest securitized tax lien sale transactions. In 1993 Jersey City sold real estate tax liens with a face value of approximately $44 million for $25.5 million in cash and a $19.5 million note. Subsequently, in 1994 Jersey City sold real estate tax liens with a $14 million face value, for $7 million in cash and a $7 million note.

These two lien securitization sales resulted in extensive litigation. Some of the legal issues concerned whether New Jersey law was at the time sufficiently clear enough to allow the servicer to actually collect taxes and to enter into installment payment agreements with delinquent taxpayers. Although these questions were eventually resolved in the servicer's favor, they clearly hampered collection.

However there was also a clear problem of the value of the tax liens that had been sold. The servicer alleged that Jersey City had provided them with liens that were insufficient in value to pay all the bondholders and to pay the subordinated notes given to Jersey City. According to at least one report, a substantial tax lien on the Porte Liberte development that had been sold to the trust was eventually abated by Jersey City as part of a workout on the formerly troubled development.[22] Ultimately Jersey City relinquished its two notes and never did another tax lien securitization.

[21] D'Ambosio, Jill "As Predicted, Philadelphia Agency Defaults on $46M of Insured Tax-Lien Debt," The Bond Buyer, July 27, 2004, p4.

[22] See Third Amended Complaint in The City of Jersey City vs. Breen Capital Services, (Superior Court of New Jersey, Chancery Division Hudson County, Index # C-57-98) filed September 7, 1999.

MBBA: Syracuse-Buffalo-Binghamton-Plattsburgh, New York

In September 2003 the State of New York Municipal Bond Bank Agency (MBBA) on behalf of the cities of Syracuse, Buffalo, Binghamton, and Plattsburgh in upstate New York combined to sell approximately $15.1 million worth of bonds, securitized by $22.5 million of unpaid tax liens.[23] Of the initial amount of $15.1 million of bonds issued, only $13.9 million were repaid through tax lien collections.

Approximately 64% of the liens in the trust were in properties with lien to value ratios in excess of 20%. A substantial number of the tax liens in the trust proved to be uncollectible for a variety of reasons. Liens from Buffalo, which made up the bulk of the trust, were the primary problem. Of the original 1,499 tax liens on property in Buffalo owned by the trust, 1,039 were determined to have no value.[24]

Abandoned houses in Buffalo.

[23] Buffalo accounted for 41% of the bonds, Syracuse for 38.7%, Binghamton for 19.6% and Plattsburgh for .67%

[24] New York Housing Finance Agency, Press Release, "NYS Municipal Bond Agency Resolves Tax Lien Securitization Trust" (New York Housing Finance Agency, September 11, 2007)

CONCLUSION

The dual policies of lien securitization and the Third Party Transfer Program have been a clear success based on the revenue derived through securitization, the increase in tax collection, and the preservation of an at-risk pool of affordable, mostly rental housing. The ability of the City to separate from the lien pool residential buildings in need of greater public sector intervention has been a significant reason for the programs' overall success. It has helped to maximize the return to the City from the securitization of the tax liens while preserving and improving a critical housing resource.

Thus we find that to maximize the financial benefits of tax lien securitizations, they must include a well constructed screening process which excludes properties that require other forms of intervention. The lessons learned from implementation of these policies should inform new strategies to address the crisis in over-mortgaged multifamily buildings in New York. Banks and CMBS's now hold significant portfolios of such properties in widely varying conditions—from those in excellent repair in strong market areas to those in a dilapidated state in weaker market areas. Banks could strengthen the value of these assets by creating objective screening criteria to identify the more troubled properties, and creating targeted intervention for them rather than simply selling troubled assets to the highest bidder. The Third Party Transfer Program and tax lien securitization sales in NYC can provide useful insights into innovative government solutions to complex market conditions. By presenting these results and some of the resources from which they were drawn, it is hoped that those lessons can be put to good use in addressing future challenges of the housing market.

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