Government Home Equity Theft and Home Values

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Abstract: The Supreme Court's 2023 decision in Tyler v. Hennepin County severely restricted the ability of state and local governments to profit from forced tax sales of real property over and above any taxes or fees owed by a delinquent homeowner. Prior to the decision, perhaps as many as a dozen states engaged in home equity theft in which they retained the full proceeds from a tax sale even if the amount greatly exceeded any existing tax debt. The Tyler decision held that this practice constitutes a taking, requiring just compensation under the Fifth Amendment. We examine the effect of this property right protection on home values in the states that allowed home equity theft, focusing on homes in the lowest quartile of home prices given that lower socio-economic status homeowners are likely most susceptible to losing their equity. We find that the risk of home equity theft significantly depressed home values in most of the states where the practice existed. In those states not exhibiting this effect, state law and practice had previously limited the risk substantially.

INTRODUCTION

Geraldine Tyler owed $2,300 in unpaid taxes and another $13,200 in associated fees and fines dating back to 2010 related to her Minneapolis condo. In 2015, Hennepin County seized and foreclosed on the condo, selling it for $40,000. The County retained the almost $25,000 surplus. A 2019 class action filed on the behalf of Tyler and other victims of home equity theft was dismissed by the district court in 2020, and this dismissal was upheld by the Court of Appeals for the Eighth Circuit in 2022. The Appeals Court noted that Hennepin County complied with state statute which did not allow surplus proceeds to be distributed to the former landowner but, instead, directed that the funds be used for forest and recreation development with any remaining funds going to the county, school district, and the city.[1] The Circuit Court held that the Minnesota statute abrogated any common law property right to "surplus equity" in finding that the county's actions did not constitute a taking. In upholding the motion to dismiss, the court also noted that homeowners like Tyler are given notice and provided with other procedural safeguards prior to foreclosure.

Minnesota's statute and actions regarding surplus equity are not uncommon. As of 2023, similar practices existed in at least a dozen states. These practices were not new. Indeed, a 1956 US Supreme Court case upheld New York City's retention of more than $6,000 in surplus equity for the failure to pay a $65 water bill.[2] However, with the 2023 Tyler v. Hennepin County decision, the US Supreme Court made it clear that this home equity theft constitutes a taking for which just compensation is required. The Court made clear that procedural safeguards and state statutes blessing the practices do not relieve state and local governments from their obligations under the Fifth Amendment.

We use the 2023 Court decision as a shock to identify the value of the property right protections created by the takings clause. Because the risk of home equity theft is likely to fall most heavily on relatively poor individuals, who are both more likely to fall behind on their tax payments and who

[1] Tyler v. Hennepin County, 26 F.4th 789 (2022)
[2] Nelson v. City of New York, 352 U.S. 103 (1956)

are less able to litigate successfully in the foreclosure process, we analyze how home values at the low end of the distribution changed after the Tyler decision relative to home prices at the top of the distribution. We find that the prospect of home equity theft significantly depressed home prices in eight of the twelve states engaging in the practice. In three of the four remaining states engaging in the practice, effects were not statistically distinguishable from zero, and in the remaining state, there was a statistically significant positive effect of the practice. However, in each of those four states, there are reasons to believe that they did not engage in home equity theft in practice, even though the law formally allowed for it.

Our results indicate that the market positively values protections against uncompensated takings. Further, our results suggest that the Court's decision in Tyler v. Hennepin County positively helped individuals owning relatively low value homes.

LEGAL AND ECONOMIC THEORY

Gideon stuff.

STATE LAWS

The class in Tyler was represented by the Pacific Legal Foundation which examined the laws and practices of the states and DC. PLF research categorized 12 states plus the District of Columbia as not protecting an owner's property rights in home equity.[3] The other states have procedures by which the previous homeowner can petition for the surplus equity.

Status of tax theft laws at time of Tyler v Hennepin County (decided May 25, 2023) based on Pacific Legal Foundation research

State	Caveats
Alabama	Probably previously undone by state court decision and government has duty to sell smallest piece of real estate necessary to satisfy debt (excluded)
Arizona	
Colorado	
District of Columbia	Doesn't apply to owner/occupier
Illinois	
Maine	Can do personal property
Massachusetts	Generally wait a long time
Minnesota	
Nebraska	
New Jersey	
New York	
Oregon	
South Dakota	Reconveyance procedure

[3] Pacific Legal Foundation, Home Equity Theft: Tax Foreclosure Laws in 50 States and the District of Columbia

The status of the Alabama law is unclear since Douglas v. Roper, No. 1200503, 2022 WL 2286417 (Ala. June 24, 2022) appears to limit government's ability to engage in home equity theft. In any event, the government was under a duty to satisfy debt by selling smallest amount of real estate necessary to clear debt if practicable. For these reasons, Alabama is excluded from the sample given the ambiguous nature of Tyler's effect on Alabama.

DC's law required a refund of surplus home equity to owner-occupiers of residential properties with five or fewer units. This should provide a falsification since any effect of Tyler should be zero.

Maine requires the return of surplus home equity for senior citizens and allows the seizure and sale of personal property to satisfy property tax debt, so effect of Tyler should be blunted if not zero.

Many municipalities in Massachusetts, according to the Pacific Legal Foundation, wait until the tax debt and interest equal the value of the property to engage in foreclosure. This should blunt the effect of Tyler.

South Dakota, according to Pacific Legal Foundation, allows that "The county may reconvey by quitclaim deed to the record owner of the property for consideration of at least the amount of the taxes, interests, and costs represented by the tax deed." This process may effectively mean that South Dakota governments do not actually engage in home equity theft but merely use seizure/foreclosure to induce payment.

DATA AND ESTIMATION APPROACH

Monthly Zillow house price estimates at the state level from January 2000 through July 2024 are used. This represents the entire time series available from Zillow at the time of drafting. For the treatment group, we use the average price of houses in the 5^{th} - 35^{th} percentile range (Zillow's bottom-tier range) and we use houses in the 65th – 95^{th} percentile range (Zillow's upper-tier range) as the within state counterfactual comparison group.

Given the differences in state practices, we examine each state where home equity theft is possible separately, using all of the states with protections against home equity theft according to the PLF as a comparison group. That is, our regressions are estimated only on states that disallowed home equity theft at the time of Tyler and a single state that allowed home equity theft.

We estimate a triple differences model of the following form

$$\ln(p_{svt}) = \alpha + \beta \cdot HEtheft_{svt} + \sum \delta_{sv} + \sum \varphi_{st} + \sum \lambda_{vt}$$

Where the s subscript denotes the state, the v subscript denotes the value range (i.e., bottom/upper tier), and the t subscript denotes the time period. The model includes three sets of fixed effects, specifically state X value category fixed effects, state X time period fixed effects, and value category by time period fixed effects. The treatment variable (HEtheft) indicates whether the state allowed home equity theft in that time period, but it only takes the value of one for the low value category given our assumption above. Due to the Supreme Court's decision in Tyler v. Hennepin County, the treatment variable takes the value of zero for all observations after May 2023.

We multi-way cluster our standard errors at the state and time period level to account for within state and within time period dependence (see Cameron, Gelbach, and Miller 2011).

RESULTS

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier	
(Standard Errors Clustered on State and Time Period)	
Arizona	
Tax Theft Allowed	-0.08*** (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,546
The Upper tier house group constitutes the within state counterfactual group. *** $p < 0.01$ ** $p < 0.05$	

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier	
(Standard Errors Clustered on State and Time Period)	
Colorado	
Tax Theft Allowed	-0.02** (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,548
The Upper tier house group constitutes the within state counterfactual group. *** $p < 0.01$ ** $p < 0.05$	

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier	
(Standard Errors Clustered on State and Time Period)	
District of Columbia	
Tax Theft Allowed	0.01 (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,548
The Upper tier house group constitutes the within state counterfactual group. *** $p < 0.01$ ** $p < 0.05$	

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier
(Standard Errors Clustered on State and Time Period)

Illinois	
Tax Theft Allowed	-0.02** (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,548
The Upper tier house group constitutes the within state counterfactual group. *** p < 0.01 ** p < 0.05	

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier	
(Standard Errors Clustered on State and Time Period)	
Maine	
Tax Theft Allowed	0.02 (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,548
The Upper tier house group constitutes the within state counterfactual group. *** p < 0.01 ** p < 0.05	

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier	
(Standard Errors Clustered on State and Time Period)	
Massachusetts	
Tax Theft Allowed	0.04*** (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,548
The Upper tier house group constitutes the within state counterfactual group. *** p < 0.01 ** p < 0.05	

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier	
(Standard Errors Clustered on State and Time Period)	
Minnesota	
Tax Theft Allowed	-0.06*** (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,548

The Upper tier house group constitutes the within state counterfactual group. *** p < 0.01 ** p < 0.05

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier	
(Standard Errors Clustered on State and Time Period)	
Nebraska	
Tax Theft Allowed	-0.04*** (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,548
The Upper tier house group constitutes the within state counterfactual group. *** p < 0.01 ** p < 0.05	

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier	
(Standard Errors Clustered on State and Time Period)	
New Jersey	
Tax Theft Allowed	-0.03*** (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,548
The Upper tier house group constitutes the within state counterfactual group. *** p < 0.01 ** p < 0.05	

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier	
(Standard Errors Clustered on State and Time Period)	
New York	
Tax Theft Allowed	-0.08*** (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,548
The Upper tier house group constitutes the within state counterfactual group. *** p < 0.01 ** p < 0.05	

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier
(Standard Errors Clustered on State and Time Period)
Oregon

Tax Theft Allowed	-0.05*** (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,548
The Upper tier house group constitutes the within state counterfactual group. *** p < 0.01 ** p < 0.05	

Table X: Effect of Allowing Home Equity Theft on Home Values in the Bottom Tier	
(Standard Errors Clustered on State and Time Period)	
South Dakota	
Tax Theft Allowed	0.02 (0.01)
State X Value Category Effects	Yes
State X Time Period Effects	Yes
Value Category X Time Period Effects	Yes
Observations	22,540
The Upper tier house group constitutes the within state counterfactual group. *** p < 0.01 ** p < 0.05	