

Are Cities Land Banking or Sandbagging the Public?

Land banking is the systematic process where a city, county, state or the Federal Government acquires land for the benefit of the public. Sounds pretty simple, so why would there be controversy about this practice? Maybe you haven't heard anything about it because it is often a best kept secret. It can be a best kept secret because possible leaks of the information could cause an increase in land values or because the governmental agency is doing it in a discriminatory manner under the guise of cleaning up blighted areas.

Let's assume a city decides to "un-blight" an area by condemning the apartments or houses that are within a defined area. Up until the past few years, this process had to be negotiated with the property owners or resolved in court. In most states, the property owner was actually given money to fight his case – not a bad deal. If you asked me how that went, it generally went in the favor of the property owner for either getting a higher dollar amount or keeping his property.

But as some appeals wound their way through the court system, the outcome from the Supreme Court turned in favor of the "eminent domain" ruling. Property owners now seldom have a chance to save their property, or get a fair market value for it without extensive and expensive legal challenges. Even the sanctity of property ownership seems to have been lost to all but the very wealthy.

The land banking activities of various levels of government are generally kept secret to keep speculators from making money on surrounding parcels of land. This speculation is very common where revitalization districts called "CRA's" are established to refurbish older downtown areas of cities. Speculators snap up all the property around the area to be re-vitalized in a mad frenzy (especially condo developers) knowing that the chances are very high they can get a "ride" out of the property boom that is to follow. Ironically, it is the city or county that's involved which gives these same developers sweetheart deals by selling them land below market value and often even loaning them tons of money to do their development!

But a more sinister form of land banking has been increasingly happening in the past few years; and it doesn't cost cities or counties any money for the properties they are acquiring. This became obvious to me about a year ago when we started to hear about code liens for substantial sums that were not being negotiated to reasonable levels.

Prior to this time, almost all cities and counties would discount outstanding liens from 5% to 10% of their total amount. If the lien was for construction work that was done improperly, the liens were negotiated and paid prior to the investor buying the property. Personally, we had \$200,000 lines reduced to \$10,000 and a \$168,000 lien reduced to \$167. Some city or county managers or

commissioners were blatantly obnoxious and would not reduce some liens at all, but they were the exception until recently.

There are a couple types of code violations that account for 99% of the problems that an investor will generally see. The first is where there is a safety issue because of not doing construction work to current code requirements. Unfortunately, these code requirements can change during the actual construction or enforced differently by different code enforcement officers. What has actually happened in the wake of some of the hurricanes is the property's construction was started with permits that fell under the existing code but the code changed and the final installation or construction had to be changed to meet the new requirements.

The second type of very prominent issue is uncut grass, lack of maintenance of the property, or "stuff" in the yard like abandoned cars. Often these problems are fixed (cured) and the homeowner forgets to call the code officer. The problem escalates in the cities computer elevating itself to a daily fine after a hearing before a special magistrate. The homeowner may never be aware this process is depleting the equity in his property at the rate of \$50 to \$1,000 a day!

Another common problem is where a contractor or homeowner pulls a permit to do work, does the works (properly or not) but fails to close out the permit by having an inspection by a code officer. When the homeowner gets ready to sell his property years later, he finds out he has an open permit that has to be closed – sometimes the work must be redone because of code changes. Worse yet, some contractors file a mechanic's lien on a property they will be doing work, often before the work starts. They do this to make sure they will get paid which greatly reduces the homeowner's negotiating power at the end of the job.

Since the sub-prime crisis, the number of bank-owned properties (REOs) has skyrocketed. The vacant properties are at the epicenter of code violations. Many of these violations are because of the lenders' lack of maintenance of the properties, but they can also be from homeowners who rehabbed their properties without permits. Seldom are these "Do It Yourself" rehabs done up to code, so when an inspection is done on the property by a perspective buyer, a formerly 2 bedroom, 2 bathroom suddenly has become a four bedroom, four bath home – without adding any additional square footage. Very often garages and carports are converted into illegal bedrooms – just watch for stairs or a large step-down into another room to find this out the hard way.

Cities are benefiting more and more by land banking these properties by not negotiating with the banks who own these REO properties. The city commissioners and code officials flatly state that the lenders have caused the blight in their cities because of their loan practices and related foreclosure actions. Consequently, an investor can call the head of the building department and ask how much he can expect to have the huge property lien reduced.

Usually, after a small tirade about the bank not taking care of the property, the code officer or commissioner will say, "We will generally reduce it to 10% (or 5%) of the full amount – but no promise, nothing in writing, and we will only consider it after you (investor) close on the property."

An investor has a few choices, the first being to take a chance and close and see what happens. If he is wrong and the department head changes his mind, and the commissioner(s) say "No" to a fine reduction, the investor has likely just ended his real estate investing career. His other option is to pass on the purchase and let the bank take care of it. The bank will send their attorney begging to the special magistrate, department head, or the city commission and plead that the bank has an investor buyer who will bring the property back to its original glory.

Here the land banking opportunity comes to the city – by saying "No" to a lien reduction, the only economical option for the bank is to give the property to the city! There is at least one city locally that has made it a focus of their staff and commissioners to get properties back from banks and investors by not reducing liens. They then demolish the building on the property and go after the current owner to pay the demo costs. They have openly stated they are looking to revitalize the areas they are focused on but more likely, the cities will end up selling these consolidated parcels to investors and give them special tax breaks and even loans to do new development.

For the homeowners and holdouts who just want to live in peace, the cities have the eminent domain card to take the homes of the last few remaining homeowners so the project can move forward unobstructed by residents. As investors should this really matter to us? Only if you are buying and holding rental properties in these areas and you see it happening all around you; or if you decide to take the chance and see what the lien reductions will be when you get title to the property.

I have had success with the city officials saying to them, "If I close on the property with the lien in place, the bank gets off scot-free. Why not make them pay the reduced fines at the closing instead of me so I can put more money in the rehab of the home?" If the city's motive is not to land bank the property, they will give the bank a reduced payoff for the closing.