

**The Urban Foreclosure Crisis, Eminent Domain and Blight Designations
Under N.J. Stat. Ann. § 40A:12A-5: An Analytic Memo**

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I. Topic Question

Faced with a growing crisis of homeowner residents whose properties are “underwater” or already in foreclosure, many cities around the United States have explored the possibility of expediting mortgage principal write-downs through the extraordinary exercise of eminent domain.¹ As of this writing, no city has actually followed through, and one, Richmond, California, has already been sued.² Several cities in New Jersey are contemplating the use of redevelopment law as the only available local power to stabilize their tax bases and bring relief to homeowners. This legal memorandum explores the threshold question: **Can the problem of foreclosure patterns satisfy the requirements of a “blight” designation under N.J. Stat. Ann. § 40A:12A-5?**³ Several statutory criteria may apply. We analyze the most applicable here

¹ See, e.g., *Eminent Domain as a Tool for Underwater Mortgages*, EFFICIENTGOV.COM (February 5, 2014), <http://efficientgov.com/blog/2014/02/05/eminent-domain-tool-underwater-mortgages/> (describing Richmond, California’s efforts to pass an eminent domain plan); Terrence Dopp, *Newark Advances Eminent Domain Plan to Slow Foreclosures*, BLOOMBERG.COM (Dec 5, 2013, 1:59 PM), <http://www.bloomberg.com/news/2013-12-05/newark-advances-eminent-domain-plan-to-slow-foreclosures.html>; Eunice Lee, *Irvington considering eminent domain to stem foreclosure crisis*, NJ.COM (Updated November 16, 2013, 4:12 PM), http://www.nj.com/essex/index.ssf/2013/11/leaders_in_irvington_announce_plans_to_use_eminent_domain_to_stem_foreclosure_crisis.html; Christina Mlynski, *North Las Vegas Closer to Using Eminent Domain for Underwater Mortgages*, HOUSINGWIRE.COM (June 20, 2013, 10:45 AM) <http://www.housingwire.com/articles/north-las-vegas-closer-using-eminent-domain-underwater-mortgages>.

² See Complaint, Wells Fargo Bank, Nat’l Assoc. v. City of Richmond, California (No. 13-03663) (N.D. Cal. filed Aug. 7, 2013); Complaint, Bank of New York Mellon v. City of Richmond, California (No. 13-03664) (N.D. Cal. filed Aug. 7, 2013).

³ See *BMIA, LLC v. Planning Bd. of Belmar*, No. A-5974-05T5, 2008 NJ. Super. Unpub. LEXIS 1653, at *9 (App. Div. Feb. 4, 2008) (“[T]he terms ‘blighted area,’ as used in [the New Jersey Constitution] and ‘in need of redevelopment,’ as used in [§ 40A:12A-5], are synonymous.”).

to determine whether independently or in the aggregate, the existence of mortgage security collective action problems, underwater mortgages, and properties at serious risk of foreclosure give rise to the conditions required for blight designation.

II. Brief Answer/Recommendation

No New Jersey court has ever addressed the particular issue of foreclosure and blight designations, thus leaving no clear answer. Our analysis suggests that two of the eight disjunctive statutory criteria most closely address the factual problem—N. J. Stat. Ann. § 40A:12A-5(d), which concerns deteriorating physical conditions of property; and (e) which concerns problems made acute by diverse ownership.

The legislature probably did not anticipate using blight designation and eminent domain to remedy a mortgage collective action problem. A reviewing court, therefore, would likely hesitate to interpret loosely a statute that the New Jersey Supreme Court recently restricted in scope. Nevertheless, a comprehensive and sophisticated record of evidence to substantiate a designation of blight has almost always been well received, even in novel circumstances. As a policy matter, eminent domain is particularly suitable to preventing “ghetto” conditions.

Therefore, considering that New Jersey redevelopment law prioritizes remedying the general needs of broad geographic areas as opposed to isolated instances, and given the statute’s long-standing goal to eliminate neighborhood slum conditions, a court is more likely to uphold a blight designation if the targeted conditions must be remedied to further a broader redevelopment plan aimed at reducing the spread of ghetto neighborhood conditions.

III. Background

In the context of a nationwide recession,⁴ decimation of the housing market is unprecedented and sets the most recent credit bubble apart from previous economic crises.⁵ “This suggests something very different, and something indeed very worrying, has recently been afoot,” and it is therefore critical to examine this unique problem in the housing market as more than a mere symptom of today’s recession.⁶

From 2006 to 2012, housing prices fell nationally to 26.4%, a figure that fails to properly represent the severity in areas most affected.⁷ While home equity values fell, debt obligations contracted during the housing bubble have remained fixed; now almost eleven million mortgaged homes are “underwater.”⁸ An underwater mortgage describes the circumstance in which the secured property—in this case, a home—is valued less than the amount of money the

⁴ See DANIEL ALPERT, ROBERT HOCKETT & NOURIEL ROUBINI, *THE WAY FORWARD: MOVING FROM THE POST-BUBBLE, POST-BUST ECONOMY TO RENEWED GROWTH AND COMPETITIVENESS* 1-8 (2011) [hereinafter *THE WAY FORWARD*] (contextualizing U.S. economic struggles within the global economic context), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1987139.

⁵ *Id.* at 8-9 (“Never before has the U.S. seen a decadal, or indeed anywhere near a decade of, retreat in household net worth. Not during the oil crisis of the 1970s, not after the Lesser Credit Bubble, and not after the internet bubble.”).

⁶ *Id.* at 8.

⁷ See ROBERT HOCKETT, *ACCIDENTAL SUICIDE PACTS AND CREDITOR COLLECTIVE ACTION PROBLEMS: THE MORTGAGE MESS, THE DEADWEIGHT LOSS, AND HOW TO GET THE VALUE BACK* 55 (2013) [hereinafter *ACCIDENTAL SUICIDE PACTS*] (“In Nevada, for example, house prices remain 51.6% below their 2006 peak levels.”), *available at* <http://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=2172&context=facpub>; *see also id.* at 55-56 (explaining that the cyclical fluctuations in the housing market are often mistaken as the market “recovering,” and inevitably have dropped each time on the backend of each cycle).

⁸ *Id.* at 57 (Citing *Strengthening the Housing Market and Minimizing Losses to Taxpayers: Hearing Before the S. Subcomm. on Hous., Transp. And Tmt. Dev.*, 112th Cong. 1 (2012)).

homeowner borrowed to purchase the property.⁹ Today, eleven million constitutes almost a quarter of all homes in the United States that secure outstanding mortgages.¹⁰

The debt overhang in the housing sector has since stabilized and even made “modest progress in reducing its overall indebtedness.”¹¹ Yet given the already vulnerable resident population, potential further devaluation of real properties remains a significant risk.¹² “Mass foreclosures and expected foreclosures further depress home prices, which further depress consumer expenditures, which further depress employment and income, which further heighten the incident of default and foreclosure, which further depress home prices—and so on”¹³ “Our foreclosure crisis, then, bad enough already, is prone to continued self-worsening.”¹⁴ More underwater mortgages go delinquent with each passing day, and when the properties are inevitably liquidated, they are inserted into a backlog of properties for sale.¹⁵

A. The Collective Action Problem

Professor Robert Hockett, a faculty member at Cornell Law School with expertise in finance and economics, has spearheaded the effort to recognize the significance of underwater

⁹ ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 57.

¹⁰ ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 57.

¹¹ THE WAY FORWARD, *supra* note 4, at 10.

¹² See THE WAY FORWARD, *supra* note 4, at 10 (“Indeed, we are still in the early middle innings of what will be a multi-year debt-delevering process. Housing prices and other asset values are still adjusting to the new economic realities, and could fall further if the economy falters yet again and unemployment increases yet more.”).

¹³ ROBERT HOCKETT, BREAKING THE MORTGAGE DEBT IMPASSE: MUNICIPAL CONDEMNATION PROCEEDINGS AND PUBLIC/PRIVATE PARTNERSHIPS FOR MORTGAGE LOAN MODIFICATION, VALUE PRESERVATION, AND LOCAL ECONOMIC RECOVERY 14 (2012) [hereinafter BREAKING THE MORTGAGE DEBT IMPASSE], *available at* <http://www.lawschool.cornell.edu/spotlights/upload/Memorandum-of-Law-and-Finance-21-April-Municipal-Plan.pdf>.

¹⁴ *Id.* at 14.

¹⁵ See ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 57.

mortgages and has engineered possible remedies.¹⁶ He argues that action must be taken because “[h]ome prices are *not* going to rise back to pre-crisis, boom-period levels” because those prices were fueled by excess credit and thus artificially overvalued.¹⁷ He then identifies only two “conceivable options for ending the ongoing crisis”: (1) “restart and resume the bubble itself”; or (2) “revalue assets and liabilities formally [and] [r]eflate the bubble” by writing down the principal.¹⁸ Only the second is possible and desirable.¹⁹

Writing down principal is not only the logical solution to this particular problem, Hockett argues, but the only economically-rational response to loans at high risk of default.²⁰ Lowering the principal makes it more likely that the borrower will be able to pay at least some of the loan back.²¹ As a result, banks have already been writing down principals for loans held in bank portfolios—where a bank is the sole entity that owns the debt and retains rights to collect upon that debt.²²

The problem, however, exists with loans held in securitized trusts where mortgages have been fragmented and sold to various entities that now hold the right to collect on their piece of the loan.²³ This fragmentation of ownership makes it impossible for the various creditors to find

¹⁶ See Robert C. Hockett Professor of Law: Professional Biography, CORNELL UNIVERSITY LAW SCHOOL (last visited Feb. 13, 2014),

http://www.lawschool.cornell.edu/faculty/bio_robert_hockett.cfm.

¹⁷ BREAKING THE MORTGAGE DEBT IMPASSE, *supra* note 13, at 15.

¹⁸ BREAKING THE MORTGAGE DEBT IMPASSE, *supra* note 13, at 15-16.

¹⁹ BREAKING THE MORTGAGE DEBT IMPASSE, *supra* note 13, at 16.

²⁰ See ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 61.

²¹ See ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 61.

²² See ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 61.

²³ See Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121, 139 (2012) [hereinafter *It Takes a Village*].

each other, let alone coordinate principal write-downs.²⁴ Logistically, banks were therefore typically vested with centralized authority to collect loan payments from the borrower under pooling and servicing agreements (“PSAs”).²⁵ In light of the housing bubble, the contracting parties usually prohibited or limited in significant fashion—by way of supermajority consent requirements—servicers from modifying the loans.²⁶ And because no one foresaw the impending housing market collapse, the PSAs were structured in a manner that would deliver greater profits to bank-servicers when a borrower defaulted, than if it were to restructure the loan.²⁷

Another problem that Professor Hockett highlights is that underwater homes typically involve second liens that secure home equity lines of credit (“HELOCs”), which borrowers used to “supplement stagnating incomes during the housing boom years.”²⁸ In these circumstances, the first lienholders, the fragmented creditors, have a priority over second lienholders to recoup if the property were to be liquidated.²⁹ In practice, however, until homeowners must involuntarily liquidate all assets, they tend to use their assets towards paying off the HELOCs first, because not paying would have significant credit implications.³⁰ This means that if first lienholders lower their principals, the savings will be used to pay off second lienholders. First lienholders, therefore, will not write-down principals unless second lienholders also write down principals.

²⁴ *Id.* at 139 (stating that this is probably “hundreds of thousands of people); *see id.* at 149 (“if not indeed millions, of dispersed interested parties”); *see also id.* at 139 (“And this is not even to mention the fact that each pool holds multiple loans, each distinct one of which would have to be dealt with, in the event of impending insolvency, by the fragmented and fragmented-interest-holding creditors.”).

²⁵ *Id.* at 139.

²⁶ *Id.* at 140.

²⁷ *See id.* at 140.

²⁸ ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 62.

²⁹ *See* ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 62-63.

³⁰ *See* ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 62-63.

Oddly enough, the HELOC-lenders are typically composed of the servicer-banks, creating a conflict of interest.³¹

B. Professor Hockett's Proposal

To remedy what Professor Hockett has anointed as a collective action problem, he proposes that municipalities use eminent domain powers to seize mortgages and write-down the principles.³² Eminent domain allows governments to seize private property in exchange for “just” compensation as long as certain federal and state law requirements are met.³³ Aside from substantive constitutional issues, the greatest logistical problem is financing—finding money that could be used as fair compensation for the seizures.³⁴

Professor Hockett engineered the following proposal: (1) municipalities can partner with private investment firms, who would finance the project hoping to profit from the principal write-downs that would restore value to loans originally doomed to default; (2) municipalities would then write-down the loans and either transfer them to original investors to sell for profit or merely distribute to them the proceeds.³⁵ Ideally, Hockett argues, the original creditors would partake in partnering with the municipalities such that profits may complement the “just compensation” to soften the uninvited seizure.³⁶

While the legality of this project could turn on a number of requirements for an eminent domain taking, this piece focuses solely on the public purpose prong under New Jersey state law.³⁷ In New Jersey, if a municipality wishes to execute a taking under eminent domain law for

³¹ *It Takes a Village*, *supra* note 23, at 142.

³² ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 69.

³³ See ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 69.

³⁴ See ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 70 (“given that states and their subdivisions are even more strapped for cash these days than the federal government”).

³⁵ See ACCIDENTAL SUICIDE PACTS, *supra* note 7, at 70; *It Takes a Village*, *supra* note 23, at 152.

³⁶ *It Takes a Village*, *supra* note 23, at 152-153.

³⁷ See *It Takes a Village*, *supra* note 23, at 167.

the purposes of redevelopment, it must first designate the area to be “blighted.”³⁸ Considering recent significant changes in New Jersey’s requirements for blight designation, testing this unique proposal under the law may produce valuable insight applicable to future innovation in redevelopment and municipal remedies in times of economic crisis.

IV. Discussion

A municipality’s decision to designate an area as blighted under N.J. Stat. Ann. § 40A:12A-5 carries a “presumption of validity.”³⁹ Adverse parties, therefore, “ha[ve] the burden of overcoming that presumption and demonstrating that the blight determination was not supported by substantial evidence.”⁴⁰ “Although the Blighted Areas Clause in the New Jersey Constitution undoubtedly enlarges the Legislature’s eminent domain power to include the taking of private property for redevelopment purposes, the Judiciary is the final arbiter of the institutional commissions articulated in the Constitution.”⁴¹ Thus, “[t]he clause operates as both a grant and limit on the State’s redevelopment theory.”⁴²

Recently, in *Gallenthin Realty Development, Inc. v. Borough of Paulsboro*, the New Jersey Supreme Court restricted the once broad reading of § 40A:12A-5, and established the threshold at which an area may be considered blighted.⁴³ The Court held that each of the conditions that constitute an area eligible for “in-need-of-redevelopment” designation cannot exceed the traditional definition of “blight” as intended in the New Jersey Constitution.⁴⁴ In large

³⁸ See N.J. Stat. Ann. § 40A:12A-5.

³⁹ *Levin v. Twp. Comm. of Bridgewater*, 57 N.J. 506, 537 (1971).

⁴⁰ *Id.* at 538.

⁴¹ *Gallenthin Realty Dev., Inc. v. Borough of Paulsboro*, 191 N.J. 344, 358 (2007).

⁴² *Id.* at 359.

⁴³ See 191 N.J. at 348 (holding that “where the sole basis for redevelopment is that the property is ‘not fully productive’” § 40A:12A-5 has not been satisfied).

⁴⁴ See N.J. Const. art. III, § 3; see also *Gallenthin*, 191 N.J. at 361 (defining blight as “deterioration or stagnation that negatively affects surrounding areas”).

part, this meant that the conditions alleged must affect the surrounding properties as the framers of the statute and New Jersey Constitution had intended.⁴⁵ For the purposes of testing the legality of Professor Hockett’s proposal, this Memorandum finds two subsection of § 40A:12A-5—(d) and (e)—most relevant. § 40A:12A-5(d) outlines effects of general disinvestment one would expect in areas of concentrated foreclosures or risks of foreclosures, and § 40A:12A-5(e) outlines circumstances in which complex ownership issues preclude private development and maintenance due to logistical issues.⁴⁶

A. Whether Underwater Mortgages can Satisfy the Conditions Set Forth in N.J. Stat. Ann. § 40A:12A-5(d)

Section 40A:12A-5 states: “[a] delineated area may be determined to be in need of redevelopment if, after investigation, notice and hearing . . . , the governing body of the municipality by resolution concludes that within the delineated area any of the following conditions is found” The statute then provides eight sets of conditions—subsections (a) through (h)—that independently constitute an area in need of redevelopment. Here, the issue is whether geographically concentrated underwater mortgages, risk of foreclosure, or mortgage collective action problems can satisfy § 40A:12A-5(d) (“Subsection (d)”) or § 40A:12A-5(e) (“Subsection (e)”), or the two in combination.

Subsection (d) states:

(d) Areas with buildings or improvements which, by reason of dilapidation, obsolescence, overcrowding, faulty arrangement or design, lack of ventilation,

⁴⁵ See *Gallenthin*, 191 N.J. at 362-63.

⁴⁶ The remaining Subsections are either inapplicable or only tangentially relevant: Subsection (a) primarily deals with conditions giving rise to safety and sanitation concerns; Subsection (b) refers to conditions in commercial, manufacturing and industrial buildings; Subsection (c) concerns lots not owned by private residents and vacant lots; and Subsections (g) and (h) apply only to specialized circumstances irrelevant to the mortgage collective action problem. See N.J. Stat. Ann. § 40A:12A-5(a)-(h).

light and sanitary facilities, excessive land coverage deleterious land use or obsolete layout, or any combination of these or other factors

Whether underwater mortgages can satisfy Subsection (d) is highly contingent on whether the particular underwater mortgages produce the conditions outlined in Subsection (d). Most likely, a municipality will have to prove that underwater mortgages lead to foreclosures, and that foreclosures in that particular area have caused the buildings to become “dilapidated” or “obsolete.” Successful blight designation, therefore, may then depend on the number of properties already foreclosed and whether foreclosure is imminent for properties associated with underwater mortgages.

In support of a blight designation under Subsection (d), a municipality must conduct a fact intensive investigation and produce a comprehensive and sophisticated record of relevant findings.⁴⁷ The report would ideally include both exterior and interior inspections of buildings, block by block, consisting of detailed written reports and photographic exhibits.⁴⁸ If possible, the municipality should identify a diverse aggregate of conditions that support blight designation, perhaps employing a variety of experts or resources when conducting the investigation.⁴⁹ Every building need not be inspected, but enough such that the area as a whole can be deemed to share general characteristics of blight.⁵⁰

⁴⁷ See *Gallenthin*, 191 N.J. at 373 (stating that the evidence put forth by the municipality in support of a blight designation must “contain[] more than a bland recitation of applicable statutory criteria and declaration that those criteria are met”).

⁴⁸ See, e.g., *Suburban Jewelers, Inc. v. City of Plainfield*, No. A-3590-08T1, 2010 N.J. Super. Unpub. LEXIS 992, at *26 (App. Div. May 6, 2010) (finding municipality’s evidence sufficient because, among other reasons, it contained detailed reports of the specific relevant conditions).

⁴⁹ See *id.* (upholding the blight designation because the report, among other reasons, reported on a variety of conditions, including crime, tax assessments, building permits, construction codes, and others).

⁵⁰ See *Forbes v. Bd. of Trustees of Twp. of South Orange Village*, 312 N.J. Super. 519, 531 (App. Div. 1998) (“[N]ot every property within the redevelopment area must be shown to be itself substandard”).

Additionally, conditions of blight must “exceed cosmetic deficiencies,”⁵¹ which, if only temporary, may not warrant blight designation.⁵² The collective action problem at issue arises primarily from servicing agreements executed before the housing market collapse.⁵³ Because subsequent servicing contracts have resolved the problem going forward, the issue at hand may therefore be “phasing out.”⁵⁴ To succeed, therefore, a municipality would have to prove that the conditions arising from the collective action are more permanent and that they have triggered an “economic domino effect” that “devastat[e] surrounding properties.”⁵⁵

B. Whether the Mortgage Collective Action Problem can Satisfy the Conditions Set Forth in N.J. Stat. Ann. § 40A:12A-5(e)

The second relevant provision, Subsection (e), alternatively provides:

A growing lack or total lack of proper utilization of areas caused by the condition of the title, diverse ownership of the real properties therein or other similar conditions which impede land assemblage or discourage the undertaking of improvements, resulting in a stagnant and unproductive condition of land potentially useful and valuable for contributing to and serving the public health, safety and welfare

⁵¹ *Suburban Jewelers*, 2010 N.J. Super. Unpub. LEXIS at *17; *see, e.g., id.* at 16-17 (finding that poor layout, public safety issues, improper infrastructure, and poor lighting, in the aggregate, exceed merely cosmetic problems).

⁵² *See Land Plus, LLC v. Mayor & Council of Hackensack*, No. A-1276-07T3, 2008 N.J. Super. Unpub. LEXIS 1888, at *8 (App. Div. Oct. 10, 2008) (finding the presence of trailers, heavy equipment, and dirt to be a temporary condition and thus insufficient to support a blight designation).

⁵³ *See Complaint ¶¶ 53,56, Wells Fargo Bank, Nat’l Ass’n v. City of Richmond*, (No. 13-03663) (N.D. Cal. filed Aug. 7, 2013).

⁵⁴ *See id.*

⁵⁵ *Gallenthin*, 191 N.J. at 362 (outlining legislative history to determine that this “economic domino effect” was the “particular phenomenon” with which framers of the Blighted Areas Clause were most concerned).

“The phrase ‘other conditions’ is not a universal catch-all that refers to any eventuality. Rather, it refers to circumstances of the same or like piece as conditions of title or diverse ownership.”⁵⁶ The New Jersey Supreme Court determined that Subsection (e) applies “in circumstances where the orderly development of a particular area is frustrated by its peculiar configuration. That is . . . areas that for a variety of reasons—such as diversity of ownership and conditions of title—were not susceptible to unified development.”⁵⁷ The core impediment intended to be remedied in Subsection (e), therefore, is the inability to coordinate uniform effort due to multiplicity in ownership—akin to the present collective action problem.

In one case, “the Legislature most likely intended the term ‘diverse ownership’ to cover only individual parcels with convoluted ownership.”⁵⁸ An alternative reading would be that “the Legislature intended [to include the] pattern of individual lot ownership which typifies residential neighborhoods.”⁵⁹ This second reading, however, could not have been the intended interpretation given its overly broad implications.

For instance, in *Citizens in Action v. Twp. of Mt. Holly*, the Appellate Division adopted the second, more expansive approach, arguing that diverse ownership throughout the neighborhood “led to maintenance issues between homes because one home’s deleterious state affected those houses in the block surrounding that house.”⁶⁰ The court argued that the maintenance issues, in conjunction with having only absentee landlords who rent out buildings and a lack of a unifying homeowner’s association, was sufficient to satisfy Subsection (e).⁶¹

⁵⁶ *Id.* at 368.

⁵⁷ *Gallenthin*, 191 N.J. at 368-69.

⁵⁸ *City of Long Branch v. Anzalone*, No. A-0067-06T2, 2008 N.J. Super. Unpub. LEXIS 2204, at *58-59 (App. Div. Aug. 7, 2008).

⁵⁹ *Id.* at *59.

⁶⁰ No. A-1099-05T3, 2007 N.J. Super. Unpub. LEXIS 1437, at *37 (App. Div. July 5, 2007).

⁶¹ *See id.* at *37.

A subsequent case, however, recognized that the *Mt. Holly* reading would subject almost all neighborhoods to “unnecessary redevelopment, notwithstanding the absence of any indication that the Legislature imagined that pattern to be either a cause of blight or a symptom of it.”⁶² Immediately prior to the *Mt. Holly* case, the New Jersey Supreme Court in *Gallenthin* pointed out that Subsection (e) could not be constitutionally construed to “encompass[] . . . most property in the State.”⁶³ The approach in *Mt. Holly*, therefore, was probably a premature and incomplete attempt to incorporate *Gallenthin* into existing eminent domain case law.⁶⁴

Thus, the facts of Professor Hockett’s proposal to seize mortgages suffering from collective action problems seems consistent with the spirit and original intent of Subsection (e). The collective action problem here is composed of individual mortgages burdened by convoluted ownership among multiple creditors. Assuming, therefore, that writing down mortgages constitutes “redevelopment,” the mortgage security collective action problem is among the impediments to uniform redevelopment that Subsection (e) seeks to remedy.

There are, however, two issues that the statute may not have been written to anticipate: 1) case law is limited to scenarios where issues of diverse ownership or title concerned the particular physical real estate property as opposed to a connected abstract property interest, such as a mortgage; and 2) writing down a mortgage principal may not be within the scope of “redevelopment” when trying to designate an area as “in need of redevelopment.”

As to the first issue, the statute would likely permit convoluted title of mortgages to satisfy the stated conditions. Although under Subsection (e), “[t]he phrase ‘other conditions’ is

⁶² *Anzalone*, 2008 N.J. Super. Unpub. LEXIS at *59.

⁶³ 191 N.J. at 365.

⁶⁴ *See also Mt. Holly*, 2007 N.J. Super. Unpub. LEXIS 1437 (upholding a blight designation without analyzing the area’s impact on the surrounding community, thus further demonstrating its incomplete understanding of *Gallenthin*).

not a universal catch-all . . . [,] it refers to circumstances of the same or like piece as conditions of title or diverse ownership.”⁶⁵ Therefore an issue of mortgage ownership, which is intimately tied to the ownership of real property, is likely to suffice.

The second issue, however, presents a greater impediment. The legality of the project may hinge on whether a writing-down of mortgage principals constitutes “redevelopment.” § 40A:12A-3 defines “redevelopment” as the “clearance, replanning, development and redevelopment; the conservation and rehabilitation of any structure or improvement, the construction and provision for construction of residential, commercial, industrial, public or other structures and the grant or dedication of spaces” The repeated emphasis on brick and mortar development seems to indicate that mortgage principal write-downs are an insufficient and improper motive for blight designation.

Section 40A:12A-5 represents the “public purpose” prong of an eminent domain analysis. The problem, therefore, is that although abstract issues of title may constitute blight, the Legislature may not have contemplated using the designation for the purpose of merely altering the financing agreements behind real properties.

Yet, Subsection (e) reads, “diverse ownership of the real properties therein” In § 40A:12A-3, the Legislature defines “real property” to include “every estate, interest and right, legal or equitable, therein, including terms for years and liens by way of judgment, *mortgage* or otherwise, and indebtedness secured by such liens.”⁶⁶ The New Jersey Supreme Court in *Town of Kearny v. Discount City of Old Bridge, Inc.*, applied this definition of “real property” to infer

⁶⁵ *Gallenthin*, 191 N.J. at 368.

⁶⁶ (Emphasis added).

that the Legislature had intended to include the taking of intangible property interests.⁶⁷ It may be appropriate, therefore, to similarly deduce that if the Legislature intended for an intangible issue of ownership to constitute blight, it permits a corresponding intangible remedy.⁶⁸

Moreover, the Court has traditionally been more deferential with *how* an area is redeveloped as opposed to *what* is redeveloped.⁶⁹ For instance, as opposed to blight designation, which must overcome the “substantial evidence” standard, a redevelopment plan will be upheld unless it is “arbitrary or capricious, contrary to law, or unconstitutional.”⁷⁰ Because whether writing down a mortgage principal is likely a question of *how* redevelopment is executed as opposed to *what* is designated as blighted, the court may afford the municipality greater deference to interpret the write-down of mortgage principals as “redevelopment.”⁷¹

C. Proving the Effect on the Surrounding Community under Both Subsections (d) and (e) Under *Gallethin* and the Substantial Evidence Standard—A Recommendation

Among the most significant holdings in *Gallenthin* was the heightening of the substantial evidence standard. Because the constitutional definition of blight requires as a threshold the characteristic of affecting surrounding areas, a blight designation requires the municipality to

⁶⁷ 205 N.J. 386, 405 (2009) (finding that the Legislature had “anticipate[d] a situation in which a leasehold or an easement is the only condemned property interest”).

⁶⁸ It may also be that taking of intangible property interests was intended only when integral to a larger redevelopment plan.

⁶⁹ *See, e.g.*, *Lyons v. City of Camden*, 52 N.J. 89, 98 (1968) (“It is not for the courts to oversee the choice of the boundary line.” (quoting *Berman v. Parker*, 348 U.S. 26, 35-36 (1954))); *Maglies v. Planning Bd. of the Twp. of East Brunswick*, 414 A.2d 570, 571 (App. Div. 1980) (“[T]he municipality generally has the discretion to determine the size of the blighted area.”).

⁷⁰ *Powerhouse Arts Dist. Neighborhood Ass’n v. City Council*, 413 N.J. Super. 322, 332 (App. Div. 2010) (quoting *Downtown Residents for Sane Dev. v. City of Hoboken*, 242 N.J. Super. 329, 332 (App. Div. 1990)).

⁷¹ Nevertheless, the statutory definition of “redevelopment” unambiguously omits mention of intangible property interests and a court may be uncomfortable loosely interpreting a subsection that has recently been restricted in scope in *Gallenthin*—albeit for different reasons.

prove that effect.⁷² Subsection (d) and Subsection (e) embody this heightened component. Subsection (d) states that the conditions stated must be shown to be “detrimental to the safety, health, morals, or welfare of the community.”⁷³ Similarly, yet in slightly different fashion, Subsection (e) states that the conditions stated must be shown to be “detrimental to the safety, health, morals, or welfare of the *surrounding area* or the community *in general*.”⁷⁴

1. The Substantial Evidence Standard

“[Section 40A:12A-5] explicitly conditions the validity of [a blight] designation on whether it is ‘supported by substantial evidence.’”⁷⁵ “A city’s decision that a particular area is ‘blighted’ is ‘invested with a presumption of validity.’”⁷⁶ “Challengers have ‘the burden of overcoming that presumption and demonstrating that the blight determination was not supported by substantial evidence.’”⁷⁷

The municipality, however, must make an initial showing of substantial evidence that “contains more than a bland recitation of applicable statutory criteria and a declaration that those criteria are met.”⁷⁸ Similarly, evidence is not “substantial” if it consists merely of the “net opinion[s] of [] expert[s].”⁷⁹ Cases have often been dismissed because the municipality failed to provide sufficient data tying the conditions outlined in the statute to negative impacts on the

⁷² *Gallenthin*, 191 N.J. 363.

⁷³ § 40A:12A-5(d).

⁷⁴ § 40A:12A-5(e) (emphasis added).

⁷⁵ *Powerhouse Arts Dist. Neighborhood Ass’n*, 413 N.J. Super. at 332.

⁷⁶ *Anzalone*, 2008 N.J. Super. Unpub. LEXIS at *47 (quoting *Levin*, 57 N.J. at 537).

⁷⁷ *Anzalone*, 2008 N.J. Super. Unpub. LEXIS at *47-48 (quoting *Levin*, 57 N.J. at 537).

⁷⁸ *Gallenthin*, 191 N.J. at 373.

⁷⁹ *Id.*

surrounding community.⁸⁰ § 40A:12A-5 functions, therefore, both as a substantive threshold and as a procedural gatekeeping mechanism.

2. *Recommended Approaches*

The statute demands an investigation and subsequent report containing specific factual data relevant to the conditions outlined in § 40A:12A-5. Simple one-to-one causation theories have often failed to satisfy the courts' expectation for a multifaceted problem remediable only through extreme recourse. Accordingly, a theory of blight that hinges on only one of the conditions under § 40A:12A-5 may suggest that the municipality's investigation lacked the comprehensiveness and sophistication required to merit deference by courts.⁸¹

Similarly, identifying only one impact on the surrounding community is probably yet another indication of insufficient inquiry. For instance, the impact on a town's tax base: "[e]ven though redevelopment would be expected to result in higher property tax payments and more spending for local businesses, the difference between the actual level of economic activity in the redevelopment area and the level that might be achieved after its transformation does not by itself amount to blight."⁸² Rather, a court is more likely to uphold a blight designation when shown a variety of relevant conditions that negatively affect the community in numerous ways.⁸³

⁸⁰ See, e.g., *Cottage Emporium, Inc. v. Broadway Arts Ctr., LLC*, No. A-0048-07T2, 2010 N.J. Super. Unpub. LEXIS 835, at *42 (App. Div. April 16, 2010) (finding that merely arguing that certain conditions "created a 'negative image'" on the community was insufficient without detailed evidentiary support); *BMIA, LLC*, 2008 N.J. Super. Unpub. LEXIS at *11 (finding evidence regarding the unproductivity of an area insufficient absent data of its impact on the surrounding area).

⁸¹ See, e.g., *Gallenthin*, 191 N.J. at 348 (finding blight designation improper where, among other things, the "sole basis for redevelopment [was] that the property is 'not fully productive'").

⁸² *Anzalone*, 2008 N.J. Super. Unpub. LEXIS at *57.

⁸³ See, e.g., *Suburban Jewelers, Inc.*, 2010 N.J. Super. Unpub. LEXIS at *16-17 (upholding blight designation where municipality offered evidence that the surrounding area was affected by rise in crime, disturbance of traffic flow, and general public safety issues); *Wilson v. Long Branch*, 27 N.J. 360, 392-93 (1958) (finding that a myriad of stagnant conditions, including tax

Especially with “densely developed” inner city locations, a municipality should be able to articulate persuasive impacts that foreclosures have on the surrounding areas.⁸⁴ Significant effects may include the decimation of neighboring property values, the municipality tax base, public health and safety, private investment in the region, and perhaps even a rise in crime.

Moreover, “enough” substantial evidence can sometimes overcome a court’s discomfort with untraditional statutory application. In *Gallenthin*, the New Jersey Supreme Court explicitly upheld *Levin*’s novel expansion of § 40A:12A-5 to encompass “suburban and rural areas,” because the municipality produced substantial evidence that the conditions at issue “negatively affect[ed] surrounding properties.”⁸⁵ Thus, the novelty in construing a mortgage security collective action problem as a symptom of blight can probably be overcome.

Additionally, *Gallenthin* established that Subsection (e) requires municipalities to consider the current beneficial uses of properties before designating the area as blighted.⁸⁶ Here, for example, hypothetical challengers may assert that the mortgage servicing contracts uphold stable lending markets. Perpetuating a preexisting norm, however, is more akin to an articulation of potential harms that may arise—that a taking would harm lending markets—as opposed to affirmative benefits that the agreements independently bear. These arguments speak, therefore, not to whether a blight designation would be proper under Subsection (e), but rather ask a normative question—whether the project is a prudent remedy.

delinquent and foreclosed properties, public safety issues, plumbing problems, and issues of diverse title properly supported a blight designation).

⁸⁴ See *Suburban Jewelers, Inc.*, 2010 N.J. Super. Unpub. LEXIS at *25-26 (“[I]n a densely developed central business district of an older city, it is reasonable to infer that the deleterious conditions would have a decadent effect on surrounding property.”).

⁸⁵ 191 N.J. at 363.

⁸⁶ See *Gallenthin*, 191 N.J. at 371; see also *Suburban Jewelers, Inc.*, 2010 N.J. Super. Unpub. LEXIS at *27 (finding that Subsection (d) does not require weighing the current beneficial uses).

A final means to strengthen a municipality's blight designation would be to relate the project to a larger plan that involves other conditions of blight and other methods of redevelopment. The court has shown tremendous deference to the idea that redevelopment requires prioritizing the needs of a broader area, often forfeiting strict application of the law regarding relatively minor property interests.⁸⁷ Therefore, if writing down mortgage principals was integral to a broader redevelopment plan supported by independent justifications for blight designation, a court would likely afford this project significant deference.

⁸⁷ See *Wilson*, 27 N.J. at 379 (finding the setting of boundary lines of a blighted area to be within the discretion of the Legislature even when "an area includes some sound homes or buildings . . . which are not substandard").