PREFERENCE LIENS FOR THE COSTS OF REPAIRING SLUM PROPERTY

Housing codes set standards for the operation and maintenance of residential housing. Their purpose is to halt deterioration and to insure that conditions dangerous to health and safety do not develop. The great potential of housing codes was recognized by Congress, which made the adoption and enforcement of such codes a prerequisite to participation in the federal urban renewal programs.[1] Housing codes are essentially preventive rather than remedial, and are thus particularly adaptable to the task of preserving urban areas. Housing code enforcement is designed to stimulate expenditure of private funds and thereby supplement expensive public programs. Most important, housing codes are local programs which can be adapted to solve the unique problems in various American urban centers. "Without question, the failure to enact, improve, soundly administer, and *effectively enforce adequate local codes, more than any other single cause,* accounts for the huge tasks of the present urban renewal effort.[2]

Housing code enforcement has been inadequate, as reflected by the frightening increase in blighted areas in recent years.[3] Low wage scales, poorly trained personnel, weak criminal sanctions against violators, scarcity of inspectors, and inspections on a complaint basis only are some of the reasons why enforcement has been ineffective.[4] To overcome these problems

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1. Rhyne, *The Workable Program—A Challenge for Community Improvement,* 25 LAW & CONTEMP. PROB. 685, 686 (1960).

2. Osgood & Zwerner, *Rehabilitation and Conservation,* 25 LAW & CONTEMP. PROB. 705, 719 (1960) (emphasis added).

3. [W]hile 'Boston's urban renewal program has made discernible progress . . . *the rate of renewal activity still is being outstriped by the rate of decay.* . . . 22,000 more dwellings have fallen into the sub-standard category. This is nearly three times the amount of poor housing eliminated in the last ten years.' *What is true in Boston is true in virtually every urban area in the United States.* Leach, *The Federal Urban Renewal Program: A Ten-Year Critique,* 25 LAW & CONTEMP. PROB. 777-78 (1960) (emphasis added).

4. Note, *Enforcement of Municipal Housing Codes,* 78 HARV. L. REV. 801 (1965). In general, enforcement of housing codes has two goals: to bring about correction of violations and to deter would-be violators. Criminal sanctions would appear to be the most effective means of achieving these goals. However, criminal sanctions in the form of fines and imprisonment have failed to accomplish either of these goals with the consistency necessary to arrest and eliminate urban blight.

Imposition of fines raises several problems. First, the size of the fine must be determined by balancing two nearly irreconcilable considerations. On the one hand, the fine must not be so large that it leaves the slum owner no funds with which to finance repairs.

of housing code enforcement two relatively new methods of code enforcement—direct municipal repairs laws and receivership proceedings—are being used by some municipalities.[5]

A receivership law usually provides that when the owner of a building in which there are serious housing code violations refuses to repair the structure in conformity with city regulations, the local housing code commissioner can petition in equity to have the city or a private agent appointed as a receiver for the property.[6] The appointed receiver collects the rents and income from the property, which are used to pay for basic repairs. Thus the court becomes the overseer of the property's rehabilitation under the receivership program. Under a direct municipal repair law, when a recalcitrant landlord refuses, after due notice, to take any steps toward effecting renovation of his property, city housing officials simply contract to have basic repairs made. The costs of these repairs becomes a lien on the property in favor of the city if the owner refuses to pay for them. This program involves no court action, but rather direct municipal action to alleviate slum conditions.

City governments cannot afford to defray the costs of rehabilitating the large amount of slum property present in most urban areas.[7] The expenditures of receivers appointed by courts or of city governments under direct

On the other hand, it must not be so small that it is no real deterrent to future violations. The courts are generally hesitant to impose severe fines on landlords, because, all too often, the accused's property is in no worse condition than are myriad other dwellings in the community. To make an example of one unfortunate property owner who was the victim of sporadic inspection and enforcement procedures is obviously unjust. In addition, both the courts and the community often look upon housing code violations as something less than morally reprehensible. Thus, there is often no public demand for stiff penalties, and only weak ones are imposed as a result. However, even if fines are levied, many slum property owners view them as no more than operating expenses which are much cheaper than repairs. HOUSE COMM. ON SLUM HOUSING AND RENT GOUGING, 74th Ill. Gen. Assembly 3 (Comm. Print 1965). In the Illinois investigation, tenants' complaints—which, at best, elicited only sporadic action by landlords—were found to be the primary impetus for making repairs. Pressure by tenants may, however, be nugatory, since landlords can retaliate against complaining tenants with higher rents or even eviction. Richey, *Tenant Oppression: Our Smoldering Housing Scandal,* 24 ANTIOCH REV. 337, 341 (1964).

5. HOUSE COMM. ON SLUM HOUSING AND RENT GOUGING, *supra* note 4, at 4. The shortcomings of present housing code enforcement are examined in Note, *Enforcement of Municipal Housing Codes,* 78 HARV. L. REV. 801 (1965).

6. A receiver may be public or private. If the receiver is public, the problem of finance is the same as that involved in a direct municipal repair law, since the local municipality must furnish the funds. Often, non-profit corporations serve as private receivers, thus relieving the city of the problem of financing repairs. However, the private receiver must have some assurance that it will be able to recoup its expenditures.

7. There is evidence that many city governments cannot even afford a full staff of inspectors, much less actual repairs. *See* Note, *supra* note 4, at 804-05.

municipal repair laws must be recovered if this type of program is to be successful. If receivers are appointed, the expenses of repair may often exceed the rent return on the property even for long periods. The slow recovery of repair expenses from rental income may cause the property to remain in receivership for an abnormally long time, or may discourage private receivers from investing in the property. A lien on the property, which could be foreclosed if the owner balked at paying for necessary repairs is an obvious solution to the problem. Quite often, however, slum housing is heavily mortgaged,[8] so that any secondary repair lien is practically worthless. Any attempt to foreclose a secondary repair lien would result in the foreclosure of prior mortgages or other liens and leave the city government or receiver without a remedy. Mortgagees and holders of prior liens would have gained a windfall. Hence, any effective slum repair program involving receivership or direct municipal repair necessitates the use of *prior* liens for the rehabilitation expenses. However, if preference is given to slum repair liens, a great number of existing encumbrances will be relegated to subordinate positions. A displaced lienor may have several objections to such subordination.

If a receivership or direct municipal repair law does not give a lienor notice of violations, opportunity to make repairs, or opportunity to show cause why the property should not be placed in the custody of a receiver, the lienor may contend that he has been deprived of his property without due process of law.[9] However, this objection is easily met by including such provisions.[10] The lienor's most significant objection to such a measure will doubtless be that the lien provision violates the impairment of the obligations of contracts clause of the federal constitution.[11] Obviously, prior mortgagees' and lienors' contracts with the owners of slum properties will be impaired by the involuntary subordination of their liens to the lien for slum rehabilitation expenses.[12] If the slum repair liens are found to be an unconstitutional impairment of the obligations of contracts, this objection cannot be overcome without making the repair liens subordinate to existing encumbrances; this would, of course, emasculate any slum repair program of this nature.

8. Gribetz, *New York City's Receivership Law,* 21 J. OF HOUSING 297, 298 (1964).

9. *See* Central Sav. Bank v. City of New York, 279 N.Y. 266, 18 N.E.2d 151 (1938), *opinion amended,* 280 N.Y. 9, 19 N.E.2d 659, *cert. denied,* 306 U.S. 661 (1939).

10. The New York receivership law, N.Y. MULT. DWELL. LAW § 309 (McKinney Supp. 1966), which provides a similar procedure, has been upheld as constitutional. *In re* Department of Bldgs., 14 N.Y.2d 291, 200 N.E.2d 432, 251 N.Y.S.2d 441 (1964).

11. U.S. CONST. art. I, § 10.

12. This was the major objection to a 1937 New York slum repair law declared unconstitutional in Central Sav. Bank v. City of New York 279 N.Y. 266, 18 N.E.2d 151 (1938), *opinion amended,* 208 N.Y. 9, 19 N.E.2d 659, *cert. denied,* 306 U.S. 661 (1939).

This note examines the case law bearing upon the issue of whether preference liens for slum repair costs are a legitimate impairment of the obligations of contracts. First, the possibility of creating a legitimate preference lien for the costs of direct municipal repair of slum housing will be explored. Then, the use of a preference lien receivership program to defray slum repair expenses will be examined.

I. Prior Liens for Costs of Municipal Repair of Slum Dwellings

A. *Central Savings—Its Current Status*

In 1937, the New York legislature reacted to the shortcomings of housing code enforcement with a bold innovation.[13] The measure[14] provided that when the owner of a building with housing code violations which endangered the health and safety of the occupants refused to repair the structure, the local housing commissioner could order that the repairs be made by the city or could let a contract to a private company. The measure's effectiveness was dependent upon a provision that the costs of repairs could be charged as a lien against the property with preference over all prior encumbrances except taxes.[15] In *Adamec v. Post*[16] the law was upheld as constitutional with regard to the property owner. But the provision for a prior lien for the repair costs was struck down in *Central Sav. Bank v. City of New York,*[17] when challenged by the mortgagee of a slum dwelling whose lien on the property arose prior to the passage of the statute. The Appellate Division[18] held that the receivership costs could be imposed as an exercise of state taxation power, since any property tax may interdict existing mortgages without running afoul of the impairment clause. The New York Court of Appeals, however, held that the slum repair measure violated the mortgagee's constitutional guarantee of due process of law and impaired the obligations of his contract with the property owner. The Court of Appeals found that the assessment for municipal repair of a slum dwelling was a police power assessment, not an exercise of taxation power.[19] Taxes must be *in invitum.*[20] The receivership lien was held not *in invitum,* because an

13 *See* 52 Harv. L. Rev. 684 (1939).

14. N.Y. Sess. Laws 1937, ch. 353.

15. N.Y. Sess. Laws 1937, ch. 353, § 3.

16. 273 N.Y. 250, 7 N.E.2d 120 (1937).

17. 279 N.Y. 266, 18 N.E.2d 151 (1938), *opinion amended,* 280 N.Y. 9, 19 N.E.2d 659, *cert. denied,* 306 U.S. 661 (1939).

18. Central Sav. Bank v. City of New York, 254 App. Div. 502, 5 N.Y.S.2d 451 (1938).

19. Central Sav. Bank v. City of New York, 279 N.Y. 266, 280-81, 18 N.E.2d 151, 156-57 (1938), *opinion amended,* 280 N.Y. 9, 19 N.E.2d 659, *cert. denied,* 306 U.S. 661 (1939).

20. *Id.* at 280, 18 N.E.2d at 156.

operator of a slum dwelling can simply close his building and avoid the assessment.[21] Thus, the court reasoned that this assessment was an exercise of the state's police power.[22] Furthermore, the 1937 slum repair law was designed to regulate the condition of the dwellings, not to raise revenues.

In holding the municipal repair law unconstitutional, the New York court distinguished an earlier Massachusetts decision which held that an assessment for water liens could be given statutory priority over liens in existence at the time the statute was passed.[23] The New York court said that mortgagees could not have anticipated the receivership program, whereas the water rental provision could have been anticipated.[24] The court seemed to emphasize the retroactive effect of the statute, leaving open the question of the validity of a statute which operates only prospectively.[25]

Furthermore, in distinguishing the Massachusetts decision, the New York court ignored the following language:

> The primary and fundamental inquiry is whether *the interests of the public require the improvement. When that inquiry is answered in the affirmative, and the means adopted are reasonable, private rights must yield.* . . . Private property, *including contract rights* and real and personal estate, is held subject to the lawful exercise of the police power.[26]

In addition to the earlier Massachusetts case, later cases involving preference liens for police power assessments cast doubt on the New York Court of Appeals' conclusion that the lien for slum repair costs was an unconstitutional impairment of the obligations of contracts.[27]

A year after *Central Savings,* a New York trial court interpreted that case as not invalidating the provision for a preference lien for the costs incurred by a city in the demolition of unsafe buildings.[28] The 1937 slum repair law and the demolition measure were distinguished by the court on three grounds: (1) the demolition lien provision required notice to mort-

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21. *Id.*

22. In *Provident Institution for Sav. v. Jersey City,* 113 U.S. 506 (1884), the United States Supreme Court held that a statutory police power assessment for water rents could create a preference lien ahead of an existing mortgage. The Court was careful to point out that the plaintiff's lien arose after the passage of the assessment.

23. Loring v. Commissioner of Public Works, 264 Mass. 460, 163 N.E. 82 (1928).

24. Central Sav. Bank v. City of New York, 279 N.Y. 266, 280, 18 N.E.2d 151, 156 (1938), *opinion amended,* 280 N.Y. 9, 19 N.E.2d 659, *cert. denied,* 306 U.S. 661 (1939).

25. *Id.*

26. Loring v. Commissioner of Public Works, 264 Mass. 460, 466, 163 N.E.2d 82, 85 (1928) (emphasis added).

27. State v. Gebhardt, 151 F.2d 802 (2d Cir. 1945); Thornton v. Chase, 175 Misc. 748, 23 N.Y.S.2d 735 (Sup. Ct. 1940).

28. Thornton v. Chase, 175 Misc. 748, 23 N.Y.S.2d 735 (Sup. Ct. 1940).

gagees while the slum repair law did not; (2) the slum repair measure unfairly compelled a mortgagee to use his property for rental housing; and (3) it went too far in its interference with contract rights as compared with the demolition law, which could have more easily been anticipated.[29]

The first distinction is obviously valid. It is difficult, however, to see how a mortgagee is compelled to repair the property at his own expense. Mortgagees may prevent preference liens from displacing their interests by paying rehabilitation costs and recovering in restitutionary or breach of contract actions against mortgagors. Most mortgages contain agreements making the property owner responsible for the payment of encumbrances on the property which subsequently arise. It is generally held that when a junior lienor pays off a prior encumbrance, he is subrogated to the position of the first lienor.[30]

If the owner is insolvent, a mortgagee is probably in no worse position when a slum repair measure is employed than when his building is demolished. Under a slum repair measure, the mortgagee's lien, at worst, is reduced by the costs of basic rehabilitation. Under a constitutionally permissible demolition law, the mortgagee's lien, at worst, is reduced by the value of the demolished building plus the demolition costs. If the standards for demolition are the same as the standards for municipal repair, as in New York, city authorities have the option of either demolishing or repairing dangerous property. If repair is ordered, the mortgagee will lose more than if demolition were ordered only in case the costs of rehabilitation exceed the value of the structure plus the demolition costs.

However, when the costs of basic rehabilitation exceed the value of a dangerous structure, demolition, not municipal repair, would seem to be the appropriate remedy. If the costs of repairing a building exceed its value, it is probably not structurally sound—an obvious prerequisite to any municipal repair. Some ordinances allow demolition when a property has deteriorated to fifty per cent or less of its value.[31] If the city can demolish an entire building which is fifty per cent deteriorated, it should be able constitutionally to repair the property and create a prior lien for the costs which

29. *Id.* at 749-50, 23 N.Y.S.2d at 737-38.

30. Allyn v. Dreher, 124 Neb. 342, 246 N.W. 731 (1933); Marks v. Baum Bldg. Co., 73 Okla. 264, 175 P. 818 (1918).

31. NEW ORLEANS, LA., CITY CODE § 30-38 (1956); DALLAS, TEX., REV. CODE OF CRIMINAL ORDINANCES: § 27-38 (1960), *as amended,* Dallas, Tex., Ordinance 11339, Jan. 24, 1966; *see* Yen Eng v. Board of Bldg. & Safety Comm'rs, 184 Cal. App. 2d 514, 7 Cal. Rptr. 564 (1960); West Realty Co. v. Ennis, 147 Conn. 602, 164 A.2d 409 (1960); Soderfelt v. City of Drayton, 79 N.D. 742, 59 N.W.2d 502 (1953); Abraham v. City of Warren, 67 Ohio App. 492, 37 N.E.2d 390 (1940).

do not exceed the value of the building. The mortgagee is in the same position in either case.

In most instances, mortgagees contract with mortgagors knowing the unsafe, unsanitary conditions of slum properties; it would be an anomaly if those who voluntarily contracted with housing code violators were to be protected at the expense of effective enforcement of housing laws.

The third distinction, that mortgagees could not have reasonably anticipated a slum repair program, may well have had some validity in 1937. But as suggested earlier, the failure of conventional methods of housing code enforcement combined with serious shortages in low income housing and the deteriorated conditions of such housing seriously weakens this argument. In addition, it is difficult to see how it is easier to anticipate the demolition of a structure than it is to anticipate a lien for repair costs, since both actions usually require that the structure be in an advanced state of disrepair.[32] These unconvincing distinctions suggest that the Supreme Court was attempting to escape the effect of *Central Savings.*

In the 1945 case of *State v. Gebhardt,*[33] the Second Circuit held constitutional a New York statute authorizing a prior lien on railway property for expenses incurred by the state in making certain crossings safe, even though the mortgage lien in that case had been created before the passage of the law.

Central Savings was again distinguished on the ground that proper notice was given the lienors in *Gebhardt* through the extensive publicity while the law was under consideration by the legislature. *Gebhardt* also distinguished *Central Savings* on the impairment of contracts issue:

> The statue [which provides liens for expenses involved in repairing railroad crossings] does not impair the obligation of appellant's mortgage contracts within the constitutional prohibition. Grade crossing elimination has been long accepted as a valid exercise of the police power; and this statute has already been sustained on that ground, as well as on others, against attack by the mortgagor railroad. *It is of course settled that a state may modify contract rights in the legitimate exercise of its police power.*[34]

It should be noted that these statements can be made about New York's 1937 municipal repair law as well. As in the New York Supreme Court decision, the Second Circuit attempted to distinguish *Central Savings* on the ground that the mortgagees of a railway could contemplate a measure

32. N.Y. MULT. DWELL. LAW § 309 (McKinney Supp. 1966).

33. 151 F.2d 802 (2d Cir. 1945).

34. *Id.* at 805-06 (emphasis added; citations omitted).

to repair dangerous grade crossings and provide for primary liens, while the mortgagees of urban property could not anticipate a law to repair slum property at the owner's expense.[35]

Twenty-three years after *Central Savings,* the New York legislature attempted to meet the Court of Appeals' objections with the 1962 Receivership Law.[36] The new measure provided for the appointment of a receiver to make repairs of slum dwellings. Under this statute mortgagees were given notice and the opportunity to contest the receivership appointment.[37] The costs of repairing dilapidated dwellings incurred by a court-appointed receiver were prior liens only on the rents, not on the real estate itself as in the earlier provision. The conditions which necessitate the appointment of a receiver were described as violations so grave as to constitute a danger to health and safety, and, thus, a nuisance.[38] The new receivership law[39] was held constitutional by the New York Court of Appeals in *In re Department of Bldgs.*[40] The notice, appeal, and opportunity-to-defend provisions in the new law eliminated the due process objections to the 1937 law.

In two brief paragraphs the court dismissed the argument that the lien provision unconstitutionally impaired the obligations of the mortgagee's contract.[41] First, it noted that urban blight is much more serious today than in 1939; second, the limitation of the lien to rents was deemed much less stringent and, therefore, more reasonable, even though the displaced lien was in existence before the passage of the statute.[42]

Would a measure which imposed a lien on the whole property have been found a reasonable exercise of police power? The broad language used in

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35. *Id.* at 805. The court said, however, that *Central Savings* should be strictly limited to the particular facts of that case, and took note of the law reveiw criticism of the opinion. *Id.*

36. N.Y. MULT. DWELL. LAW § 309 (McKinney Supp. 1966).

37. N.Y. MULT. DWELL. LAW § 309(5)a (McKinney Supp. 1966).

38. N.Y. MULT. DWELL. LAW § 309(1)a (McKinney Supp. 1966). Although this new law results in the appointment of a receiver, it is discussed in connection with direct municipal repair laws, because the lien on the rents under the 1962 Receivership Law is statutory and is not the result of the issuance of receivership certificates. The significance of the distinction between express statutory liens such as those in the 1937 New York law and prior liens arising as a result of the issuance of receivership certificates by equity courts will be examined in the general discussion of receivership as a method of housing code enforcement.

39. N.Y. MULT. DWELL. LAW § 309 (McKinney Supp. 1966).

40. 14 N.Y.2d 291, 200 N.E.2d 432, 251 N.Y.S.2d 441 (1964).

41. *Id.* at 300, 200 N.E.2d at 438-39, 251 N.Y.S.2d at 448-49.

42. The facts of the case do not make this clear although language in the opinion indicates a retroactive application of the law.

parts of this unanimous opinion would seem to justify a primary lien applied to the whole property.

> The same public interest which supports the statute when directed against an owner, even though it impinges on his right to deal freely with his property, *equally justifies the legislation as a reasonable exercise of the police power insofar as it affects the rights of the mortgagee.*[43]

This language would appear to support a preference lien provision whether prospectively or retroactively applied.

Obviously spurred by the decision in *In re Department of Public Buildings,* the New York legislature recently amended its receivership law to give the receiver a lien on the entire premises which has priority "over all other mortgages, liens and encumbrances of record except taxes and assessments levied pursuant to law."[44] The amendment indicates that the New York legislature felt that a receivership program which allowed a lien on rents alone is insufficient to meet the costs of housing code compliance, and that sufficient doubt had been cast on the holding in *Central Savings* to enact a statute which allows a retroactive lien on the entire property.

B. *Analogous State Laws Which Displace Existing Liens*

States in the exercise of their taxation powers, especially in the area of public improvement assessments and special taxes, have imposed primary liens on the property of mortgagors without doing violence to the inpairment clause. Since public improvements theoretically increase the value of property as much as assessment costs,[45] some courts have reasoned that earlier lienors suffer no damage from such tax liens.[46] This justification, however, does not apply to receivership liens for repair costs, which may not increase the market price of the premises equivalently.

Nevertheless, taxes imposed upon realty, regardless of whether a particular property is directly benefited by expenditure of the tax receipts, have been enforced to the detriment of liens in existence at the time of the passage of the tax measure.[47] In *Puerto Rico v. Federal Land Bank,*[48] no attempt had been made to collect property taxes more than three years delinquent. When a law was adopted which extended the time period, during which these taxes constituted a lien on the properties, mortgagees

43. *In re* Department of Bldgs., 14 N.Y.2d 291, 301, 211 N.E.2d 432, 439, 251 N.Y.S.2d 441, 449-50 (emphasis added).

44. N.Y. MULT. DWELL. LAW § 309(4)a (McKinney Supp. 1966).

45. 1 PAGE & JONES, TAXATION BY ASSESSMENT § 9, at 15 (1909).

46. Annot., 78 A.L.R. 513, 517 (1932).

47. *See* Puerto Rico v. Federal Land Bank, 108 F.2d 275 (1st Cir. 1939).

48. *Id.*

claimed that enforcement would impair the obligations of their contracts. The court found that the public welfare justified this infringement of lienors' property rights. The power of legislatures to upset lien priorities as an exercise of the taxation power clearly illustrates that contract rights may be sacrificed to alleviate social and economic inequities.

The regulation and control of liens is not limited to the tax and police powers. State legislatures as a matter of public policy have provided for the displacement of certain liens by later encumbrances which were deemed to merit priority. Thus, a Virginia law giving persons furnishing supplies to railway, mining, or manufacturing companies a lien superior to earlier mortgages or trust deeds[49] was held constitutional as applied prospectively, although unconstitutional as applied retroactively.[50] A North Dakota law,[51] held constitutional, gave subsequent mechanics' liens (for materials and labor furnished to build structures) priority over mortgages on the land which were in existence when the law was enacted.[52] Under section 513 of the New York Lien Law, materials or labor liens arising from the improvement of real property have preference over earlier liens which have nothing to do with the improvement of the property. When a dispute arose under this law in 1962, its constitutionality was apparently not challenged; at least the opinion of the court did not mention the issue.[53] These cases illustrate state legislatures' control over the priority of liens. Lien preferences are not absolute rights. They must be examined in light of their consistency with the goals of public welfare.

II. Receivership Certificates as a Method of Financing Slum Repairs

Receivers are generally appointed to maintain property while various claims against it are being litigated or otherwise determined.[54] The most

49. Va. Sess. Laws 1878-79, ch. 82, § 1, at 352.

50. Citizens' & Marine Bank v. Mason, 2 F.2d 352 (4th Cir. 1924); Crowther v. Fidelity Ins., Trust & Safe-Deposit Co., 85 Fed. 41 (4th Cir. 1898); Virginia Dev. Co. v. Crozer Iron Co., 90 Va. 126, 17 S.E. 806 (1893).

The Oregon Supreme Court upheld a similar statute. Haines Commercial Co. v. Grabill, 78 Ore. 375, 152 Pac. 877 (1915). In New York, a measure which provided that if three-fourths of the lienors agreed, a mortgage subsequent in time could take priority over mechanics' liens, N.Y. Sess. Laws 1916, ch. 507, § 16 (now N.Y. Lien Law § 29 (McKinney 1966)), was upheld with the comment that the legislature had created mechanics' liens and could certainly control their priority. Max Fine & Sons, Inc. v. Lindarose, Inc., 226 App. Div. 616, 221 N.Y.S. 690 (1927).

51. N.D. Sess. Laws 1929, ch. 155.

52. Dunham Lumber Co. v. Gresz, 71 N.D. 491, 2 N.W.2d 175 (1942).

53. Betcher v. Rademacher, 35 Misc. 2d 693, 230 N.Y.S.2d 535 (Sup. Ct. 1962). The controversy in this case centered around the powers of referees in foreclosure proceedings.

54. H. McClintock, Equity § 211 (2d ed. 1948).

frequent use of the receiver is found in bankruptcy and foreclosure proceedings. The power of an equity court to appoint a receiver in these situations is a function of the general equity power and is not dependent on any statutory authority.[55] A difficulty may arise, however, when a receiver is appointed to aid in the enforcement of a housing code ordinance. The crux of the problem lies in the maxims that equity will not enjoin the commision of a crime,[56] and that punishment for past acts in relation to property is a matter of criminal, not equitable, procedure.[57] The appointment of a receiver to collect rents and make repairs does not fall squarely within either of these equitable maxims because the court neither enjoins the commission of a crime nor punishes the slum owner for past acts. Yet, since the effect of the appointment of a receiver is to force compliance with a housing code ordinance, there is some doubt whether the traditional equity powers are sufficient to give a court jurisdiction in these cases.[58]

Local officials can be given statutory authority to petition an equity court for the appointment of a receiver of slum property. This approach was taken in an Illinois statute which provided that local housing commissioners could petition in equity when relief at law was inadequate.[59] When statutes give local officials authority to petition in equity, equity courts will not only issue injunctions but will also appoint receivers of slum property.[60] Equity courts have long considered that the power to issue receivership certificates, a matter of judicial discretion, was inherent in the power to appoint a receiver.[61]

When issuance of certificate has been contested by displaced lienors, however, appellate courts have looked only to see if the issuance was an abuse of the lower court's discretion under the facts of the particular case. It has generally been held that if the certificates are to take preference over existing liens, the permission of mortgagees and other lienors must first be given.[62] Such permission will doubtless not be obtained in slum receivership cases. However, two lines of cases have carved out exceptions to this general proposition—those involving businesses which are public in character,[63] especially

55. 1 R. CLARK, RECEIVERS § 46a (3d ed. 1959).

56. Note, *Enforcement of Municipal Housing Codes,* 78 HARV. L. REV. 801, 826 (1965).

57. 1 R. CLARK, *supra* note 55, § 65.

58. *See* 6 E. MCQUILLIN, MUNICIPAL CORPORATIONS § 20.33 (3d ed. 1949).

59. Ill. Laws 1953, § 23-70.3, at 1112 (repealed 1961).

60. Note, *Urban Renewal: Problems of Eliminating and Preventing Urban Deterioration,* 72 HARV. L. REV. 504, 548 (1959).

61. 2 R. CLARK, *supra* note 55, § 455.

62. *Id.* at § 470.

63. Wallace v. Loomis, 97 U.S. 146 (1878); Smith v. Shenandoah Valley Nat'l Bank,

railroads, and those in which the preservation of the property in receivership is at stake.[64]

The property of a railroad during bankruptcy or foreclosure proceedings is sometimes placed in the hands of a receiver who operates the railroad in the public interest and maintains the equipment and franchise of the company. The continued operation of the line is financed by the profits, and, if any deficit occurs, by the issuance of receivership certificates which take priority over existing liens with or without the consent of the lienors. Courts reason that the importance of railroads to the public justifies this interference with the contract rights of mortgagees and lienors.[65] The New Mexico Supreme Court has upheld the issuance of receivership certificates as preference liens under a state statute which provides for the operation of a railway by a receiver to test the solvency of the line when its owners claim that its operation is unprofitable.[66] The language in other cases qualifies the issuance of certificates to those instances in which it is in the best interests of all parties.[67] If this means that the public interest might on occasion be subordinated to protect the individual interest of a single lienor, these cases are probably anomalies. Two cases involving preference lien receivership certificates issued by the receiver of a railroad have been before the United States Supreme Court; both times equity courts were found to have acted within their legitimate powers.[68] But a federal district court, in a case involving an irrigation corporation, held that when the renovation costs would completely destroy a mortgagee's interest, it would be injudicious for an equity court to authorize the issuance of preference lien certificates.[69]

246 Fed. 379 (4th Cir. 1917); Meyer v. Johnston, 53 Ala. 237 (1875); Cox v. Snow, 47 Idaho 229, 273 Pac. 933 (1929); Equitable Trust Co. v. Chicago, P. & St. L.R.R., 223 Ill. App. 445 (1921); Weaver v. Pacific Improvement Co., 234 N.Y. 418, 138 N.E. 42 (1923); Vilas v. Page, 106 N.Y. 439, 13 N.E. 743 (1887); State v. Iman Mining Co., 144 W. Va. 46, 106 S.E.2d 97 (1958).

64. Woodbury v. Pickering Lumber Co., 1 F. Supp. 92 (W.D. Mo. 1932); Pemberton Lumber & Millwork Indus. v. Ridgway Constr. Co., 38 N.J. Super. 383, 118 A.2d 873 (Ch. 1955); Royer v. New Upper Lehigh Coal Co., 33 Luz. L. Reg. 425 (Pa. C.P. 1939); McDermott v. Pentress Gas Co., 82 W. Va. 230, 95 S.E. 841 (1918).

65. *See* Wallace v. Loomis, 97 U.S. 146, 162 (1878); Smith v. Shenandoah Valley Nat'l Bank, 246 Fed. 379, 381 (4th Cir. 1917); State v. Iman Mining Co., 144 W. Va. 46, 56, 106 S.E.2d 97, 98 (1958).

66. Santa Fe, S.J. & N.R.R. v. Helmick, 36 N.M. 157, 9 P.2d 695 (1932).

67. Barton v. Barbour, 104 U.S. 126, 136 (1881); Cody Trust Co. v. Hotel Clayton Co., 293 Ill. App. 1, 11, 12 N.E.2d 32, 39 (1937); Equitable Trust Co. v. Chicago, P. & St. L.R.R., 223 Ill. App. 445, 449 (1921).

68. Miltenberger v. Logansport R.R., 106 U.S. 286 (1882); Wallace v. Loomis, 97 U.S. 146 (1878).

69. Farmer's Loan & Trust Co. v. Burbank Power & Water Co., 196 Fed. 539 (E. D. Wash. 1912).

When the preservation of property in a receiver's custody is at stake, another line of cases[70] allows the issuance of receivership certificates which take precedence over an existing lien without the lienor's consent. In cases involving preservation, there is no requirement that the property be public in nature.[71] Some courts require that the property of the insolvent be in imminent danger of destruction before any receivership certificates may be issued to protect it.[72] Other courts are less stringent, holding that receivership certificates can be used to finance maintenance which preserves the status quo.[73] On the other hand, the word "preservation" has been construed as encompassing the completion of construction of houses begun by a corporation which has become bankrupt.[74] A liberal interpretation of "preservation" might support the issuance of prior lien receivership certificates to finance repairs of slum dwellings, especially when a failure to repair would cause a city condemnation proceeding. Such a holding would be consistent with the usual justification for the issuance of primary lien receivership certificates in preservation cases; *i.e.*, that the repairs are actually in the interest of lienors since such expenditures "preserve" the value of their collateral.

A 1965 amendment to the Illinois law discussed above gives the court which appoints a receiver under the statute the power to authorize receivership certificates which take preference over all prior encumbrances.[75] The fact that the Illinois legislature felt it necessary to give express authority to the equity courts to issue preference lien certificates indicates a belief that without this authority equity courts would be unable to displace existing liens. At least, such statutory authority should mean that appellate courts will be less likely to find that a lower court has abused its discretion in authorizing a preference lien.

Will the impairment clause of the Constitution be a decisive argument for those whose liens are displaced by court-authorized receivership certificates? There is some question whether the impairment clause is even applicable to receivership certificates. The impairment clause is generally

70. Woodbury v. Pickering Lumber Co., 1 F. Supp. 92 (W.D. Mo. 1932); Pemberton Lumber & Millwork Indus. v. Ridgway Constr. Co., 38 N.J. Super. 383, 118 A.2d 873 (Ch. 1955); Royer v. New Upper Lehigh Coal Co., 33 Luz. L. Reg. 425 (Pa. C.P. 1939); McDermott v. Pentress Gas Co., 82 W. Va. 230, 95 S.E. 941 (1918).

71. *See* 2 R. CLARK, *supra* note 55, § 470(c).

72. Clifford v. West Hartford Creamery Co., 103 Vt. 229, 153 Atl. 205 (1931).

73. Oldroyd v. McCrea, 65 Utah 142, 235 Pac. 580 (1935); McDermott v. Pentress Gas Co., 82 W. Va. 230, 95 S.E. 841 (1918).

74. Pemberton Lumber & Millwork Indus. v. Ridgway Constr. Co., 38 N.J. Super. 393, 118 A.2d 873 (1955).

75. ILL. ANN STAT. § 11-31-2 (Smith-Hurd Supp. 1965).

applied only to legislative acts and not to court actions,[76] lest every contract case become a federal question. It is the province of the equity court, within its inherent power, to authorize the issuance of preference lien certificates; and it would seem that the impairment clause should not apply to such court actions. Only one case has been discovered in which the impairment of contracts argument has been discussed. An 1857 New York supreme court case held that the issuance of prior lien receivership certificates impaired the obligations of a contract,[77] but the court seemed to be under the impression that the impairment clause applies to court actions as well as statutes.[78] The majority view today is definitely to the contrary.[79]

Problems may arise when, as in Illinois, state legislation expressly provides for the displacement of existing encumbrances by receivership certificates to remedy housing code violations. Although the actual decision to issue such certificates is left to the courts, the authority to do so rests on a legislative act. Some United States Supreme Court cases,[80] though factually not in point, contain broad language to the effect that a court decision which gives effect to a legislative enactment is subject to the limitations of the impairment clause. In Illinois, the courts will obviously be giving effect to a statute when authorizing receivership certificates. If before the enactment of a statute when authorizing the issuance of certificates in slum housing cases, equity courts refused to allow such issuances, it would seem that the act displacing existing liens was essentially that of the legislature, not the court. If the impairment clause is found applicable, the arguments against applying to municipal slum repair laws should apply to receivership certificates as well.

Summary and Critique

The failure to enforce housing codes effectively has been described as one of the major factors in the deterioration of urban areas. To combat this problem, some states have provided for direct municipal repair laws and receivership certificates programs. Since city governments cannot afford to defray the costs of rehabilitating large amounts of slum property, the use of liens which can be foreclosed if a recalcitrant owner refuses to pay for necessary repairs is essential. However, slum property is invariably heavily mortgaged, making any secondary repair lien virtually worthless. Thus the

76. Barrows v. Jackson, 346 U.S. 249, *rehearing denied,* 346 U.S. 841 (1952).

77. Patten v. Accessory Transit Co., 13 How. Pr. 502 (N.Y. Sup. Ct. 1857).

78. *Id.*

79. *See* Barrows v. Jackson, 346 U.S. 249, *rehearing denied,* 346 U.S. 841 (1952).

80. Columbia R.R., Gas, & Elec. Co. v. South Carolina, 261 U.S. 236, 247 (1922); Detroit United Ry. v. Michigan, 242 U.S. 238 (1916); Cross Lake Shooting & Fishing Club v. Louisiana, 224 U.S. 632, 638-39 (1912).

efficacy of these programs depends on the extent to which repair liens are allowed to displace prior liens on slum property.[81]

The major obstacle to the displacement of prior liens by a direct municipal repair law has been the impairment of the obligations of contracts clause of the federal constitution. Although *Central Savings* held New York's direct municipal repair law unconstitutional,[82] its present-day effect on the constitutionality of slum repair liens which displace prior liens is unclear for a number of reasons.

First, the New York statute was held unconstitutional because it did not provide the mortgagee with notice and an opportunity to be heard.[83] This legislative oversight was corrected in the 1962 New York slum repair law which gave the mortgagee notice of the proceedings and the opportunity to contest the appointment of a receiver.[84] This provision was held to satisfy any due process objections of displaced mortgagees.[85]

Secondly, it is impossible to determine the effect of the retroactive application of the 1937 statute in *Central Savings*. Thus, the constitutionality of a repair law which would replace only liens arising after the enactment of the statute was not litigated. Certainly, the effect of such a statute on a mortgagee would be less harsh. However, a slum repair law given only prospective effect would be ineffective as a means of alleviating the conditions in existing slum property, most of which is heavily mortgaged. Yet, even a prospective law would be of some value, since it could be applied to property which is not mortgaged at the time of passage of the statute and would cetainly serve as a deterrent to the formation of future slum areas.

In addition, New York cases have held consitutional statutes authorizing preference liens for expenes incurred in demolishing unsafe buildings[86] and repairing railroad crossings.[87] These holdings cast additional doubt on the validity of the *Central Savings* case. To the extent that these decisions distinguish *Central Savings* on the ground that a mortgage could contemplate a measure to demolish unsafe buildings or repair dangerous grade crossings, but not one to repair slum property, they are unconvincing. Since all these measures involve attempts to protect the public from unsafe conditions, it is difficult, if not impossible, to understand why one provision is more easily

81. *See* note 8 *supra* and accompanying text.

82. Central Sav. Bank v. City of New York, 279 N.Y. 266, 18 N.E.2d. 151, *opinion amended,* 280 N.Y. 9, 19 N.E.2d 659, *cert. denied,* 306 U.S. 661 (1939).

83. *Id.*

84. N.Y. MULT. DWELL. LAW § 309 (McKinney Supp. 1966).

85 *In re* Department of Bldgs., 14 N.Y.2d 291, 200 N.E.2d 432, 251 N.Y.S.2d 441 (1964).

86. Thornton v. Chase, 175 Misc. 748, 23 N.Y.S.2d 735 (Sup. Ct. 1940).

87. State v. Gebhardt, 151 F.2d 802 (2d Cir. 1945).

anticipated than another. This is especially true when the slum repair law requires that a structure be in such a deteriorated condition that it endangers the health and safety of its occupants—a condition which is also a prerequisite to the demolition of property.

Yet, even if one grants that a mortgagee who lends money with a dilapidated dwelling house as collateral cannot anticipate a slum repair law, the question remains whether the inability of the mortgagee to expect this type of program should control in these cases. When property is infested with rats and vermin, has unsanitary toilet facilities, has no locks for individual apartments, has inadequate fire escapes, and has large holes in plastered walls and ceilings, the naivete of a mortgagee in failing to foresee stringent corrective measures should hardly be a controlling factor in determining the constitutionality of measures to eliminate these hazards. A program to renovate blighted areas is certainly as important to the public welfare as repairing dangerous railroad crossings, and ought equally to justify the displacement of contract rights.

The present status of the *Central Savings* case is also greatly affected by *In re Department of Buildings*,[88] which held New York's 1962 repair law constitutional. The cases are, of course, distinguishable because the statute in *In re Department of Buildings* authorized preference liens only on the rents of slum property. Such a statute is much less burdensome on a displaced mortgagee than is a law which allows a preference lien on the entire property. Thus, in any discussion of the effect of this case on *Central Savings*, this distinction must be borne in mind.

It is important to note, however, that the lien arising out of the repairs in *In re Department of Buildings* was allowed to displace a lien *in existence at the time the statute was passed.* The statute was applied retroactively despite the language in *Central Savings* which indicated that the retroactive application of the 1937 statute was an important factor in holding it unconstitutional.[89] Furthermore, the court made it clear that it felt it was engaged in a balancing process, and that the seriousness of urban blight in 1964—as compared with that of 1938—was a sufficient reason for tipping the scales in favor of the repair law. This case then offers some support for a retroactive statute establishing priority liens on the *entire* property. The importance of such a lien cannot be overemphasized. A lien limited to the *rents* of the rehabilitated property often will not provide sufficient funds to meet the costs of rehabilitation. At best such a lien will delay the recovery of the

88. 14 N.Y.2d 291, 200 N.E.2d 432, 251 N.Y.S.2d 441 (1964).

89. Central Sav. Bank v. City of New York, 279 N.Y. 266, 280-81, 18 N.E.2d 151, 156-57, *opinion amended,* 280 N.Y. 9, 19 N.E.2d 659, *cert. denied,* 306 U.S. 661 (1939).

rehabilitation costs for a considerable period, thus reducing the funds available for future rehabilitation.

Although the impairment clause is a significant stumbling block when a slum repair measure takes the form of a direct municipal repair law, it is much less of an obstacle when the measure in question involves the issuance of receivership certificates by a court of equity.[90] The problem arises only when the court's jurisdiction is based on a statute. When statutory authority is invoked, the same principles which determine the constitutionality of municipal repair laws under the impairment clause should be applied to determine the statute's constitutionality.

The central problem regarding the issuance of receivership certificates is whether an equity court, in the exercise of its discretion, should allow a receivership lien to displace prior liens. Equity courts have been willing to allow the displacement of liens when the businesses involved were public in character and when the preservation of the property in question was at stake.[91] The rationale behind these decisions lies in the courts' belief that the public interest in these areas is sufficient to justify the displacement of prior liens. These cases should be sufficient authority for the displacement of liens by receivership certificates. Even though a landlord who avoids compliance with basic health, sanitation, and safety standards does not create a problem of public proportions, avoidance begets avoidance. Soon other landlords in the neighborhood may allow their properties to deteriorate. Deteriorating properties constitute, of course, the core of city slums. If equity courts are willing to characterize the continued operation of the country's railroads as essential to the public interest, they should have no problem finding that the adequate maintenance of low income housing is just as vital to the public interest.

A provision allowing preference liens for the costs of repairing slum dwellings may cause hardships to some mortagees. Little sympathy can be given one who extends credit on a structure which is in an advanced state of disrepair at the time of the loan. However, suppose a lender accepts as security a building which, at the time the loan is made, is in excellent condition and is located in a neighborhood of similar structures. It may offend some to allow such a mortgagee's lien to be displaced if the property falls into disrepair ten years later. The slum repair law could be drafted to apply only to properties which violate the housing code at the time of enactment. But this would negate one of the principal purposes of a slum repair law—the prevention of the spread of blight in the core city.

90. For a discussion of the impairments issue in certificates cases, see notes 76-80 *supra* and accompanying text.

91. Notes 62-73 *supra* and accompanying text.

However, a mortagee is not without a means of protecting himself in this situation. He may condition the mortgage on a guarantee that housing code regulations will be complied with for the duration of the mortgage. A property owner would thus be under pressure to maintain his property from a private source—the mortgagee. This solution is not without its potential drawbacks; it may tend to curb the availability of credit to property owners in an already tight money market. Thus, the slum repair law could actually hinder the most basic means of housing code enforcement—self compliance by property owners.

However, if borrowed money is used for the repair of slum property, lenders should have little fear that the appointment of a receiver will be needed. Nevertheless, if it is found that a slum repair law greatly hinders sincere property owners in obtaining loans to finance the repair of slum property, perhaps liens created to pay for improvements to dilapidated buildings should be made an exception to the general rule allowing displacement of prior liens. However, since such an exception would be a potential loophole for those who wish to avoid compliance with housing codes, it should be made only upon a showing that the law is limiting the availability of such loans.

No one will dispute the fact that it is desirable that the priority of liens be stable so business transactions can be made with certainty. But, the displacement of liens under a receivership or municipal repair program will be no more disruptive than displacement because of property taxes, demolition laws, mechanics' liens laws, and public improvement assessments, all of which have been upheld as constitutional even when applied retroactively.

Preference liens to cover the expenses of municipal repair or receivership programs would be an effective method of accomplishing the goals of housing code enforcement. Ramshackle property would be repaired, and knowledge of expenses incurred by the owners of the repaired property would probably encourage other owners to repair their properties to avoid municipal action. Both programs should be held constitutional. They would not be a complete panacea for the urban slum problem; no one program could be. However, preference lien provisions to insure the solvency of local slum repair programs could be one of the most effective means of supplementing the urban renewal and public housing efforts.