



## A Pennsylvania Commercial Lender's Guide to Collecting Debts in New Jersey

Pennsylvania commercial lenders may be surprised when collecting debts in New Jersey. This alert outlines some material differences in the treatment of real estate taxes and municipal liens, foreclosure and deficiency actions in Pennsylvania and New Jersey.

# REAL ESTATE TAXES AND MUNICIPAL LIENS

Like most jurisdictions, unpaid real estate taxes and municipal charges in New Jersey become liens on real estate that prime the liens of secured creditors, including a first mortgagee. As outlined here, unlike Pennsylvania tax sales, New Jersey tax sales transfer title to the tax lien rather than title to the property.

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## PENNSYLVANIA

In Pennsylvania, municipalities hold annual tax sales to foreclose on real estate taxes and municipal liens. Pennsylvania tax sales may result in a transfer of title to the real estate to a third party. A summary of the two types of Pennsylvania tax sales follows.

- (1) Upset Sale:** Municipalities hold an “upset sale” as the first step in Pennsylvania to foreclose on a municipal or tax lien.
  - a. Nature of Interest Transferred:** The successful bidders at an upset sale take title to the real estate **subject to** all liens and encumbrances, including mortgages. If no bidders take title to the real property at the upset sale, a judicial sale may be held.
  - b. Notice Required:** The foreclosing authority must publish notice of the upset sale and serve the notice on the property owner. Because the upset sale is **subject to** all liens and mortgages, lienholders and mortgagees are not required to receive notice of the sale by mail.
- (2) Judicial Sale:** If the upset sale does not result in a successful bidder, the municipality may petition the court to sell the real estate at a “judicial sale.”
  - a. Nature of the Interest Transferred:** The successful bidder at a judicial sale takes title to the real estate **free and clear** of all taxes, liens and mortgages. The judicial sale is subject to confirmation by the court before title is transferred.
  - b. Notice Required:** The foreclosing authority must give mortgagees notice of the judicial sale that is reasonably calculated to apprise the mortgagee of a pending judicial sale. Methods that satisfy this requirement include personal service and service by certified mail.
- (3) Taxes Paid at Sheriff Sale on Foreclosure:** If the real estate is not exposed to tax sale during the pendency of a foreclosure proceeding, unpaid taxes must be paid in full at the time of the sheriff sale.

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## NEW JERSEY

In New Jersey, municipalities hold annual tax sales at which title to the *tax lien*, rather than title to the real estate, is sold at auction. The winning bidders may be third parties or the municipality itself.

- (1) Interest:** Once auctioned, the tax lien will accrue interest at a rate of up to 18% per annum.
- (2) Penalties:** Depending on the amount of the lien, penalties will accrue in the range of 2%–6% of the face amount of the lien.
- (3) Foreclosure:** A municipality holding a tax lien certificate can commence foreclosure proceedings six (6) months after the certificate is sold. A third party holding a tax lien certificate can commence foreclosure proceedings two (2) years after the certificate is sold.
- (4) Notice:** Mortgagees should receive notice of the tax lien certificate sale by regular and certified mail. Mortgagees must be named as a defendant in a proceeding to foreclose on the tax lien certificate.

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## RECOMMENDATIONS FOR MORTGAGEES

Notices of tax sales are frequently misdirected and sometimes overlooked, but there are some proactive steps lenders can take to protect their rights.

- (1)** Obtain periodic title searches for real property collateral and request (or have your title company request) a statement of taxes and municipal charges from the municipality. Tax monitoring services can be engaged to monitor the property after each tax due date to ensure taxes have been paid. In New Jersey, lenders may obtain a certificate from the municipality as to all taxes, assessments or other municipal liens and charges, including unpaid installments of assessments levied and in force, whether due or not.
- (2)** In the event of tax or municipal delinquencies, the lender should contact the applicable taxing authority to ascertain the date of any tax sale and to provide the taxing authority with the lender’s correct and current notice information.
- (3)** Encourage the borrower to negotiate with the taxing authority to set a payment plan for delinquencies, and consider whether the lender should pay the taxes directly.
- (4)** Delinquent taxes signal a borrower’s weakening financial position. Lenders should conduct a thorough assessment of loan documentation and collateral position/perfection to prepare for a workout or potential bankruptcy.

# FORECLOSURE: TIMELINE AND PROCEDURES

Pennsylvania lenders are frequently surprised and frustrated by the long and cumbersome commercial foreclosure process in New Jersey. The timeline and procedures are outlined below.

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## PENNSYLVANIA

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Pennsylvania commercial foreclosures typically proceed along a faster track than New Jersey foreclosures — among other things, there is no “processing time” for foreclosure complaints and the answer period is shorter.

- (1) **Required Parties:** A foreclosure complaint must name the mortgagor, the personal representative, heir or devisee of a deceased mortgagor, the real owner of the property (to the extent distinct from the mortgagor), and the United States as parties to the foreclosure action.
- (2) **Hidden Liens:** Unpaid franchise, sales and corporate taxes (even those not reduced to judgment) may be a hidden lien that primes all other liens and may survive foreclosure.
- (3) **Answer Period:** 20 days from date of service (60 days for United States).
- (4) **Average Time to Sheriff Sale:** 90 days or more, depending on the county. Some counties have monthly sales, other counties hold sales less frequently.
- (5) **Right of Redemption:** None.

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## NEW JERSEY

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The New Jersey foreclosure process is centralized through the Superior Court in Trenton, which processes all foreclosure complaints filed in the State of New Jersey. The Superior Court can take several weeks to process complaints and this processing time will delay service of process.

- (1) **Required Parties:** A foreclosure complaint must name any party whose rights will be affected by the foreclosure. Examples of parties under this broad category include:
  - Mortgagor
  - Record Owner (if different from Mortgagor)
  - Spouses/Heirs
  - Junior encumbrancers — any holder of a junior mortgage, mechanic’s lien, junior tax lien (i.e. federal tax lien), judgment creditor, attachment creditor, the State of New Jersey, county welfare boards, easement holders
  - Tenants
  - Guarantors (in some cases)
- (2) **Requirement to File Lis Pendens and Amend Complaint:** After the complaint is filed, a lis pendens should be filed to place any subsequent encumbrancers on notice of the pendency of the foreclosure action. After the lis pendens is recorded, continuation searches must be performed to add as defendants to the action any lienholders who obtained liens between the date

the prior searches were performed and the filing of the lis pendens.

- (3) **Answer Period:** 35 days from date of service, 60 days for the United States and the State of New Jersey.
- (4) **Contesting Answer vs. Non-contesting Answers.** To preserve the right to receive surplus funds in a foreclosure, a junior encumbrancer must file a non-contesting answer setting forth the basis and amount of its claim. The non-contesting answer does not hold-up the foreclosure process and the foreclosure will be treated as an uncontested action.
- (5) **Average Time to Sheriff Sale:** 12 months or more, depending on the county and whether or not the action is contested. If the action is contested, the case will be referred to the court sitting in the county in which the property is situated.
- (6) **Limitation on amounts recoverable:** While Pennsylvania has no limitations on the amounts to be recovered in a foreclosure proceeding, subject to reasonableness, New Jersey limits both late fees and attorneys’ fees.
  - a. **Cutoff of Late Charges:** The calculation of late charges is cut-off on the date that the foreclosure complaint is filed.
  - b. **Limitation on Collection of Attorneys’ Fees:** The maximum amount of attorneys’ fees allowed by statute in a foreclosure action is \$7,500. A foreclosing mortgagee may apply for fees in excess of \$7,500, but whether or not a court will entertain such a claim is highly dependent on the facts. Recovery of attorneys’ fees in connection with a suit on the note, however, is not limited.
- (7) **Right of Redemption:** 10 days.

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## RECOMMENDATIONS FOR MORTGAGEES

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In order to name and notify all required parties of a pending foreclosure proceeding and obtain clean title at a sheriff sale, complete and accurate title searches are essential.

- (1) Utilize a reputable title company to provide a title commitment (not merely a last record owner search) relating to the subject property.
- (2) In New Jersey, obtain a real estate and municipal charges search certified by the applicable municipality. Consider engaging a tax monitoring service.
- (3) In Pennsylvania, obtain tax clearance certificates from the Department of Labor and Industry and the Department of Revenue.
- (4) In all states, obtain a search of state and federal tax liens.

# DEFICIENCY ACTIONS

When the value of real estate realized at foreclosure (or via deed in lieu of foreclosure, quit claim deed or otherwise) fails to satisfy the entire debt owing, the lender may pursue a deficiency action for the balance owed.

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## PENNSYLVANIA

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The deficiency judgment act applies whenever real property is sold to a judgment creditor in execution proceedings.

- (1) **Limitations Period:** 6 months from the date of the sale.
- (2) **Required Parties:** All debtors on the judgment shall be named in the petition and be served with a copy thereof. Failure to name an obligor as a defendant bars any action against such party for the deficiency.

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## NEW JERSEY

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New Jersey law has separate rules for pursuing a deficiency judgment for residential loans and commercial loans.

- (1) **Non-commercial loans:** New Jersey's deficiency judgment statute applies to all mortgage loans, except where: (1) the loan is for a business or commercial purpose; (2) the mortgaged property is a residence in which the owner or his immediate family do not reside at the time of the foreclosure suit is filed; (3) the mortgaged property is not the primary security for the debt; or (4) the mortgage is a second or subsequent lien.
  - a. **Limitations Period:** 3 months from the date of the foreclosure sale.
  - b. **Fair Market Value Credit:** The mortgagor in a deficiency action is entitled to a fair market value credit of the mortgaged premises against the amount due on the mortgage note.
  - c. **Required Parties:** All entities that may be liable on the debt shall be named as defendants.

- (2) **Commercial Loans:** Where the statute does not apply, an action on the note and an action on the mortgage can be concurrent or successive. While the statute of limitations for enforcing a note remains applicable, there is no specific statute of limitations for pursuing deficiency. In certain circumstances, the defendant in a non-statutory deficiency action will be entitled to a fair market credit for the value of the mortgaged premises.

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## RECOMMENDATIONS FOR MORTGAGEES

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In Pennsylvania deficiency actions and New Jersey statutory deficiency actions, time is of the essence. To enable the timely filing of a deficiency action:

- (1) Obtain an appraisal of the real property as close to the sale date as possible to facilitate the timely filing of the deficiency action.
- (2) To the extent the property is sold to a third party, keep records of all marketing efforts, brokerage costs, and analysis of the listing price to offer as evidence in support of the fair market value of the property.

## CONCLUSION

When faced with a troubled credit, contacting experienced counsel with knowledge of the state-specific law can give lenders a leg-up in maximizing recovery.



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