August 2005

Acting Governor Richard J. Codey
The President and Members of the Senate
The Speaker and Members of the General Assembly

The State Commission of Investigation, pursuant to N.J.S.A. 52:9M, herewith submits a letter report of findings and recommendations stemming from an inquiry into certain matters affecting the proper operation and funding of County Clerks' and Registers' Offices in New Jersey.

Respectfully,

W. Cary Edwards
Chair

Joseph R. Mariniello, Jr.
Commissioner

Kathy Flicker
Commissioner

Patrick E. Hobbs
Commissioner

In 2004 and 2005, the Commission received complaints of unreasonable and potentially deleterious delays in the recording and proper disposition of mortgages and deeds by various County Clerks' offices in New Jersey.[1] Subsequent investigation, including extensive review of documents provided by these offices and interviews with Clerks' personnel throughout the state, not only confirmed these complaints but also identified serious systemic anomalies with respect to the funding of Clerks' offices that contributed to the delays.

State law requires that these offices be adequately funded, maintained and modernized so that they are able to carry out a fundamental statutory obligation to receive and record documents crucial to the legal sufficiency and completion of real estate transactions in a timely manner (N.J.S.A 46:25-1 *et. seq.*). The Commission, however, found a pattern in which Clerks' offices have in many instances been transformed into "cash cows" for purposes well beyond the ambit of their regulatory jurisdiction. Between 2000 and 2003, the last complete year for which records were made available, tens of millions of dollars were diverted from revenue collected on behalf of Clerks' offices in connection with real estate transactions. Drawn from fees assessed for the express purpose of underwriting the cost of document filing and recordation, the bulk of this revenue instead was used to subsidize the general operating accounts of the broader spectrum of state and county budgets. At the same time, and despite enormous growth in this fee-based revenue, the budgets to support the operations of Clerks' offices remained essentially flat. **(See Chart 1)** Because this phenomenon coincided with a sharp rise in mortgage and deed applications amid a vast wave of re-financing and purchasing triggered by record-low interest rates, explosive growth in construction and sustained inflation in home-sale prices, many Clerks' offices were ill-prepared to respond to the consequent spike in demand for timely processing of records. Such delays not only create widespread inconvenience, but they also leave real estate transactions vulnerable to a variety of fraudulent schemes that could produce potentially serious financial losses for participants in the title insurance industry and the real estate market in general.

During the period that was the focus of the Commission's inquiry, reliance on real estate fee revenue for general budgetary relief increased significantly. In addition to absorbing recording and filing fees, the state and its counties rely heavily upon an even richer source of revenue associated with real estate transactions – the so-called "Realty Transfer Fee" assessed when actual transactions occur. Essentially a real estate sales tax, this fee has risen sharply through the enactment of legislation in recent years.[2] Based

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[1] Each of New Jersey's 21 counties is required by law to provide the services of a duly elected constitutional officer known as the County Clerk and/or an elected County Register. For purposes of this report, "Clerk" and "Clerks' offices" denote the Recording Officer(s) and/or Register(s) of Deeds.

[2] The Legislature repeatedly has taken steps to revise and increase fees charged by county Clerks, in such a way as to allow for disproportionate shares of the proceeds of such fees to be diverted for general budgetary expenses at the county and state levels of government. Chapter 370, P.L. 2001, enacted January 8, 2002, increased fees for the purpose of enhancing county revenues with only a small portion earmarked

upon past and current trends, growth in this revenue is likely to be even more dramatic in the future, notwithstanding the cyclical nature of the real estate market. In 1968, when the original Realty Transfer Fee was enacted as an "additional recording fee", the seller of a $300,000 house paid a transfer fee of $300 and, for the sale of a house priced at $500,000, a $500 fee.[3] Today, the transfer fees on the same home sales values are $1,715 and $4,175 – increases, respectively, in excess of 500 percent and 800 percent. Yet, comparatively little of this windfall has been earmarked for improvement of services rendered by Clerks' Offices even though these fees/taxes remain mandatory prerequisites of recordation.

Use of fees to cover general budgetary obligations raises a number of troubling questions that bear upon the proper exercise and full disclosure of revenue-raising authority. In the case of real estate recording and filing fees, the persistent diversion of revenue for general-fund purposes has become tantamount to a hidden tax that has little to do with the explicit purpose for which the fees were established, i.e. to support a regulatory scheme carried out by Clerks' Offices directly commensurate with services they are required to provide. The bottom line is that the public has paid a premium for poor service because, bereft of adequate funding, many such offices were unable to fulfill their statutory duties to the fullest extent possible.

Details of Key Findings

<u>Manipulation of Fees for Taxation Purposes</u>

During the four-year period from 2000-2003, County Clerks' offices across New Jersey – on average – experienced an 88 percent increase in the number of real estate transactions requiring consequent document processing and recordation. In addition to substantially boosting workloads, this surge fueled record increases in revenue derived from transaction fees. Indeed, recording/filing fee revenue taken in at the county level grew by 318 percent during this period, rising from $32.7 million to $136.4 million.

Despite the heavier workload and the gush of available resources, however, that portion of county budgets devoted to the operations of Clerks' offices rose by only 23 percent overall during this same period – a rate of growth less than eight percent that of the fee revenue**.** In some instances, Clerks reported that their annual budgets during this period actually suffered net reductions based, in part, on the vagaries of ever-changing

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for increased salaries limited to the positions of Clerk, Register of Deeds and Mortgages, Sheriffs, and Surrogate. Chapter 113, P.L. 2003, effective July 1, 2003, established a supplemental realty transfer fee, adding a second tier to the rates for sales of real estate, in addition to the basic realty transfer fee already in place. Chapter 66, P.L. 2004, effective August 1, 2004, added a third tier to the rates, referred to as a "general purpose fee," for real estate sales in excess of $350,000. Again in 2004, in addition to the fees charged to grantors, another fee was imposed on buyers of residential property carrying a purchase price of more than $1 million. This fee, equal to one percent of the total sale price, goes directly to the General Fund of the state budget with no share to the counties.

[3] <u>N.J.S.A.</u> 46:15-7

political landscapes affecting relationships between Clerks, County Boards of Freeholders and/or County Executives.

As illustrated by **Chart 2**, the bulk of proceeds from fees associated with real estate transactions were diverted into the broader spectrum of state and county budgets. During the period reviewed by the Commission, of more than $1.2 billion collected overall, just $107.9 million – less than nine percent of the total – found its way into direct budgetary support for Clerks' Offices. More than $509 million was retained by the counties for a variety of purposes. Meanwhile, nearly $750 million went into the state's general coffers. In terms of comparable annual revenue flows, the share claimed by the state rose by more than 159 percent during this period, while that retained by the counties increased by 185 percent. Meanwhile, the budgets afforded Clerks' Offices increased by the relatively paltry 23 percent.

<u>Diminished Service</u>

The failure to provide Clerk's offices with a sufficient share of the revenue collected on their behalf through real estate recording and filing fees has created a number of operational problems that constrain and disrupt the timely delivery of statutorily required services. Those impacted by such disruptions include not only legal practitioners and county officials but also any citizen or entity involved in the transfer or mortgaging of real estate. Problems identified by the Commission include:

- ***Delays in Recording of Documents***

  The law requiring recordation of real estate documents, such as deeds, mortgages and assignments, is designed to protect the holders or the owners of these instruments from having their legal rights infringed upon by other significant intervening transactions involving that same property. Recordation is premised on providing swift public notice of the rights of the parties involved. To function appropriately and effectively, Clerks' offices must carry out this task " 'on presentation' and when [the proper documents are] delivered to [the Clerk's office]."[4] This statutory language implies timeliness and no undue delay. As a result, New Jersey is commonly referred to as a "race-notice state" in terms of how it protects the interests of title holders with regard to recordation.[5]

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[4] <u>N.J.S.A.</u> 46: 22-1 <u>et seq.</u>

[5] The issue of delays in recordation was the subject of a lawsuit filed by New Jersey Land Title Association (NJLTA) more than a decade ago. An advocacy group and trade association for title insurance underwriters licensed to do business in this state, NJLTA charged that the recording system as utilized by the clerks at that time was operating in violation of state law. Under a consent order signed in February 2000, the clerks and other recording officers agreed to be in compliance with all provisions of the recording statute by December 2006 or face the prospect of an enforcement action.

During the course of this inquiry, the Commission found multiple instances in which the recording of appropriate documents was inordinately delayed due to the inability of Clerks' offices to keep up with rising demand for processing. While such delays historically have been a chronic problem, they have reached extremes due to unprecedented activity in the housing market in recent years, a period in which various Clerks' offices reported delays of as long as three months (12 weeks) from receipt of records to completion of processing and recordation. As recently as June 2005, seven of the state's 21 counties – Bergen, Camden, Hudson, Middlesex, Morris, Passaic and Sussex – reported recordation delays ranging between three and eight weeks, according to data compiled by the New Jersey Land Title Association (NJLTA).

Based upon data developed by title companies and the NJLTA, it is clear that recordation delays have opened real estate transactions to fraud by unscrupulous groups or individuals who take advantage of a temporal gap – the lag between the date of execution of documents required for completion of real estate transactions and the date of official recordation – to manipulate title information for monetary gain. Serious problems can arise even in the absence of fraud or unscrupulous intent, particularly in instances where the recording delay exceeds a legislatively-mandated protection period of 45 days during which the transfer-of-title process is statutorily protected against liens or other judgments.[6]

In order to cope with backlogs, Clerks' offices have been forced to resort to various strategies, including assigning overtime shifts and hiring inexperienced temporary workers, although their leverage in this regard was limited due to the endemic budgetary constraints. In one longstanding episode of consumer frustration remedied by the Bergen County Clerk's Office during the course of the Commission's inquiry, members of the public seeking timely recordation service were, for a number of months, required to deposit documents in an unsecured corridor drop-off box after 11 a.m. because counter service was not available due to a shortage of personnel.

[6] Concern over the implications of extended recordation delays permeates the history of legislative efforts to ensure so-called "quiet title to real property" for real estate buyers in New Jersey. In 1979, N.J.S.A. 46:16A-1 was enacted to permit filing a "Notice of Settlement" by prospective buyers or mortgagees to protect the proposed conveyance for a period of 20 days from the date of filing. In 1987, the insulation period was extended to 45 days. Pending legislation (A-1800) would extend the effective period to 60 days and grant an additional 60 days under certain circumstances.

Although county recording offices remain legally responsible under the Clerk's Liability Act of 1877 (N.J.S.A. 46:25-1) for damages arising from neglect or refusal to perform any service or duty required of them, or for giving any undue preferences, this statute was essentially rendered unenforceable by provisions of the Tort Claims Act of 1972, which was designed, in part, to absolve the County Clerks from liability for malfeasance or nonfeasance. This statute, N.J.S.A. 59:9-2, precludes recovery of negligence damages through civil litigation against County Clerks to the extent that a complainant is covered by title insurance. Thus, ironically, the statutory framework on one hand acknowledges that delay in recording requires protection – now 45 days – but on the other, that Clerks' Offices are immune from responsibility for failing to promptly record. The burden instead ultimately falls upon buyers, sellers and lien holders.

- ***Delays in Opening/Returning Mail***

The Commission found numerous instances in which mail was stamped as having been received on a given date – and yet remained unopened for inexplicably lengthy periods of time. At one point in 2002, more than 50 boxes of unopened mail piled up in the Morris County Clerk's Office.[7] Problematic in its own right, this type of situation can spiral into additional delays, particularly in cases where the documents submitted are found to be statutorily deficient or non-compliant and thus must be returned for re-submission.

Furthermore, even in instances where documents were properly recorded, notification of such was inordinately delayed due to lags in the mail-back process. In one extreme instance, such mail-backs were delayed by as much as ten weeks. Such delays were found to affect Clerks' offices without regard to location, in both urban and suburban/rural counties.

Concurrent with such delays is that fact that consumers, attorneys and other participants in the real estate market are afforded limited opportunity to obtain timely information on the status of pending recordation and filing applications. Only nine of New Jersey's 21 counties, for example, currently provide remote access to computer-based on-line document search and retrieval systems. Moreover, all such searches are conducted under an "information-only" caveat and are not officially certified, and some counties charge additional fees for this service

- ***Insufficient Personnel and Supplies***

Despite the cascade of fee-based revenue stemming from real estate transactions during the period examined by the Commission, a number of Clerks' offices found themselves with insufficient staff, supplies and equipment to keep up with the demand for timely service.

In some instances, Clerks required employees to work weekends or hired temporary workers; eventually they exhausted their budgeted allotment for payment of overtime. In others, Clerks' offices had to scrape for rudimentary equipment and supplies, including computers, pens and legal pads. In one case, in Mercer County, the efforts of the Clerk to cope with the growing backlog of document filings were hampered when county officials eliminated $250,000 in funding for overtime costs.

[7] In Morris County, revenue from real estate transaction fees was reported at $33.9 million for 2003, of which $16.3 million was appropriated to the county budget and more than $17.6 million to the state, while the Clerk's operating budget was a mere $2.3 million – less than 7 percent of the county portion of the fee-revenue collected.

Chronic shortages of personnel and supplies occur despite revenue from a \$2.00 check-off fee collected by Clerks' offices under N.J.S.A. 22A:2-5.1 and placed in trust for the purpose of modernizing document recording and the handling of election-related records. These significant trust accounts are controlled by the various county Boards of Freeholders and cannot be used for personnel salaries. The amounts of revenue involved, however, are substantial. For example, according to the NJLTA, Monmouth County during 2003 received more than \$523,000 for its modernization trust account. Even rural Warren County had more than \$194,000 in its trust account in 2003. The Commission's inquiry turned up no evidence of any uniform auditing of these funds by state or county officials.

Recommendations

The Commission found that in most instances, Clerks and their staffs recognized the need to remedy these problems and responded with aggressive stopgap measures to persevere through the worst of the crunch. However, it became abundantly apparent during the course of the Commission's inquiry that significant steps should be undertaken at the state level to ensure these offices are able to fulfill their constitutional obligations with consistency and effectiveness. Therefore, the Commission makes the following recommendations:

1. Provide Clerks' Offices with Sufficient Budgetary Resources

Given the cyclical volatility of the real estate market, Clerks' offices will always face variations in the level of demand for statutorily-mandated record-processing services. What should not vary, however, is the level of funding sufficient to meet that demand in all instances.

Therefore, legislation should be enacted to explicitly dedicate revenue from real estate recording and filing fees sufficient to enable Clerks' offices to carry out their duties under the law.

As an alternative, the Legislature and Governor should consider legislation requiring counties to establish within their budget process a mechanism to ensure that revenue would be set aside to serve as additional funding for Clerks' offices based upon changing needs and requirements. Maintenance of such funds in a dedicated escrow account by each county would also serve to insulate Clerks' budgets from the vagaries of political considerations and provide them with uninterrupted and unimpeded ability to carry out their constitutional duties and obligations during times of heightened demand for document filing and recordation services. This could be accomplished through amendments to existing statutory language in N.J.S.A. 22A:2-5.1.

2. Authorize Access to Dedicated Accounts

Statutes governing special trust accounts established over the years for certain explicit activities involving Clerks' offices should be examined to determine the utility and practicality of amendments that would authorize expenditures in a broader range of areas.

Under current law, the use of such accounts is restricted to the management, preservation and storage of public records and to the purchase of updated equipment, furniture and other hardware. Consideration should be given to allowing Clerks' offices to access these funds to support the acquisition of personnel and supplies directly related to real estate document processing and recordation.

3. Require Proper Disclosure of Revenue-Raising Mechanisms

As stated in the text of this report, the use of regulatory fees to fund general budgetary obligations raises serious questions about the proper exercise of revenue-raising authority, particularly when it comes to the matter of adequate and accurate disclosure to the citizens of this state.

New Jersey courts have reviewed this issue over the years and have stated that if the Legislature intends a levy primarily to raise general revenue and not to compensate a governmental entity for the cost of providing an explicit regulatory service, or to assist the police power, it should identify that revenue-raising mechanism as a "tax" rather than a "fee."[8] Indeed, the Constitution of New Jersey mandates that every law enacted must embrace a singular objective or purpose, which should be expressed in the statute's very title. Therefore, if a statute does not reveal that the principle objective of a fee is a tax, and there is an unreasonably disproportionate gap between defraying the cost of the service and the amount of revenue raised – both key findings of this inquiry – appropriate amendments should be enacted to clarify and disclose the true purpose.

The Commission is mindful of the pressures that come to bear upon the budget process in times of scarce resources, but the public expects and deserves to be properly and accurately informed of the full scope of government's revenue-raising practices.

4. Standardize Documents and Evaluate Filing Mechanisms

Document forms utilized by Clerks' offices should be standardized throughout the state to effectuate clarity and efficiency in recordation process. Further, although most Clerks' offices have begun to offer the public some form of computer-based electronic filing of documents as an alternative to paper processing, "e-filing" is not uniform across the state. Thus, the Legislature should

[8] See BTD – 1996 NPC 1 L.L.C. v. 350 Warren L.P. and Hudson County Sheriff 170 NJ 90 (2001).

undertake a comprehensive evaluation to determine the most practical, cost-effective approach toward achieving uniformity in the filing process.[9]

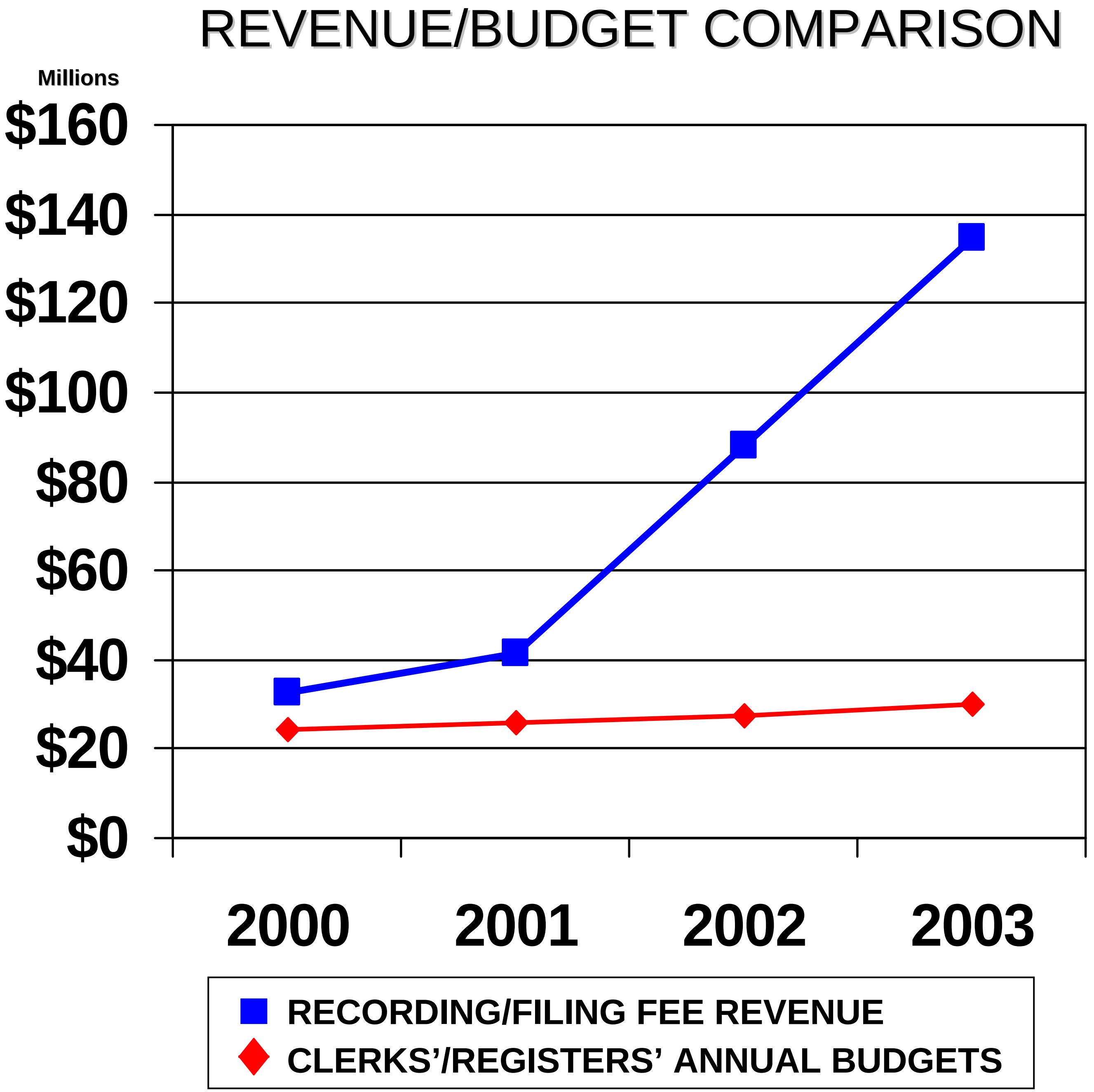
5. Establish a Uniform Electronic Search and Retrieval System

Despite the availability of funding dedicated to modernization, Clerks' offices throughout New Jersey have made limited progress in the use of technology, including for the purpose of providing easy access to information on the status and disposition of documents under their control. Moreover, in the handful of counties where such initiatives have been undertaken, the use of multiple vendors and different operating systems and software raises issues of technical consistency and economic efficiency. Therefore, a uniform computer-based document search and retrieval system should be established to streamline and standardize such activities. The Department of State, through its Division of Archives and Records Management (DARM), and the Department of the Treasury, through its Office of Information Technology (OIT), should undertake this initiative jointly and in conjunction with the state's 21 counties.

6. Implement Cross-Training of Staff

In order to maximize the efficient deployment of personnel, county governments across New Jersey should provide training that would enable non-Clerks' office employees to assist where needed during periods of heightened demand for real estate document processing and recording.

[9] A bill addressing the matter of e-filing, S-1800, is pending in the New Jersey Senate.



REVENUE/BUDGET COMPARISON
Millions
$160
$140
$120
$100
$80
$60
$40
$20
$0
2000
2001
2002
2003
RECORDING/FILING FEE REVENUE
CLERKS'/REGISTERS' ANNUAL BUDGETS

Chart I

COUNTY CLERKS'/REGISTERS' OFFICES
REVENUE GENERATED BY REAL ESTATE TRANSACTIONS
COMPARISON WITH TRANSACTIONS AND GROWTH IN CLERKS'/REGISTERS' BUDGETS
2000 - 2003

REVENUE SOURCE	YEAR 2000	YEAR 2001	YEAR 2002	YEAR 2003	TOTAL	% INCREASE 2000 - 2003
RECORDING/FILING FEE REVENUE	32,663,557	41,412,555	87,878,889	136,398,775	298,353,776	318
RE TRANSFER TAX - COUNTY SHARE	40,698,073	42,845,075	55,427,912	72,406,604	211,377,664	78
RE TRANSFER TAX - STATE SHARE [1]	122,312,850	143,042,995	164,514,844	317,321,510	747,192,199	159
TOTAL REVENUE STREAM	195,674,480	227,300,625	307,821,645	526,126,889	1,256,923,639	169
TOTAL TRANSACTIONS	1,788,686	2,078,909	2,574,332	3,355,538	9,797,465	88
CLERKS'/REGISTERS' BUDGETS	24,512,681	25,865,315	27,335,952	30,205,511	107,919,459	23

(1)The State share is reported on a fiscal basis. For purposes of this report, the State share is entered in the calender year in which the fiscal year begins.

CHART 2