EXECUTIVE SUMMARY

In recent years, policymakers and housing advocates have focused on the home mortgage crisis. The unprecedented rate of foreclosure filings has prompted federal legislation, inspired the creation of foreclosure mitigation programs, and spurred local and state efforts to preserve homeownership. However, another type of foreclosure threatens households: property tax lien foreclosures.

All states have laws that permit local governments to sell property through a tax lien foreclosure process if the owner falls behind on property taxes or other municipal charges. These laws place a lien on the property for the amount of past due taxes. A tax lien almost always has first priority over all other liens, including mortgages. If the taxes remain unpaid, municipalities auction the lien or the property to private purchasers and investors. Prior to foreclosure, most owners have a right to redeem their property by paying the tax sale purchaser the purchase price plus interest, penalties, and costs within the time period allowed by statute. The failure to redeem leads to foreclosure.

These laws serve an important purpose in ensuring that local governments recover tax revenue needed to provide essential government services. However, states rarely update these laws to reflect current economic conditions or to ensure that proper safeguards exist to avoid unnecessary loss of homeownership.

For example, the interest and penalties homeowners must pay to redeem their property after a tax sale are set by laws that were enacted decades ago in most states and do not reflect the current cost of funds. Tax sale purchasers are entitled to a return on investment, but these laws produce profits in many states at a much higher rate than ordinary investments. Although banks currently provide interest on savings accounts at less than 1 percent, many states permit tax sale purchasers to recover interest at rates of 18 percent or more, even as high as 20–50 percent. As noted by the director of a tax sale investor group, these interest rates "beat the heck out of any certificate of deposits." It is for this reason that tax lien sales are often promoted on websites and late-night television advertisements as "get-rich-quick" schemes for investors. These excessive penalties can make it impossible for some homeowners to save their homes from foreclosure.

The structure of tax lien sales also makes it far more likely a homeowner will suffer a devastating loss of home equity as compared with other auction sales. In many states, the property is sold only for the amount of back taxes owed. A tax lien sale may be started over nonpayment of a tax bill of only a few hundred or thousand dollars. Thus, a $200,000 home may be sold at a tax lien sale for $1,200. These bidding procedures mean that homeowners may lose not only a homestead but also thousands or even hundreds of thousands of dollars in equity. This equity may represent their sole savings and security for retirement. As a result, tax lien sales may destabilize communities. Very few states have enacted procedures to protect owners' equity interests or to avoid windfalls to purchasers.

The tax sale procedures in most states are exceedingly complicated and are generally understood only by investors and purchasers. Inadequate notice and a lack of judicial oversight over the process leave many homeowners in the dark about steps they can take to avoid a home loss. Homeowners most at risk are those who have fallen into default because they are incapable of handling their financial affairs, such as individuals suffering from Alzheimers, dementia, or other cognitive disorders.

Those with subprime loans also face additional challenges to remain current on their property taxes. In the conventional mortgage market, lenders usually establish an escrow account that covers the costs of property taxes and insurance. However, the vast majority of subprime mortgage loans made prior to 2008 did not include an escrow account. Some lenders used the lower monthly loan payment without an escrow to induce consumers into believing the loans were affordable. Of course, since the monthly mortgage payments on many of these loans were unaffordable even without considering property tax obligations, many homeowners with subprime mortgages have failed to make property tax payments. Local studies have shown that property tax foreclosures are highly concentrated among low-income communities with large African American and Latino populations, groups also targeted by subprime lenders.

As homeowners navigate a difficult job market, declining home values, and high mortgage foreclosure rates, property tax delinquencies are increasing. Annual property tax delinquencies amount to approximately $15 billion.

Local governments face financial pressures that necessitate a steady stream of tax revenue. At the same time, many homeowners have experienced the negative effects of the recession. States and local governments must reform their property tax lien laws to preserve homeownership. Property tax collection procedures should encourage repayment rather than property loss and they should not provide an opportunity for speculators to earn huge profits off of homeowner distress.

The following recommendations outline the reforms states and local taxing authorities can take to fend off property tax foreclosures. Although most of the recommendations are directed at the state level, some of the actions can be independently pursued by municipalities, such as redemption assistance programs. The recommendations reflect the goals of preserving homeownership and ensuring prompt payment of local taxes.

State Recommendations

- **Make redemption costs affordable by keeping investor profits reasonable.** State laws should be reformed to set the maximum interest or penalty rate for redemption amounts based on current economic conditions. The interest rate should seek to discourage speculation and promote redemption.
- **Place reasonable limitations on additional fees and costs.** States should not permit investors to pad their profits by charging homeowners unreasonable fees to redeem after the foreclosure process has been initiated. State law should establish a maximum fee schedule based on reasonable, market rates for title searches, attorneys' fees, and other fees.

- **Establish a two-step tax sale procedure, with court supervision over the final stage.** States should limit the initial tax sale to the sale of a tax lien certificate, rather than granting an entire interest in the property to a purchaser. If a homeowner fails to redeem the property, state law should require the purchaser to seek a court order authorizing final sale of the property. The court should confirm the final sale results and ensure that the sale price is fair and that any surplus funds are promptly paid to the homeowner.
- **Conduct fair market value sales with proper treatment of surplus.** Nearly one-third of states never even attempt to sell the property itself at a highest bid auction, instead settling for the amount owed for the delinquent taxes. States should change their tax sale procedure to sell the tax lien certificate or deed to the highest bidder. Purchasers could no longer scoop up properties for a fraction of their value.
- **Encourage enrollment in property tax abatement programs.** Many states operate programs to assist property taxpayers. Every state has a special property tax abatement or exemption program which grants full or partial relief to taxpayers due to age, disability, income, or personal status. The benefits are not automatic and most programs require the homeowner to proactively apply for the abatement or exemption. Local governments should publicize abatement and exemption programs at every stage of the tax assessment and collection process.
- **Adopt tax deferral programs.** Some states permit homeowners to defer property taxes. Taxpayers experiencing temporary economic problems, such as unemployment, can delay payment without losing their home. States without a tax deferral program should implement one.
- **Provide for in-hand personal service of the final foreclosure notice.** States should require personal service for owner-occupied property prior to the final proceeding to foreclose the right of redemption. State tax sale laws should operate with the greatest possible care to ensure that homeowners have actual notice of ongoing proceedings and can make informed decisions in response.
- **Provide enhanced notice to at-risk homeowners.** In some states, local social service agencies contact homeowners if records indicate the homeowner is elderly or disabled. Enhanced notice can help avoid property loss by individuals who may be at risk due to conditions affecting their ability to handle financial matters.
- **Vary the length of the redemption period.** States should grant owner-occupied properties at least one year to redeem their property. A year-long redemption period prior to foreclosure can allow homeowners to recover from temporary economic setbacks and become current on their property taxes. We urge states to adopt shorter redemption periods for abandoned and vacant properties.
- **Create redemption assistance programs.** Several states maintain small emergency loan funds for homeowners who face home mortgage foreclosures. Other states allow housing agencies to acquire the property tax lien before private investors. The housing agencies work with the homeowner to avoid a loss of the home. Most of these programs target homeowners who are experiencing temporary financial

difficulties. States should adopt an emergency assistance program to assist homeowners in exercising the right of redemption after a tax sale.

- **Create an indemnity fund to compensate owners for defective tax sales.** State laws limit the bases and time frames on which a tax sale can be set aside. States should create an indemnity fund for property owners who sustain losses or damages as a result of a defect in the tax sale, but who cannot bring legal claims.

Local Recommendations

- **Make pre-sale payment plans available.** Local tax collectors should adopt a formal installment payment program. Homeowners without an escrow account for taxes and insurance benefit from such payment programs and are able to maintain a budget to stay current on their taxes.
- **Implement redemption payment programs.** Local tax offices should collect redemption payments to eliminate the possibility that an unscrupulous purchaser may thwart the owner's attempt to redeem. The local tax office should accept partial and installment payments.
- **Adequate notice should be given at every stage of the tax sale process.** Although municipalities must provide notice to property owners prior to a tax sale, notifications should be used as a tool to avoid loss of homeownership. Comprehensive notices should use plain language, include information about tax exemptions, abatements, and repayment plans, and note the consequences of each stage of the tax sale process.
- **Provide detailed notice of redemption rights.** The notice should give all of the essential details on how the redemption right can be exercised, including the name and address to which the homeowner can remit payment, itemized costs, and the deadline for the redemption payment.