TEXAS PUBLIC POLICY FOUNDATION
Testimony

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Center for Economic Freedom

Tax Lien Lending is a Cost-Effective Way to Manage Property Tax Debt

Testimony before the House Committee on Business and Industry

by Bill Peacock, Vice President of Research and Director, Center for Economic Freedom

Mr. Chairman, members. Thank you for having me here today. My name is Bill Peacock. I am the Vice President of Research and the Director of the Center for Economic Freedom at the Texas Public Policy Foundation.

A free-market research organization, the Foundation has a particular interest in public policies that preserve the right of Texan consumers to pursue opportunities that advance their economic interests. It's with this framework in mind that I come before you to discuss the implementation and impact of SB 247 and our concern over how restrictive regulations could deny Texas property owners access to what has proven to be a cost-effective alternative to the delinquency process.

The Market for Tax Lien Lending

As you know, tax lien lending refers to a specialized financial practice that allows Texas property owners, both commercial and residential, to pay their annual tax bill if they cannot meet the terms of other payment options.

These loans satisfy an existing demand for market-based services offering tax assistance, driven in part to mounting property taxes and in part to the cost and inflexibility of the delinquency process. According to the Office of Consumer Credit Commissioner, Texas property owners elected to take out 14,526 property tax loans in 2012; this represented a 16.8 percent increase since 2008.

In competitive markets, industries only emerge and mature in proportion to value of the service provided and the size of the customer base attended. The fact that property owners are using this service at his level shows that tax lien lending satisfies a need that other payment options do not provide or at a price other payment options do not match.

Any attempt at restricting lien lending will not eliminate the demand for it; instead, it will reduce the ability of Texas property owners to receive much needed financial assistance, increase the costs of resolving their problem, and even potentially lead to the loss of their property.

Part of the demand is a clear reaction to the government's tax policy. By all accounts, Texans today surrender a higher percentage of their yearly earning towards property taxes than they did in years past. Over the last two decades, Texas property owners have seen their property taxes jump 205 percent, which is almost three-times faster than the gains in personal income. On average, Texans now dedicate nearly 5 percent of the annual household income to meet their property tax obligation.

The increase has put a growing strain on property owners' the ability to pay their taxes. As a quick example, the delinquency rate here in Travis County has jumped from 5.1 percent in 2000 to 10.6 percent in 2013.

Another part of the demand arises from the expense of the delinquency process. Delinquency penalties follow a fixed schedule that can add more than 40 percent to a property owner's tax bill within the first year, doubling it after five years. Come February 1st, taxing units attach a 6 percent penalty, adding one percent for each additional month the tax is left unpaid until July 1st, when all delinquent taxes incur an additional 12 percent penalty. In addition, overdue taxes begin to amass an additional 1 percent interest each month (or 12 percent per annum). On top of these charges, after July 1st, tax units often rely on private law firms to pursue overdue taxes, which can add another 15 to 20 percent in collection fees.

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These direct costs do not include secondary consequences such as a lower credit rating and the risk of foreclosure. Moreover, government installment plans authorized in HB 1597 last session cannot fully satisfy the demand for alternatives to the delinquency process. While these can offer property owners a cheaper method of resolving their tax debt than a tax lien transfer, they are not suitable for all property owners.

One example of this is that not every property owner qualifies. The legislation limited access to "residence homesteads," meaning that landowners of commercial and non-owner occupied properties are excluded. An investigation by the Finance Commission showed that commercial loans made up over 14 percent of the tax lending market it 2011. Another survey suggested that non-owner occupied properties represented around 20 percent. These property owners—investors, landlords, business owners, and families with a second property—are not guaranteed an installment option and will continue to have an occasional need for liquid capital.

Second, the payment plans have fixed terms which may not suit the fiscal needs of qualified property owners. For example, the statute expressly stipulates that taxpayers make their payments in equal installments. It also stipulates that all installment plans have a payment period of at least 12 months and a maximum length of 36 months. Although not unreasonable, some property owners may still find a need or preference for different terms. Texans may face delinquency for an untold number of reasons. Unlike the government installment plans, tax lien lending permits these property owners to customize their repayment plans.

Considering the long-term financial harm of delinquency and foreclosure, the inability of the government payment plans to meet every property owners need, and for other individual reasons, many property owners choose to resort to market-based options when they find themselves in temporary fiscal straits and unable to pay their property taxes.

The Costs of Tax Lien Lending and Alternatives

Tax lien lending is one of the best market alternatives available today. It offers Texas property owners a reasonable and cost-effective way to avoid the economic fallout of tax delinquency. According to the Finance Commission, a tax lien transfer can cost significantly less than remaining in delinquency. This is especially true if a property owner initiates the transfer before or shortly after the taxes turn delinquent.

To give an illustration, the Finance Commission projected how an $8,000 tax bill would fare under each payment option. The study then concluded that the delinquency process would balloon the original $8,000 to between $16,608 and $17,088 after five years. Conversely, the final tax bill under a tax lien transfer (assuming a 14.37 percent interest rate) would land somewhere between $13,156 and $17,511.

The Finance Commission also compared the costs of tax lien lending with the costs of paying property taxes by credit card. It concluded that paying an $8,000 tax bill would result in a final invoice of between $13,339 and $17,653.

Additionally, the costs and interest rates associated tax lien lending have fallen thanks in large part to market forces. Indeed, the average residential property owner saw interest rates decline from 15.92 percent in 2008 to 14.37 percent in 2011—state law currently caps interest rates at 18 percent. Additionally, closing costs have declined for residential taxpayers in terms of the amount expended, from $1,259.40 to $865.52, and their size relative to the amount borrowed, from 17.4 percent to 9.8 percent. Commercial property owners also have seen interest rates decline in the same period from 15.01 percent to 14.20 percent.

The bottom line is that tax lien transfers seem right on par, if not more economical, than other payment methods. The comparable cost of tax lien transfers, along with the declines in price, should help dispel the common fear orbiting tax lien lending that its costs are too high.

However, tax lien transfers could be even less expensive if some property owners were allowed to access them before entering delinquency. The Finance Commission study presupposed that the taxpayer became delinquent and faced a collection of penalties before taking out the tax lien transfer, $560 and $3,328 respectively. Without those extra fees, the final price of a tax lien transfer would drop markedly.

This is a meaningful point. Property tax loans are most advantageous for Texas property owners before their taxes become delinquent. Once a property owner enters delinquency, penalties start to accumulate rapidly. As such, regulations that delay property owners from seeking out market-based tax assistance foists additional, unnecessary costs onto their shoulders.

Consumer Choice

Perhaps the most important point to make about tax lien transfers is that they are voluntary transactions made in a voluntary market. If consumers did not use them by exercising consumer choice, they wouldn't exist. There are several aspects of this worth mentioning.

Property tax lenders provide a voluntary service in a highly competitive market and depend heavily on their reputation and long-term relationships to solicit business. Consequently, they would see their reception among Texas property owners would drop dramatically if they obtained a reputation for having excessive prices or inequitable terms. Competition and consumer choice operate as effective safeguards against industry excess, not restrictive regulations that hinder property owners' access a reasonable alternative to tax delinquency.

Additionally, unlike other payment methods, tax lien lending involves a personal negotiation that can have an appreciable impact on the contract's terms and prices. This means that property owners can tailor the repayment process and restructure their existing debt in a way that better suits their own particular circumstances. Simply put, tax lien lending offers property owners a way to take control over their tax debt instead of having its terms dictated to them.

Recommendations

When we look at SB 247 and its implementation, we need to ask what impact these new regulations will have on the ability of Texas to enter the market and find workable solutions to their unbending tax burden. We also need to look at how past restrictions add unnecessary costs to Texas property owners.

With that in mind, the Foundation offers two recommendations aimed at facilitating access and eliminating unnecessary costs.

First, the Legislature should amend Section 32.06(a-2) of Texas Tax Code and eliminate the prohibition on property owners with mortgages from using tax lien transfers before their taxes are delinquent. At present, the tax code requires that taxpayers with a mortgaged property wait until their taxes become delinquent before they can initiate a tax lien transfer. In contrast, Texans who own their land outright have the option of initiating a transfer once their taxes are due. This restriction imposes unnecessary expenses on property owners with a mortgage. The rule denies these taxpayers a chance to proactively take charge of their tax debt and forces them to assume at least a 7 percent increase on their tax bill. It in effect penalizes Texans for having a mortgage. This provision may be to the advantage of special interests, but it harms taxpayers and consumers.

Second, the Legislature should refrain from amending Section 32.06 to alter or eliminate the tax lien's special status, as was proposed last session with SB 1449. Critics commonly note that tax liens have superior priority than the secured interests of other creditors, which they fear could disrupt the investment-backed expectations of other creditors. However, changing the priority of the tax lien would do more than just switch the order of which creditor is paid first. It would effectively terminate tax lien lending as a viable commercial practice since, without the guarantee of payment, property tax lenders could not offer the same favorable terms or contract with customers experiencing fiscal troubles. In other words, Texas property owners would lose their access to a preferred means of tax relief, and taxing entities would lose a means by which many otherwise delinquent property tax bills are paid on time. It should also be noted that the transfer of the tax lien under the current system does nothing to change the status of other lenders on the property.

Tax lien lending fulfills a clearly-defined demand in the Texas market—one that is not fulfilled by existing government payment options. So long as this demand exists, Texas taxpayers will not be served by regulations that second guess their financial decisions and deny them access to a cost-effective way of avoiding delinquency.

About the Author

Bill Peacock is the vice president of research and director of the Texas Public Policy Foundation's Center for Economic Freedom. He has been with the Foundation since February 2005.

Peacock has extensive experience in Texas government and policy on a variety of issues including, economic and regulatory policy, natural resources, public finance, and public education. His work has focused on identifying and reducing the harmful effects of regulations on the economy, businesses, and consumers.

Prior to joining the Foundation, Peacock served as the Deputy Commissioner for Coastal Resources for Commissioner Jerry Patterson at the Texas General Land Office.

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