

THE TAX LIEN INVESTOR'S RELATION TO THE COLLECTION OF DELINQUENT TAXES

A. U. RODNEY*

In normal years and prosperous years nobody paid very much attention to real estate taxes, taking them as a matter of course. Properties, especially in the East, were practically all mortgaged, principally by institutions, and part of their business was to call the attention of property-owners to their taxes. With the break-down of the mortgage structure through the difficulties of the title companies and other lending institutions, and coincidentally the difficult times, tax delinquencies mounted to such an extent that property-owners, municipalities, and bankers for the municipalities became sharply cognizant of the situation and started to examine carefully the procedures provided by the laws for the enforcement and collection of these liens.

THE BANKER'S INTEREST IN COLLECTION OF TAXES

Many bankers for municipalities have, in the past, been surprisingly lax in their requirements for proper safeguards to secure their municipal investments. Beginning in about 1932, realizing that their security was being impaired, bankers insisted upon reforms aimed directly at tax collections and tax collection methods. The very effective weapon of refusal to refinance communities unless these reforms were adopted was used with excellent results. In Westchester County, New York, for example, at about that time, bankers for several of the municipalities, and for the county itself, refused to advance additional funds or refinance current obligations unless two major proceedings were adopted. First, they insisted that sufficient taxes be levied to bring in enough actual cash to equal the annual budget. This had to be done by levying an amount equal to the average collections plus the probable deficiency in the collections. For example, the average collections were about 70 per cent of the annual levy, leaving a deficiency of 30 per cent. Therefore, the next annual levy had to have a cushion for this probable deficiency; thus, the levy would have to be 30 per cent in excess of the actual requirements. Another method adopted was to require a municipality to include in its new budget the entire amount of the delinquent taxes from the previous year.

The other major requirement was the insistence on a sound, workable tax lien

* Class of 1917, Cornell University. President and Director, Bonded Municipal Corporation, New York City; Vice-President and Director, Atlantic Municipal Corporation. Associate Editor, *The Magazine of Wall Street*, 1919-1921.

law, making it mandatory for the municipality to hold a sale for delinquent taxes as soon after the fiscal year as was reasonable. A third requirement was, of course, the cutting of administration expenses to the lowest possible figure.

In line with the bankers' insistence on enforcement of the collection of delinquent taxes by a sound tax lien sale law, it is interesting to note that the City of New Rochelle, New York, had a tax lien law on its books for many years which contained the provisions, briefly, to the effect that if the delinquent taxes were not paid, the City Treasurer, *at his discretion*, could hold a sale of these delinquent properties. The law also contained a provision permitting the Law Department to foreclose against these properties. Practically nothing was ever done about it; the sales never held, and actions prosecuted by the Law Department were negligible.

Upon the bankers' refusal to renew certain obligations unless a new tax lien law was enacted, this city did enact a local tax lien law which was similar to the Westchester County tax lien law in effect at that time and which is one of the best laws for the sale of tax liens that the writer has examined. The results were startling. In its advertisement of sale under this new law, approximately \$1,200,000 in delinquent taxes were advertised. Between the time the first advertisement appeared and the time of the actual sale (six weeks), the amount of delinquent taxes was reduced through payment by parties interested in the properties over 50 per cent. By the time the actual sale was concluded, not over 15 per cent of the original amount advertised remained delinquent in the hands of the municipality.

That bankers may have learned their lesson is evidenced by the careful examination of tax arrears in the last few years,¹ and it is hoped that the banking community will continue to be very critical of municipal financial administration.

THE EFFECT OF THE ADMINISTRATION OF TAX COLLECTION LAWS

It is interesting to examine the wide variety of laws throughout this country for the enforcement of collection of delinquent taxes, and particularly their practical application. Interest rates for redemption of liens after sale range from as low as from 5 per cent per annum to 100 per cent. The length of time permitted to property-owners or parties of interest to redeem runs from one year to five years, and the method of the sale of the property for tax liens themselves also varies widely in different states and in different sub-divisions of the states.²

The most satisfactory type of laws provides for the sale of a tax lien certificate with actual foreclosure at the end of the redemption period to enable the title to be perfected.³ Under all the new amendments to tax collection laws, foreclosure pro-

¹In another city in the same county an article appeared in the local newspaper under date of April 7th, 1934, as follows: "Bankers . . . offered to City Officials of Mount Vernon yesterday a loan if they would enforce a one-year tax lien ordinance and levy a supplementary budget as recommended by the Westchester County Financial Advisory Committee. . . ."

²For a survey of these laws, see Allen, *Collection of Delinquent Property by Recourse to the Taxed Property*, *supra*, p. 397.

³Laws which, as in Chicago and Washington, D. C., provide for the execution by an administrative officer of a deed to the lien holder at the end of the redemption period are unsatisfactory since the courts

visions are specifically adopted. Yet from a practical standpoint, many of the best of these tax lien laws fail in their purpose if they are improperly administered, and this is certainly the case in a great many places. For example, the City of New York has a tax lien law which embodies all the features recommended by tax experts to make up a good law, yet its administration greatly nullifies its effectiveness.

Briefly, Section 1027 of the City Charter provides that a tax lien for delinquent taxes shall be sold three years after the tax becomes delinquent. As a matter of actual fact, the books containing the list of delinquent tax liens have to be printed, and sales are not held until practically another year has elapsed. Even then, only a small portion of the liens advertised are offered for sale on the date for which the sale is scheduled. The sales from the list are held at the convenience of the tax arrears department at various times, extending as much as fifteen months from the original date of sale. This, of course, is undesirable and mitigates against the sale of the lien, since there is already four years' accumulation, and the lien is supposed to be held by the purchaser thereof for an additional three years. Thus there may be a possible accumulation of seven years' taxes, plus interest, penalties, costs, etc., which usually makes the lien less attractive to the investor. Experience has proven that the volume of sales and the payment of taxes before sale decrease in direct proportion to the length of time allowed before the lien is offered for sale.

The administration of the New York City law is not the only example of the nullification of the effect of a "good" law by improper administration. In the State of New Jersey, for example, the law provides that liens for delinquent taxes must be sold as soon after July 1st as possible of the year following the year when the tax originally became a lien. Theoretically, that would mean that taxes that remain unpaid for the year 1934 must be sold by the municipality as soon after July 1st, 1935, as possible. In actual practice, a large number of the municipalities do not comply with the law, and there are innumerable instances where no sales are held at all and the taxes, for example, as far back as 1933 have not at this writing as yet been offered for sale. Atlantic City, which comes under this law, has not had a sale since 1934, and Asbury Park has held sales at odd times for delinquent taxes long in arrears. Jersey City held no sale for delinquent taxes for eight years prior to December, 1935. The City of Newark, on the other hand, has recently held its sales promptly, as have a great many other New Jersey municipalities. Newark is an outstanding example of the improvement in a city's general finances through holding tax lien sales as required by the statute.

There are many taxing bodies throughout the country which hold their sales in strict compliance of the law, such as the Counties of Westchester, Erie, Nassau, and

frown upon titles acquired in this manner. Still worse is the procedure in California where the property passes automatically to the state, and, after five years, is offered by it at public sale. Laws which provide for the sale of the smallest portion of the delinquent property necessary to satisfy the tax lien never produce appreciable results for not only is the title likely to be defective but the sale attracts only persons interested in the specific parcel itself or those who desire to acquire a portion of it for its nuisance value.

Suffolk in New York State, but even where there is strict compliance, the political aspect cannot seem to be avoided. It is nothing unusual to have certain properties withdrawn from the sales on promises that the party of interest would pay, or upon the payment of a small amount as evidence of good faith. This throws the entire machinery for the enforcement of the law out of gear with regard to those particular properties since they do not automatically become subject to liens, and many legal problems arise as a consequence.

It has been the general attitude of municipal officials to ignore tax collections, or at least to avoid discussing them, and the mere thought of any vigorous efforts to collect taxes, particularly delinquent ones, was to be scrupulously avoided. Rockland County, New York, was successful in its sale of liens to investors and, more important, in the collection of liens offered for sale before the actual sale because of the threat of the sale. Nevertheless, because of its political unpopularity, the law was changed, reducing the amount of the interest from 10 per cent to 7 per cent, with the result that the year following this amendment, the County offered approximately \$500,000 in delinquent taxes and received bids for only about \$7,000. An effort was made to change the law in the City of Buffalo, New York, but fortunately for that city, this proposal was defeated because of the consideration given to some interesting figures presented by competent municipal finance experts.

One of the exhibits presented was a comparative schedule of the annual real estate tax levies and total uncollected delinquent taxes in the Cities of Buffalo and Rochester, New York, from 1905 to 1929. This exhibit showed that annual sales were held in the City of Rochester down to the year 1905. In 1905 the Rochester real estate levy was \$2,129,646 and the uncollected delinquent taxes at face were \$276,957. In the same year in the City of Buffalo the real estate levy was \$4,923,421 and the uncollected delinquent taxes at face were \$1,908,411. This report states that investment buying of tax liens was very active in the City of Rochester while the law for their sale was in effect, and up to that time there were no tax buyers in the City of Buffalo. With a reversal in the practices of the two cities came a marked change in their situation as to tax delinquency. In 1929 the real estate levy in the City of Buffalo was \$27,875,714 and the uncollected delinquent taxes at face were \$871,218. In the City of Rochester in the same year, the real estate levy was \$16,380,688 and the uncollected delinquent taxes at face were \$1,862,985. Based on these figures, in proportion the delinquency in Rochester would be about four times greater than in Buffalo.

During the strenuous days of 1931 to 1935 there was a great deal of favorable publicity in support of strict enforcement of tax lien laws, and many municipal officials began to realize that a vigorous stand on severe methods to enforce collection of taxes could be made a political benefit rather than the opposite. They simply saw the point that since delinquencies in any one year averaged from a fraction of 1 to 20 per cent of the tax levy, therefore, the 80 to 99 per cent of the prompt tax-

payers are forced to pay increased taxes because of the minority who are delinquent. In one township in Westchester County a supervisor, faced on the one hand with running for reelection and on the other with straightening out a badly-muddled state of finances, called a general town meeting to explain why it was necessary to hold a sale of delinquent taxes on a large scale. When he pointed out to the taxpayers that the majority would have to pay increased taxes if the sales were not held, it was amusing to see how vigorously the assemblage insisted that the sales be held regularly without fear or favor thereafter.

TAX LIEN INVESTMENT COMPANIES' RELATION TO THE COLLECTION OF DELINQUENT TAXES

The purchase of tax liens for investment purposes is a highly-specialized and technical business. While there are many companies operating in the field in various sections of the country, and these companies are of a substantial nature, their combined resources are small in proportion to the amount of tax liens sold each year. Nevertheless, because of the wide variety of laws, and because most of the laws make it unsafe or unprofitable for investment in this field, more investment funds are available than there are investment opportunities.

There are in each community a few individual investors or real estate operators who purchase tax liens, tax deeds, or the property itself, whichever is sold, for the purpose of acquiring the property. The operations of this group are so small in relation to the operations for investment purposes that they are hardly worth considering. The investment companies, however, have a distinct place in the scheme of the collection of delinquent taxes. Where the law is favorable, the competition for the liens for investment purposes is very keen.

The tax lien investors' value to the municipality lies, not only in their ability and willingness to purchase the liens offered, thus supplying the municipality with the funds, but also in the fact that the property-owner has a strong incentive to pay his taxes before they go to sale when private buyers are available to purchase the liens. The description earlier in this article of what happened in the City of New Rochelle, New York, when the properties were advertised for sale under a tax lien law that meant business, is a good example. \$1,200,000 in tax liens was to be offered as advertised, and this list was reduced by 50 to 60 per cent by the time the actual sale was held. All efforts previously on the part of municipal officials to force payments by threat, foreclosure, or in any other way, were without result.

An investment company submitted an application to purchase from a municipality in New Jersey, approximately \$250,000 of tax liens held by that city, on which no collections had been made, although the city had held the liens for some time. Under the New Jersey law, a public advertisement of this proposal had to be published for five days before the liens could actually be assigned. Any redemptions in the meantime, of course, were deducted. During that five day period close to \$200,-

000, or 80 per cent of the liens, had been removed from the list, and the remainder were assigned. The city received the \$250,000, but the significant point is that the threat to transfer a primary interest in the property to a private corporation resulted in the immediate protection of the property by the parties of interest.

Many of our legislators who are evidently not familiar with the practical operation of the tax investment business cannot see why it is necessary to provide comparatively high yields in the form of interest and penalties on tax lien investments. The answer is very simple.

In the first place, in the proper conduct of the tax investment business, it is necessary to examine each and every parcel offered individually. When a list of delinquent taxes is advertised for sale, a complete check-up of this entire list must be made. This includes an examination of the tax rolls disclosing the valuations of the properties, an examination of the tax arrears, very often a title examination and physical inspection. This requires a staff of competent and experienced investigators. When these lists have been properly prepared at a very considerable expense, there is always a large reduction in the amount of liens actually to go to sale. The tax investor never knows which will be offered and which will be withdrawn, and therefore, must prepare the list from beginning to end. When the investment is made and the liens acquired, a tremendous amount of detail is involved in setting these up on the books as the items are usually small. Since all of these items are delinquent in the first place, a great deal of effort and much detail is required in the enforcement of collection. A properly conducted investment institution in this field must employ on its staff competent attorneys to handle the innumerable legal details involved.

While the investment in tax lien certificates is a sound one, its duration is indefinite, as all of the laws permit redemption at any time during the redemption period; thus the investment may be made one day and be returned the next. On practically all other comparable investments, such as municipal bonds, mortgages, etc., the investment is made in one large amount for a definite length of time and the investor has no further bother or overhead in connection with it.

Because of the legal complications, the tremendous detail and the indefinite maturity of a tax lien investment, the financing of tax liens by investment companies, presents some difficult problem. Undoubtedly, if the laws were simplified, and the procedure for the sales made more uniform, there would be considerable expansion in the activities of investment companies in the tax lien field.

GENERAL SUGGESTIONS FOR A TAX LIEN LAW

All competent authorities on municipal administration agree that a sound, workable law should contain three important factors. Quoting from "*The Enforcement of Real Estate Tax Liens*" by Mr. Carl H. Chatters, formerly City Auditor of Flint, Michigan, and now Executive Director of the Municipal Finance Officers Association:

"An efficient law for the enforcement of real estate tax liens must bring about payment of the taxes at an early date and at the same time be just to the taxpayer. Three things must be considered; first, the prompt collection of money due the municipality; second, the rights of the taxpayer; and third, the attraction of buyers for the tax certificates or other tax liens. Too much stress on any one of these points may throw the law out of balance and thus defeat its purpose."

Mr. Chatters prescribes the following three points for inclusion in any efficient tax collection law, the first of which he terms "the most important single factor in the development" of such a law:

1. The tax "sale should be held in the eleventh or twelfth month of the fiscal year for which the tax is levied."
2. "The sale should be made to the person offering to permit redemption at the lowest interest rate."
3. "The final enforcement of the tax lien should be by foreclosure in the same general manner as the methods used in foreclosing mortgages."

The National Municipal League in 1935 formed a committee with a distinguished membership, headed by Colonel Arnold Frye, prominent New York municipal attorney, to study the situation and offer suggestions for a model real property tax collection law. Quoting from the report:

"A study of the tax laws of those States where collections have been conspicuously good has led the Committee to the following conclusions as to what a model law should contain:

" . . . Tax liens should be sold at a general sale soon after the date of delinquency of the last installment. The law should make it mandatory that sales be held annually at an invariable date. Sales once begun should be continued from day to day without adjournment. Experience has shown that otherwise, favoritism may creep in and taxpayers will come to the conclusion that taxes need not be paid. The method of bidding should be on the interest rate which the purchaser will accept, thus keeping down the cost, but with a statutory maximum rate high enough to attract purchasers. The exact rate will depend on prevailing money rates but experience indicates 12 per cent per annum as a reasonable maximum. It has also been found that purchasers cannot be obtained if foreclosure is delayed and is expensive because such lien certificates are not desirable bank collateral. For this reason, the law may provide that interest be payable semi-annually and the period of redemption be shortened if interest and current taxes and assessments be not paid."

This committee drafted a model real property tax collection law, which, in the writer's opinion, has all the features that are necessary for a law that will produce the cash required by the municipalities and other taxing units for their operations. If this law were adopted generally, they would be benefited, the taxpayers would be treated fairly, and the investment companies operating in the field could greatly expand their services in relieving governmental bodies of the burden of tax delinquency.