

Legislative Analysis



COUNTY DELINQUENT TAX REVOLVING FUND INTEREST RATES

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House Bill 5074 as enacted
Public Act 33 of 2014
Sponsor: Rep. Cindy Denby
House Committee: Local Government
Senate Committee: Finance

First Analysis (1-26-15)

BRIEF SUMMARY: The bill allows a county to charge a lower monthly interest rate to other taxing units having delinquent property taxes. Previously the required rate was one percent; under the bill, the required rate would be "up to one percent."

FISCAL IMPACT: As written, the bill could potentially reduce county revenues by an unknown amount, and increase revenue to the state and other local units by that same amount. The magnitude of this shift in revenues depends on the number of counties that reduce the interest rate, the new interest rates, and the amount of delinquent taxes borrowed by local units within the county. However, these numbers cannot be known in advance, therefore an estimate of the revenue shift cannot be made. To the extent the state realizes a revenue increase, the vast majority would accrue to the School Aid Fund.

THE APPARENT PROBLEM:

A recent report prepared by researchers at Michigan State University, entitled *A Review of Municipal Bond Issues in Michigan* (published 1-17-11), includes a brief description of Michigan's tax reversion process, including an explanation of what county treasurers call "charge-backs"—the protocol they follow when local units of government have borrowed from a county's delinquent tax revolving fund.

Generally, as the report summarizes, "if summer and winter property taxes are not collected by March 1 of the following year that the tax is owed, local treasurers pass on notices of unpaid or delinquent taxes to county treasurers. In many counties, the county treasurer runs a delinquent tax revolving fund."

Upon receiving the notices of unpaid taxes, "the county treasurer advances funds to those local governments that are owed taxes, making them financially whole at that time," with the understanding that local treasurers will pay back the advance, either after the taxes in arrears are paid by the property owners, or after the property is sold at a public auction, sometimes called a 'sheriff's sale.' Under state statute, county treasurers charge a monthly interest rate of 1 percent for advancing the money to make the local unit of government whole.

"Historically," the report continues, "counties have been able to auction properties and recover delinquent tax funds through such auctions. The recent housing and financial crisis has put a major damper on these auctions. In some cases, sales are not possible or bids so low that the proceeds do not cover the delinquent taxes. In these cases, the county treasurer must 'charge back' the losses to the local governments within that county. These charge backs represent a potential hit to a local unit's revenue." (See ***Background Information***, for a more detailed explanation of the process.)

In some counties the loss of revenue from delinquent taxes has been exacerbated by the decisions of economic development agencies to create special assessment districts for new developments whose owners have now defaulted on their development loans, and declared bankruptcy. For example, in Livingston County, high expectations for rapid economic growth led township officials in Tyrone Township and Howell Township to issue bonds (that is, sell their debt), in order to build water and sewer systems in partnership with area banks and land developers. The officials, together with their partners, assumed that bond repayments would be made using the revenue from the special property tax assessment. Now, however, repayment of those bonds is the subject of continued negotiation with area lenders, because the projects never got underway and the land remains vacant or the projects are substantially incomplete, the housing unsold.

Whether the result of homeowner- or developer-mortgage defaults, a county treasurer's delinquent tax revolving fund works to make local governmental taxing units whole, ensuring a steady tax-revenue stream, although charging the customary interest (12 percent annually), and fees for the revenue-advance. Over time, the interest and fees accumulate, if the delinquent property taxes remain unpaid.

A bill similar to House Bill 5074 was debated during the 2011-2012 legislative session. (See ***Background Information*** below.) At that time, officials from Livingston County's Howell and Tyrone Townships explained that the interest charged for the advances from the county treasurer's delinquent tax revolving funds has grown excessive. For example, the manager and financial director of Howell Township testified that "Howell Township paid Livingston County \$1.7 million for chargebacks this year (2011), \$380,000 of which was interest." Because the tax reversion process extends over three years, interest rates sometimes soar. Howell Township's manager also testified: "This year we will have a property that is going up for tax sale that was given three consecutive hardships (i.e., tax waivers) by the state of Michigan, thereby increasing the interest rate (over a six-year period) charged on the delinquent tax to 72 percent."

Likewise, the Tyrone Township treasurer reported that two properties there (two of many) have taxes due equaling \$1,412,181 plus interest of \$445,123—the total amounting to over \$1.8 million. Further, Tyrone Township's bond fund for sewers is in deficit, and the pay-out required exceeds the township's general fund balance. And, the supervisor of Handy Township testified that officials there created two special assessment districts—one ordered by the courts—before "the economy tanked, and the developers walked." Now, there are lawsuits preventing property sales. Nonetheless, the township's chargebacks will

total \$2.4 million in 2014—far in excess of the jurisdiction's property value, where a mill levied in property tax generates just \$263,000.

Legislation was been introduced to allow for lower monthly interest rates charges by county treasurers on local units of government who have been made whole on delinquent property taxes, using withdrawals from the county's revolving tax fund.

THE CONTENT OF THE BILL:

House Bill 5074 would amend the General Property Tax Act (MCL 211.87b) to change the monthly interest rate that a county treasurer must charge other taxing units in the county that have delinquent property taxes due. The current monthly rate of interest is one percent. Under the bill, the monthly rate of interest would be "up to" 1 percent.

BACKGROUND INFORMATION:

This bill is similar to House Bill 4150 introduced during the 2011-2012 legislation session. Under that bill, the monthly rate of interest for "chargebacks" would have dropped to 0.5 percent through December 31, 2016; then on January 1, 2017, the monthly rate of interest would have returned to 1 percent. In contrast, this bill allows, but does not require, county treasurers to lower the rate of interest on "chargebacks."

Overview: Tax Reversion Process and Chargebacks.

(Source: *A Review of Municipal Bond Issues in Michigan*, by Eric Scorsone and Christine Plerhoples, Department of Agricultural, Food and Resource Economics, Michigan State University, published January 17, 2011. Pages 43-44.)

"Michigan has a very specific three-year process regarding property tax delinquencies. Property taxes are levied and due to local governments on December 1 (winter) and July 1 (summer). Various governments use different dates for collection. If property taxes owed are unpaid in a given year, a specific delinquent tax process begins.

"If summer and winter property taxes are not collected by March 1 of the following year that the tax is owed, local treasurers pass on notices of unpaid or delinquent taxes to county treasurers. In many counties, the county treasurer runs a delinquent tax revolving fund. The county treasurer advances funds to those local governments who are owed taxes making them financially whole at that time.

"The county treasurer then adds on a 4.0% county property tax administration fee plus a 1.0% per month non-compounded interest and sends out two tax notices, one on June 1, then another on September 1 after which a \$15 fee is added to the tax note by the county treasurer.

"In the second year of the delinquent tax process, the county treasurer sends out a third tax notice on February 1 and then on March 1 the property is forfeited to the Foreclosing Governmental Unit (FGU) with a \$175 per-parcel fee plus a 0.5% per-month interest

retroactive to March 1 of the previous year. Seventy-one county treasurers opted-in as FGUs but for 12 counties responsibility for tax reversion shifts hands from the county to the State, and the property forfeits to the State as the FGU. (Note: The counties that have opted out are Keweenaw, Iron, Dickinson, Luce, Kalkaska, Iosco, Mecosta, Clinton, Shiawassee, Eaton, Livingston, and Branch)

"Upon forfeiture, the FGU begins due process for owner notification: mails letters, conducts title research for the forfeited parcels, files circuit court petitions requesting hearings with respect to the forfeited parcels, and conducts site visits to the forfeited parcels.

"Finally, in the third year of the tax reversion process, judicial foreclosure hearings are held. Once there is a judicial order of foreclosure and the redemption period of March 31 has expired, the foreclosed property is sold at public auction to the highest bidder by the FGU beginning in July. The proceeds from the sale are distributed according to the order of priority established in the statute. The unsold properties are then transferred to the local unit of government in which the parcel is located unless a written objection is filed in which case the state or county retains possession of the property.

"Historically, counties have been able to auction properties and recover delinquent tax funds through such auctions. The recent housing and financial crisis has put a major damper on these auctions. In some cases, sales are not possible or bids so low that the proceeds do not cover the delinquent taxes. In these cases, the county treasurer must 'charge back' the losses to the local governments within that county. These charge backs represent a potential hit to a local unit's revenue."

ARGUMENTS:

For:

Proponents of this bill say that the housing and financial crises have resulted in a continuing decline in property values and record-high home foreclosures, so that a majority of local units of government are experiencing increased delinquent property taxes, most notably including delinquencies within special assessment districts where the revenue stream was intended to make annual debt payments.

Proponents of the bill note that in the past when local units of government have been "made whole" by the county revolving tax fund, they have faithfully repaid their loans, with interest, as required in state statute. That is, the delinquent taxes owed in their jurisdictions have been advanced from the revolving fund, with the repayment made following public auction of the tax-foreclosed property. However, during Michigan's recent deep economic downturn, some formerly high-growth townships have been unable to meet their repayment schedule. Tax-foreclosed properties have not sold at auction, or they are tied-up in litigation and cannot be sold. Further, township bond funds—created by selling debt to provide sewer, water, and electrical services on undeveloped land, with the expectation that bond repayments would be made after the developments were completed and the

homes sold—are near default, as land remains vacant, or partially completed homes remain unsold.

According to committee testimony during the 2011-2012 legislative session, this crisis is severe in Michigan's formerly high-growth townships and particularly on the eastern side of the state where, according to one county drain commissioner, townships were sometimes threatened by developers with lawsuits if their officials declined to create special assessment districts and sell debt to fund the expansion of the infrastructure. (In committee testimony, a spokesman for the Michigan Townships Association reported that the customary practice on the state's east side is to create special assessment districts for expanded infrastructure, making its costs the responsibility of taxpayers. In contrast, on the west side of the state, the cost of expanded infrastructure is customarily the responsibility of the developer, alone.) During public hearings, testimony as to the severity of this problem was offered by officials from Livingston County (Tyrone, Handy, and Howell Townships) and southwestern Oakland County (Lyon Township). There, the interest costs calculated on the delinquent taxes that are charged back to local jurisdictions often increase costs in excess of 30 percent, making repayment by cash-strapped townships even more unlikely.

Proponents argue that this bill is urgently needed, in order to slow the accumulating charge-back interest costs that are calculated on tax-delinquent properties.

Against:

Opponents of this bill argued that it allows county treasurers to reward extremely unwise development decisions in a few formerly high relocation areas of Michigan. Those who opposed the bill say the decision to put all local taxpayers at risk in order to build sewers and drains that support development projects on vacant land is a short-sighted land use practice that hollows out the core of communities throughout southeastern Michigan. These kinds of projects shift, rather than increase, the patterns of population growth and economic development. Opponents note: "We've expanded the urban footprint over 30 years throughout Southeastern Michigan, ostensibly to get more for our money. But the real costs of our policies are hidden. Don't we need a system that reveals the real costs?" This financial problem in formerly high relocation areas demonstrates how some local governments have been subsidizing sprawl, rather than redeveloping their urban core communities, by investing in transit options.

Opponents argued the practices that this bill is designed to address should not be validated. Further, they argue that this bill could further deplete the revenue of county governments throughout the state—not just in the two counties that seek relief—and it would do so at a time when the social services offered by county governments are in high demand by thousands of families who have been hard hit during the economic recession.

Opponents conceded, however, that the bill was an improvement over the original package of bills introduced during the 2011-2012 legislative session (which included House Bills 4148, 4149, and 4538). Together, those bills would have created a state-level special assessment delinquent tax revolving loan fund, and transferred \$10 million out of the State

Water Pollution Control Revolving Fund (currently underfunded, given a recent court order), for deposit into the new fund. Rather than raid this fund, or further deplete county government revenue, opponents have suggested that Livingston County and township officials investigate the possibility of issuing financial recovery bonds, similar to those issued by Ecorse and other southeastern Michigan communities.

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.