



Senate Fiscal Agency
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BILL



ANALYSIS

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Senate Bill 81 (Substitute S-1 as reported)
Sponsor: Senator Jack Brandenburg
Committee: Finance

(Senate-passed version)

Date Completed: 3-18-15

RATIONALE

Legislation enacted in 2012 allows a bank or other lending institution to retain the principal residence exemption (PRE) on foreclosed property for up to three years, if the property was exempt immediately before the foreclosure and other conditions are met. Under this exemption, a principal residence is not subject to the taxes levied by a local school district for school operating purposes (which are typically 18 mills), if the homeowner files an affidavit with the local tax collecting unit and meets eligibility criteria; the property then is taxed at the "homestead" rate. As a rule, when the person no longer owns or occupies the property as his or her principal residence, the exemption must be rescinded and the property will be taxed at the nonhomestead rate. This occurs when a home mortgage is foreclosed, unless the foreclosing lender retains the PRE. If it does so, however, the lender still must pay an amount equal to what would be levied if the exemption had not been retained.

Apparently, very few lenders retain the exemption because they do not receive a direct financial benefit from doing so. This evidently can make it difficult for some would-be purchasers to qualify for a mortgage on a foreclosed home. In most cases, if a purchaser is obtaining a mortgage and escrowing taxes, the escrow amount for property taxes is based on the rate of taxation at the time of the purchase. Therefore, if the bank does not retain the PRE and is paying the nonhomestead rate, the borrower must qualify at that rate, even if he or she would be able to claim the exemption after the purchase.

It also has been pointed out that, if a financial institution does retain the PRE but still must pay an amount equal to school operating taxes, that amount is in addition to other costs of foreclosure, which are ultimately passed on to the lender's customers.

To address these issues, it has been suggested that foreclosing financial institutions should be able to retain the PRE without having to pay an amount equivalent to school operating taxes. Because this would result in a cost to the School Aid Fund, which receives those payments, it also has been suggested that the period of time a lender may retain the PRE should be shortened.

CONTENT

The bill would amend the General Property Tax Act to delete requirements that a bank or other lending institution pay what it otherwise would have paid in school operating taxes, as well as an administration fee, if it retains the principal residence exemption on foreclosed property. The bill also would allow a bank or other lending institution to retain the PRE for two, rather than three, years.

The Act allows a bank, land contract vendor, credit union, or other lending institution (referred to below as a "bank") to retain the PRE on property that the bank owns as a result of a foreclosure or forfeiture of a recorded instrument, if the property had been exempt immediately before the foreclosure. The property must be for sale, must not be occupied by or leased to anyone other than the person who claimed the PRE immediately before the foreclosure or forfeiture, and must not be used for any business or commercial purpose. To retain the exemption, the bank must file

a conditional rescission form with the local tax collecting unit and annually verify to the local assessor that the property meets those criteria.

If a bank retains the exemption, it must pay an amount equal to the additional amount it would have had to pay in school operating taxes under Section 1211 of the Revised School Code if a PRE had not been retained. The payment must be collected by the local tax collecting unit at the same time and in the same manner as taxes are collected under the Act, and must be distributed to the Department of Treasury for deposit into the State School Aid Fund.

In addition, the bank must pay an administration fee equal to the property tax administration fee imposed under Section 44 of the Act. (Section 44 allows a local tax collecting unit to add and keep a fee of up to 1% of the total tax bill for taxes paid before February 15 of the following year, and allows additional amounts for delinquent taxes.)

The bill would delete the requirements that a bank, land contract vendor, credit union, or other lending institution retaining the PRE pay the amount it would have had to pay under Section 1211 of the Revised School Code and pay an administration fee.

The bill would take effect 90 days after its enactment.

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ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The Michigan economy is continuing to recover from the 2008-2009 recession, and the number of foreclosures has been declining. Based on data supplied by the Michigan Bankers Association, it is estimated that the number of home mortgage loans in the foreclosure process in Michigan as of the third quarter of 2013 was approximately 20,670, and the number as of the third quarter of 2014 was approximately 15,500. Over the same period, the State's foreclosure starts rate (the percentage of loans entering the foreclosure process during a given time period) declined from 0.56% to 0.42%, according to the Mortgage Brokers Association. Despite the downward trend, these figures show that a significant number of home mortgages continue to be foreclosed and numerous foreclosed homes remain on the market.

It is not in the interest of financial institutions to own these homes, and a proliferation of foreclosed homes is not in the interest of neighborhoods or communities. Allowing lenders to retain the principal residence exemption is one way to help consumers who wish to purchase the homes. If the PRE is in place, then the buyer does not face the possibility of having to pay property tax at the nonhomestead rate until the exemption can be claimed and reinstated. Requiring lenders that retain the PRE to pay the same amount they would have to pay without the exemption, however, apparently has discouraged them from pursuing this option. The bank or credit union gets no monetary relief and in fact incurs an additional administrative burden.

By removing the requirement that lending institutions pay the amount of school operating taxes, plus an administration fee, if they retain the PRE, the bill would give them an incentive to do so. In addition to preserving the exemption for future buyers, this would increase the number of individuals who could qualify for a mortgage when taxes are escrowed. Since a borrower must be able to pay taxes at the rate the current owner is paying, even the borrower would pay only the homestead rate under the PRE, some borrowers might have trouble qualifying. Also, new Federal regulations require a higher income-to-debt ratio, making it more difficult for some people to secure a mortgage. While many potential home-buyers are creditworthy, they still may have a lot of unsecured debt. Reducing the amount a borrower must escrow and be qualified to pay is one way that could provide some relief.

The bill also would lower the costs placed on mortgage lenders during the foreclosure process. These typically include back taxes, insurance, administrative expenses, and legal fees. In addition,

lenders often must pay significant cleanup and repair costs to return a house to marketable condition. Because these costs ultimately are passed on to the borrowers, lowering the costs would benefit consumers.

Finally, putting foreclosed homes back into the hands of individual owners, rather than investors, would help rebuild strong neighborhoods, schools, and communities.

Opposing Argument

When legislation was enacted in 2012 to allow lenders to retain the PRE on foreclosed homes, it also changed the deadline for a homeowner to file an affidavit claiming the exemption, and added a second deadline. These changes were designed to prevent individuals from having to pay property taxes at the nonhomestead rate for part of a year, until they could claim the PRE. This legislation was a product of negotiations with the interested parties and has been in effect only since May 1, 2013.

Response: If banks and other lenders are not retaining the PRE because it offers them no benefit, that aspect of the legislation would appear to be ineffective.

Opposing Argument

The additional amount that a foreclosing lender must pay if it retains the PRE is directed to the School Aid Fund. This holds the Fund harmless because it must pay local districts an equivalent amount for the school operating taxes they do not collect. Under the bill, the Fund would no longer receive this revenue during the time the lender retained the exemption.

Response: The bill would mitigate this impact by allowing a lender to retain the PRE for only two years, rather than three as currently allowed. Furthermore, if a person who claimed the PRE did not lose his or her home to foreclosure, the property would continue to be taxed at the homestead rate. Requiring the foreclosing bank to pay what amounts to the nonhomestead rate actually generates revenue to the School Aid Fund that it would not receive if the foreclosure did not take place.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would reduce School Aid Fund revenue by between approximately \$14.7 million and \$24.5 million in FY 2014-15, depending on the specific characteristics of affected property. If per-pupil funding guarantees or other education spending were lowered as a result, the bill would reduce revenue to local school districts by an unknown amount. The value of property that is currently under foreclosure and that could be affected by the bill is not known, although as of December 2014, Michigan's inventory of foreclosed homes represented 0.6% of the total Michigan housing stock. The estimated impact of the bill assumes that the average taxable value of affected properties varies between \$30,000 and \$50,000. To the extent that the taxable values for affected property are higher, the impact of the bill would be higher, while lower taxable values would reduce the estimated impact of the bill. Similarly, it is unknown what portion of these properties represent properties that are eligible for a principal residence exemption.

Local unit revenue also would be reduced by an unknown amount, due to the loss of administration fee revenue on the affected amounts. Using the range estimated above, the reduction would total between \$100,000 and \$200,000.

Fiscal Analyst: David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.