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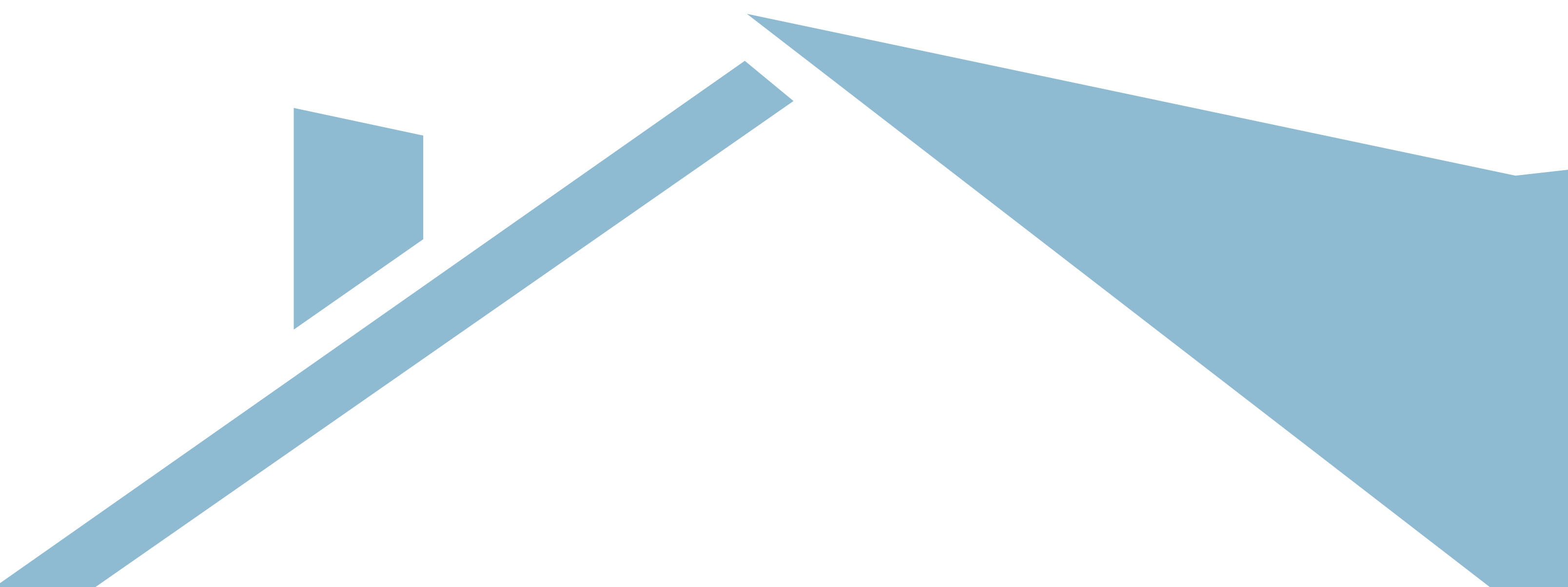
THROUGH THE ROOF

DELINQUENT PROPERTY TAXES PROVE COSTLY

BY CHARLES E. GILLILAND AND SARAH WHITMORE

Most property owners know that they will incur some penalties and interest if they do not pay their property taxes on time. However, many have little understanding of the magnitude of financial expense they face when delinquent tax provisions in the Texas Property Tax Code kick in.



Pricey Penalties, Interest

The formula specified in the code mandates a sizable initial penalty plus interest charges with monthly increases in both for five months. After that, the penalty remains at 12 percent, but interest continues to grow each month. Section 33.01a states:

> A delinquent tax incurs a penalty of 6 percent of the amount of the tax for the first calendar month it is delinquent plus 1 percent for each additional month or portion of a month the tax remains unpaid prior to July 1 of the year in which it becomes delinquent. However, a tax delinquent on July 1 incurs a total penalty of 12 percent of the amount of the delinquent tax without regard to the number of months the tax has been delinquent.

Typical property taxes unpaid on Feb. 1 immediately increase by 7 percent (6 percent penalty and 1 percent interest). By July 1, those unpaid taxes incur the maximum penalty of 12 percent plus 6 percent interest. Beginning Aug. 1, the penalty remains 12 percent while interest continues to increase by 1 percent each added month.

For a property with a $10,000 tax liability, the February payment would be $10,700; the July amount would increase to $11,800. Determining the true cost of those added charges in annualized compound interest reveals that a February payment incurs combined added amounts that actually equate to an 84 percent annual interest cost. The July payment annual equivalent amounts to 33.56 percent in annualized cost.

In addition to those charges, the code also allows taxing units to contract with law firms for collection of delinquent taxes with compensation potentially adding another 20 percent of the total of delinquent tax plus penalty and interest (Section 630). Taxing units using attorneys for delinquent tax collection often refer accounts for collection on July 1. Adding 20 percent attorney's fees boosts that July payment to $14,160 for the original $10,000 tax liability. That drives the annualized cost of the July payment to 71.62 percent annual compound cost. Clearly, allowing taxes to become delinquent imposes onerous costs on the property owner.

Property Tax Lender Role

An increasing number of those delinquent on their property taxes have discovered special lenders that will pay the taxes, thus stopping the increases in tax plus penalty and interest costs. In return, a loan is secured by transfer of the property tax lien from the taxing unit to the lender. Used frequently in the 1930s, these private party loans all but vanished for eight decades. Now they have re-emerged as an option for cash-strapped owners.

Although Texas property taxes are legally a personal obligation of the owner on Jan. 1 of the tax year, they are secured by a lien on the property. The property tax lien is superior to all other liens, meaning in the event of foreclosure, the property tax lienholder gets paid first.

If the owner fails to pay his or her property taxes on time, a taxing unit can foreclose and sell the property to recover the liability. Customarily, the local taxing unit holds the lien while attempting to obtain payment from the owner. However, the code allows for the transfer of the property tax lien from the taxing unit to a private entity lender that has paid the taxes.

Loan funds can apply only to delinquent property tax payments and associated fees. They cannot cover current taxes. Traditionally, the loan amount covers past due property taxes, penalties, interest and attorney's fees plus closing costs and origination fees associated with the loan. State law protects the property owner by limiting tax lien transferee interest charges to 18 percent. The annual interest on these loans typically ranges from 12 percent to 18 percent.

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Most property tax lenders base loan decisions on property features, loan amount and the borrower's creditworthiness. Borrowers cannot be involved in a bankruptcy proceeding and must be sole titleholder of the property.

The Texas Property Tax Lender License Act requires all property tax lenders to be licensed by the state and requires a separate license for each office a lender operates. Lenders are regulated by the Office of Consumer Credit Commissioner (OCCC) and the Texas Finance Commission. A list of property tax lenders who belong to the Texas Property Tax Lienholders Association is at http://www.tptla.org/.

Doing the Math

This table shows the annual compound cost for delinquent tax payments including penalty, interest and attorney's collection fees. A 2011 tax paid in February 2012 incurs an 84 percent annualized cost. A payment in September 2012 on $10,000 in delinquent tax would amount to $14,400 with an annualized cost of 55.96 percent. A February 2012 payment of tax delinquent since 2008 amounts to $17,880, a 19 percent annual compound cost.

Annual Compound Percentage Cost
Delinquent Property Taxes, Penalty, Interest and Percent Attorney's Fees

	Month of Payment											
Year of Tax Liability	Oct 2011	Nov 2011	Dec 2011	Jan 2012	Feb 2012	Mar 2012	Apr 2012	May 2012	Jun 2012	Jul 2012	Aug 2012	Sept 2012
2008	20.31%	19.96%	19.62%	19.30%	19.00%	18.71%	18.43%	18.17%	17.92%	17.67%	17.44%	17.22%
2009	27.01%	26.19%	25.44%	24.74%	24.10%	23.51%	22.96%	22.44%	21.96%	21.51%	21.09%	20.69%
2010	50.77%	46.62%	43.23%	40.41%	38.02%	35.97%	34.18%	32.62%	31.24%	30.01%	28.91%	27.92%
2011					84.00%	52.84%	42.48%	37.23%	34.02%	71.62%	62.66%	55.96%

Pros, Cons of Tax Loans

A property tax loan can benefit owners in a number of ways. The primary benefit is that it ends the compounding of penalties and interest. It also affords the owner a way to overcome temporary financial difficulties. By resolving the delinquency, it eliminates the threat of immediate foreclosure. And it consolidates all taxes, interest, and fees into a lump sum amortized in manageable monthly payments.

The public taxing unit benefits from a property tax lien transfer because it no longer needs to take action to collect on the account, saving the unit time, effort and administrative costs. Plus, the entire delinquent property tax balance, including penalties and interest, is immediately available to the taxing unit.

The benefits come with potential problems, however. While a property tax loan initially buys time for an owner, private lenders may be more likely to foreclose quickly if the owner falls behind on payments, defaults on the loan or violates provisions in the loan contract. Indeed, the private lender may prefer to own the property rather than continuing to collect payments.

Local taxing authorities, on the other hand, do not routinely own and manage real estate and may be more reluctant to foreclose. In fact, property owners with delinquent taxes may find it beneficial to approach the taxing unit and ask to set up installment payments. Once an installment agreement is executed, foreclosure is barred as long as the owner makes payments on time, pays current taxes and does not violate any provision of the agreement. Interest and penalties continue to accrue on the unpaid balance.

Collectors for taxing units can create escrow accounts that work like the accounts most mortgage servicers maintain for homebuyers. Buyers prepay taxes in installments designed to cover the amount of property tax owed when tax bills become due. Executing an escrow agreement should ensure that most or all taxes are paid before the delinquency date.

For some homeowners, property tax lien transfers are not the only solution to property tax delinquency. Disabled homeowners or those over 65 can opt to participate in the Property Tax Deferral Program. Participants postpone paying taxes on their homesteads as long as they continue to both own and reside in the homestead. The program allows participants to defer payment but does not eliminate the liability.

Along with the deferred property taxes, participants are responsible for interest, which accrues at 8 percent annually. If the owner moves from or sells the property, he or she is responsible for paying all deferred taxes, interest and penalties in a lump sum payment by the 180th day. This program should be used with caution because excessive property tax deferrals could erode all of the owner's equity.

Property tax lien transfers and installment payments are effective methods of dealing with delinquent tax liabilities. However, owners should strive to avoid the costly consequences of paying taxes late.

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THE TAKEAWAY

Failing to pay property taxes on time is costly. The Texas Property Tax Code ensures that penalties and interest start high and keep going up. Some lenders offer property tax loans to owners, but those may take a big bite out of equity.

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