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Making Debt Pay: Examining the Use of Property Tax Delinquency as a Revenue Source

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MAKING DEBT PAY: EXAMINING THE USE OF PROPERTY TAX DELINQUENCY AS A REVENUE SOURCE

ABSTRACT

In tough economic times, everyone looks for ways to do more with less. Local governments, however, face the challenge of doing more with money they do not have. With the recent shrinking of their budgets, it is critical that governments use their limited funding and opportunities for future funding wisely. One such opportunity for future revenue, the payment of delinquent property tax obligations, is critical to providing basic public services, such as education and emergency services. However, government officials may not be maximizing this resource and there is a risk that governments' financial needs are being exploited.

In an effort to generate revenue and overcome budgetary shortfalls, many local governments sell the right to collect delinquent taxes, along with interest and penalties applied to the amount owed, through the sale of property tax liens. The liens are sold, often for less than the amount of total debt, to private investors who are able to use the government's enforcement tools—including property foreclosure—to collect the debt owed. Although this \$20 billion market generates short-term funds, it obscures the amount of revenue that is forgone in exchange.

This Comment examines the strategies available for managing delinquent tax digests in search of a method that maximizes the return received by local governments while preserving political accountability, protecting consumers, and minimizing aggregate social costs. It analyzes the risks posed by tax lien sales to these objectives and suggests that delinquent tax anticipation notes and contracted lien servicing, or a combination of the two alternatives, best enable governments to maximize revenue, meet policy objectives, and serve taxpayer interests.

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INTRODUCTION

Both borrower and creditor benefit from a loan. However, what results is not necessarily an even exchange. The creditor has some degree of power because the borrower has a need. In some circumstances, the interest rate that a borrower pays on the principal received is greater if there is a need that the lender can exploit. Title lending and payday lending, for example, are financing schemes of last resort that convert assets or future receivables to cash in exchange for high interest rates or fees.¹ Although these high borrowing costs reflect a substantial risk of nonpayment by the debtor,² they also take advantage of the financial hardships of borrowers who lack the financial stability needed to obtain lower interest loans.³

Local governments often find themselves borrowers due to property tax delinquencies. Property tax revenues are critical for providing services such as education and police protection,⁴ and delinquent payments of tax obligations can create budgetary shortfalls that threaten the provision of those services. Government officials are then faced with deciding whether to cut or modify services, generate additional revenue, or borrow money. None of these solutions comes without a tradeoff: cutting services can be politically infeasible, finding a new revenue source is difficult, and increasing the amount of debt creates an additional cost because of the loan's interest. After weighing these options, many local governments elect to generate revenue through the sale of future receivables—property tax liens.⁵ The decision has evolved into a \$20 billion market.⁶

¹ See Michelle Hodson, Serena Owens & Steve Fritts, *Payday Lending, An Update on Emerging Issues in Banking*, FED. DEPOSIT INS. CORP. (Jan. 29, 2003), <http://www.fdic.gov/bank/analytical/fyi/2003/012903fyi.html>.

² See Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707, 720–21 (2006) (describing lenders' use of borrowers' risk to derive interest rates); Hodson et al., *supra* note 1 (stating that payday borrowers "have cash flow difficulties and few, if any, lower-cost borrowing alternatives").

³ See Hodson et al., *supra* note 1.

⁴ See JEFFREY L. BARNETT, U.S. CENSUS BUREAU, STATE AND LOCAL GOVERNMENT FINANCES SUMMARY: 2009, at 4 (2011) (describing how local government expenditures made up nearly 87% of state and local government spending on police protection expenditures while education represents 37% of all local government spending). The property tax accounts for nearly three-quarters of all tax revenue received by local governments. *See id.* at 3.

⁵ *See infra* notes 90–95 and accompanying text.

⁶ See Robert A. Jarrow & Vikrant Tyagi, *Tax Liens: A Novel Application of Asset Pricing Theory*, 10 REV. DERIVATIVES RES. 181, 181 (2007).

The sale of property tax liens produces needed revenue, but it is unclear if this strategy produces the best outcomes for taxpayers. When a government sells property tax liens, it incurs an opportunity cost of forgone future tax collections.⁷ This cost is potentially higher than the cost of other financing options—for example, issuing bonds that allow governments to borrow at low-interest rates⁸—because it transfers to the purchaser all of the potential earnings from tax liens. In addition, the sales create negative externalities because they transfer control of tax foreclosure processes from the government to private parties.⁹ Finally, tax lien sales impede transparency and political accountability and may trigger constitutional due process and consumer protection concerns.¹⁰

This Comment advocates using a more transparent and more cost-effective, revenue-generating strategy, and argues that using tax lien sales masks the true costs borne by governments, taxpayers, and consumers. Part I provides an overview of how the property tax and its enforcement affect local government finance. It first describes the statutory tools for tax enforcement, including the attachment of property tax liens to tax delinquent property, then discusses the options available for servicing delinquent property tax digests, and finally provides a detailed discussion of the methods that governments use to sell property tax liens.

Part II compares the effects of tax lien sales to the effects of other strategies for managing a delinquent property tax digest and explores what exactly a local government exchanges for the revenue it receives. It analyzes risks associated with tax lien sales, including negative externalities, lower economic rates of return, diminished political accountability, and constitutional and consumer protection concerns.

Part III asserts that governments should select a servicing strategy that maximizes their returns and enables control over social costs. It advocates for

⁷ Tax lien sales transfer the right to use remedies available to governments to the purchaser, such as levying interest and penalties. *See, e.g.*, CONN. GEN. STAT. § 12-195h (2011); GA. CODE ANN. § 48-3-19(b)(1) (West 2011). *See generally* Part II.B.

⁸ Compare CMTY. CAPITAL MGMT., A COMPARATIVE ANALYSIS: TAXABLE MUNICIPAL BONDS AND CORPORATE BONDS 6 (2010) (describing rates no higher than 6.5%), with *infra* note 33 and accompanying text (describing how tax liens can accrue 18% interest), and ALLAN LUNDELL, OHIO LEGISLATIVE BUDGET OFFICE, FISCAL NOTE & LOCAL IMPACT STATEMENT H.B. 371, at 2 (1997) (describing how governments forgo the collection of interest and penalties assessed to delinquent tax obligations).

⁹ *See infra* Part II.A.

¹⁰ *See infra* Part II.C–D.

two solutions to help mitigate the risks addressed in Part II. First, it proposes using short-term municipal financing secured by the tax liens, which treats the delinquent taxes as creating a receivable asset that can be used to secure financing. It argues that a combined strategy of government servicing and delinquent tax anticipation notes offers the most political accountability, financial transparency, and government control over externalities. Second, it recognizes that private servicing of delinquent tax digests may be necessary in jurisdictions that lack capacity to service them, and advocates for using contracted servicing or consolidated government servicing in those jurisdictions.

I. ENFORCEMENT OF THE PROPERTY TAX AND REVENUE RECOVERY

Nearly 40,000 municipalities have jurisdiction over local taxation, services, and debt financing.¹¹ States grant municipalities these powers by exercising their Tenth Amendment power to govern;¹² therefore, the municipalities are limited to operating under authority granted through state constitutions and state statutes.¹³ Under this authority, they levy, collect, and enforce ad valorem taxes, which can include both real and personal property taxes based on a rate applied to a property valuation.¹⁴

Property tax revenues¹⁵ are vital to the operation of local governments. Nationally, the revenues comprise nearly three-quarters of local government tax revenue (approximately 73.9%) and more than one-third (approximately 39.5%) of all local government revenue sources.¹⁶ They provide a substantial proportion of funds used to finance key services such as education, public safety, and public health.¹⁷ In 2009, local government spending on public safety represented approximately 87% of total state and local government

¹¹ See JOHN L. MIKESSELL, *FISCAL ADMINISTRATION* 29–30 (Carolyn Merrill et al. eds., 8th ed. 2011).

¹² U.S. CONST. amend. X; MIKESSELL, *supra* note 11, at 31–32.

¹³ MIKESSELL, *supra* note 11, at 32. For example, some local governments have “home-rule charter” authority to operate in any manner that does not conflict with state law. *Id.*; e.g., GA. CODE ANN. § 36-35-3(a) (West 2003).

¹⁴ JONATHAN GRUBER, *PUBLIC FINANCE AND PUBLIC POLICY* 650 (Craig Bleyer et al. eds., 2005); e.g., GA. CODE ANN. § 48-5-3 (West 2009); see also Byron F. Lutz, *The Connection Between House Price Appreciation and Property Tax Revenues*, 61 NAT’L TAX J. 555, 557 (2008).

¹⁵ This Comment addresses ad valorem taxation of real property, which comprises the majority of property tax collections, rather than ad valorem taxation of personal property, which provides a negligible revenue source. See Lutz, *supra* note 14, at 557.

¹⁶ BARNETT, *supra* note 4, at 3.

¹⁷ See *id.* at 3–4. Local government funds also substantially contribute to total government expenditures for highways, hospitals, and parks. *Id.* at 7.

expenditures for police protection.¹⁸ Local governments alone finance fire protection.¹⁹

Because of this reliance on property taxes, nonpayment or delayed payment of tax obligations can impede provision of government services.²⁰ The effect is most severe in periods of declining economic activity when tax revenues generally decline while need for government services, such as public safety, grows.²¹ This effect is compounded by the generally lean budgets of local governments,²² which make revenue gaps difficult to overcome. As a result, tax delinquency can affect a local government's overall fiscal health. The slim margin for error in budgeting has led to recent bankruptcy filings of local governments, including the largest Chapter 9 bankruptcy in the country's history in Jefferson County, Alabama.²³ Finally, tax delinquency creates revenue uncertainty, which makes budgeting difficult and inaccurate.²⁴

The importance of property tax revenues in public finance heightens the need to enforce the tax, and state statutes provide local governments with authority to do so.²⁵ Despite the incentive for compliance that this enforcement authority creates, a portion of tax obligations remains unpaid, estimated at more than \$7 billion annually.²⁶ Government officials, then, must select a strategy to overcome revenue shortages: cut funding for services, improve tax collection effectiveness, or find additional revenue sources. After weighing these options, many governments elect to generate revenue through the sale of future receivables—property tax liens.²⁷ This Part describes how state law establishes local governments' enforcement authority by creating property tax liens and creates incentives to sell tax liens. It also details how tax lien sales are used to service a government's delinquent tax digest and generate

¹⁸ *Id.* at 4.

¹⁹ *Id.* at 4, 7.

²⁰ See PAUL T. GRAZIANO ET AL., HOUS. AUTH. OF BALT. CITY, A PLAN TO CREATE THE BALTIMORE CITY LAND BANK app. 2, at 8 (2007).

²¹ See ALAN MALLACH, BROOKINGS INST., TACKLING THE MORTGAGE CRISIS: 10 ACTION STEPS FOR STATE GOVERNMENT 6–7 (2008); Julie A. Roin, *Privatization and the Sale of Tax Revenues*, 95 MINN. L. REV. 1965, 1971 (2011).

²² PAUL T. GRAZIANO ET AL., *supra* note 20, app. 2, at 8.

²³ Michael Cooper & Mary Williams Walsh, *Distressed Cities Weigh Bold Tactics in a New Fiscal Era*, N.Y. TIMES, Apr. 1, 2012, at A19; Mary Williams Walsh, *Bankruptcy Filing Raises Doubts About a Bond Repayment Pledge*, N.Y. TIMES, Dec. 24, 2011, at B1.

²⁴ PAUL T. GRAZIANO ET AL., *supra* note 20, app. 2, at 8.

²⁵ See *infra* notes 30–37 and accompanying text.

²⁶ Jarrow & Tyagi, *supra* note 6, at 184.

²⁷ See *infra* notes 96–102 and accompanying text.

additional revenue and describes other servicing strategies that local governments use.

A. *Delinquency Deterrence and Tax Enforcement Authority*

Property tax liens enable tax enforcement. They are statutorily created, attach to the underlying property, and establish a debt to the local government that is secured by the property.²⁸ The debt has “super-priority” status, which permits governments to collect it before other creditors can collect debts secured by the same property—including mortgage liens and federal income tax liens.²⁹

Once the liens attach, state statutes equip local governments with a range of enforcement procedures, such as financial penalties and tax foreclosure sales of properties attached to tax liens.³⁰ These types of remedies are common nationally, but different jurisdictions use a variety of procedures and time limits.³¹ Financial consequences to delinquency compensate the government for the delayed receipt of taxes and may deter lengthy delinquency. A property tax lien can accrue monthly interest and can incur monthly or annual penalties based on a percentage of the lien’s face value.³² Annual interest rates can reach at least 18% in many jurisdictions³³ and combined interest and penalties can near or exceed 30% annually.³⁴ These high-interest rates and penalties can

²⁸ See Frank S. Alexander, *Tax Liens, Tax Sales, and Due Process*, 75 IND. L.J. 747, 770 (2000). Property tax liens can attach on the date taxes are due or before taxes are due. Compare, e.g., ARIZ. REV. STAT. ANN. §§ 42-17153, -18052 (2006), with MD. CODE ANN., TAX-PROP. § 14-804 (West 2002).

²⁹ A federal statute permits states to set the priority of property tax liens above that of all federal income tax liens, even those that arose earlier in time. I.R.C. § 6323(b)(6) (2006). In each state, property tax liens have priority over all or most other liens. See, e.g., FLA. STAT. § 197.122(1) (2012); MD. CODE ANN., TAX-PROP. § 14-805(a) (West 2002); see also Alexander, *supra* note 28, at 770–72.

³⁰ See *infra* notes 32–34, 36–37 and accompanying text.

³¹ See, e.g., CONN. GEN. STAT. § 12-146 (2011); IOWA CODE § 445.39 (2011); MASS. GEN. LAWS ANN. ch. 60, § 62 (West 2009). Some jurisdictions establish the remedies by local procedure only and thus tax enforcement can vary significantly even within the same state. See, e.g., GA. CODE ANN. § 36-35-3 (West 2003).

³² See, e.g., CONN. GEN. STAT. § 12-146 (2011) (18% annual interest); 35 ILL. COMP. STAT. 200/21-15 (2011) (1.5% monthly interest).

³³ E.g., CONN. GEN. STAT. § 12-146 (2011) (18% annual interest); 35 ILL. COMP. STAT. 200/21-15 (2011) (1.5% monthly interest); IOWA CODE §§ 445.39, 447.1 (2011) (1.5% monthly interest that can increase to 2%); MO. REV. STAT. §§ 140.100(1), .340(1) (2011) (up to 10% annual interest and 18% annual penalty). A 1.5% monthly rate is equivalent to a 19.56% annual rate if compounded.

³⁴ Annual interest and penalties can total 35% in Alaska and 28% in California, Missouri, and Washington, D.C. ALASKA STAT. ANN. § 29.45.250(a) (West 2007); CAL. REV. & TAX. CODE §§ 2617–18, 4103(a) (West 1998); D.C. CODE § 47-811(c) (2005); MO. REV. STAT. §§ 140.100(1), .340(1) (2011).

quickly raise a lien's value to a substantial proportion of the underlying property's value.

Once a lien is established, a property owner can extinguish it by paying the taxes owed plus any interest or penalties.³⁵ However, if a property owner remains delinquent for an extended period, local governments may foreclose upon the tax lien and compel a transfer of the underlying property so that they can recover the debt.³⁶ The proceeds from this "tax sale" are used to extinguish the lien and can be used to provide government services.³⁷

However, before tax sales occur, the tax foreclosure process is often lengthy and can take as long as four to six years to implement.³⁸ The time needed to complete a tax foreclosure is influenced by the degree of judicial involvement,³⁹ the ability to initiate foreclosure proceedings in bulk,⁴⁰ and the length and timing of a "redemption period" during which a property owner can redeem a property either before or after it is sold through tax foreclosure.⁴¹ A tax sale occurs in one of three scenarios: a pre-foreclosure redemption period and a single foreclosure process; a post-sale redemption period and a single foreclosure process; or two foreclosure processes, one before the tax sale of a property and one after expiration of the redemption period.⁴²

³⁵ Alexander, *supra* note 28, at 774–75.

³⁶ *E.g.*, MD. CODE ANN., TAX-PROP. § 14-820 (West 2002); *id.* § 14-833 (West 2002 & Supp. 2010), amended by Act of May 2, 2012, ch. 188, 2012 Md. Laws 1.

³⁷ *See id.* §§ 14-820, -833.

³⁸ Frank S. Alexander & Leslie A. Powell, *Neighborhood Stabilization Strategies for Vacant and Abandoned Properties*, ZONING & PLAN. L. REP., Sept. 2011, at 1, 5; *see* OFFICE OF THE CONTROLLER, AUDIT OF PHILADELPHIA INDUSTRIAL DEVELOPMENT CORPORATION AND THE PHILADELPHIA AUTHORITY FOR INDUSTRIAL DEVELOPMENT 27 (2000) (stating that the foreclosure process is "expensive and time-consuming" and thus serves better as a threat than as a collection procedure). *But see, e.g.*, IDAHO CODE ANN. § 63-1006(1) (West 2006); NEV. REV. STAT. ANN. § 361.570(1)–(3) (West 2011) (transferring property to the creditor automatically on a set date).

³⁹ Judicial involvement also slows the speed of property disposal and increases transaction costs; in contrast, non-judicial foreclosure is faster and has lower costs. Georgette C. Poindexter et al., *Selling Municipal Property Tax Receivables: Economics, Privatization, and Public Policy in an Era of Urban Distress*, 30 CONN. L. REV. 157, 181 (1997).

⁴⁰ *E.g.*, FLA. STAT § 197.502(9) (2012); *see also* Alexander & Powell, *supra* note 38, at 5.

⁴¹ *See* Alexander, *supra* note 28, at 775; Alexander & Powell, *supra* note 38, at 4 (describing the differing time frames for property redemption and the process differences affecting timing).

⁴² Alexander, *supra* note 28, at 779–80.

B. *The Divergent Effects of Tax Foreclosure*

Tax foreclosures have widely varying effects as sources of revenue and community improvement, which differ based on the property, the foreclosure process, and the tax sale purchaser. In some cases, a delinquent property does not generate additional government revenue. First, the property may not be subject to tax foreclosure. Some governments may elect to approve payment plans or mitigate property tax burdens on disadvantaged groups, such as elderly or disabled persons.⁴³ Some governments also have authority to reduce the debt attached to a certain property to allow transfer and rehabilitation.⁴⁴

Second, some properties that are foreclosed upon may not generate a high enough price to recover the aggregate tax-related indebtedness secured by the tax lien on the property. Properties that have a market value lower than the lien face value will not sell for the full face value. Further, some jurisdictions only permit the sale of properties for the full face value of the lien and do not permit partial recovery.⁴⁵ These types of properties can remain vacant for years.⁴⁶

Finally, some of the properties that are ultimately sold in a tax sale can create future problems in the community if they are sold to a certain type of new owner. Tax sale purchasers can be parties who will pay taxes on and maintain or rehabilitate the property, such as “prospective homeowners, adjacent owners, and developers.”⁴⁷ However, they also may be “over enthusiastic investors” who plan to resell or rent property at unrealistic profits or “speculators” who seek to take as much value as possible from property.⁴⁸ Properties purchased by such parties can experience a cycle of tax foreclosure

⁴³ E.g., CONN. GEN. STAT. §§ 12-124a(a), -129n(a) (2011) (permitting relief to homeowners aged sixty-five or older, permanently and totally disabled, or assessed taxes exceeding 8% of income); N.J. STAT. ANN. § 54:5-65 (West 2002) (permitting entry into a payment plan with property owner).

⁴⁴ DEL. CONST. art. VIII, § 1 (allowing county councils to give tax exemptions for property if it “will best promote the public welfare”); MD. CODE ANN., TAX-PROP. § 14-806 (West 2002 & Supp. 2005) (allowing municipality to release liens of vacant and abandoned properties to facilitate transfer).

⁴⁵ E.g., ARIZ. REV. STAT. ANN. § 42-18104(B) (2006); GA. CODE ANN. § 48-3-19(b)(1) (West 2011).

⁴⁶ Stephan Whitaker & Thomas J. Fitzpatrick IV, *The Impact of Vacant, Tax-Delinquent and Foreclosed Property on Sales Prices of Neighboring Homes* 4 & n.3 (Fed. Reserve Bank of Cleveland, Working Paper No. 11-23, 2011).

⁴⁷ Margaret Dewar, *The Effects on Cities of “Best Practice” in Tax Foreclosure: Evidence from Detroit and Flint* 18–19 (Ctr. for Local, State, and Urban Policy, Univ. of Mich., Working Paper Series No. 2, 2009) (describing a study of Michigan’s tax foreclosure sales).

⁴⁸ *Id.*

under multiple owners,⁴⁹ be resold shortly after purchase,⁵⁰ or even be sold back to the initial owner.⁵¹

Conversely, tax foreclosures also can benefit a community. Foreclosures enable the transfer of tax delinquent properties to tax compliant parties or parties who will otherwise improve the property.⁵² Tax sale proceeds can result in the recovery of part or all of the taxes owed.⁵³ If used consistently and fairly, tax foreclosures also can create an incentive for property owners to pay their taxes and can increase voluntary compliance with the property tax.⁵⁴ This incentive only exists, however, if property owners see foreclosure as a realistic consequence of tax delinquency and have a desire to retain rights in their property.⁵⁵ For example, the inconsistent use of foreclosure by the city of Philadelphia was cited as a factor in the city's inability to collect enough taxes to meet revenue needs.⁵⁶ Poor enforcement of tax foreclosures can actually increase a government's administrative costs because more effort is required to service a larger delinquent tax digest.⁵⁷

Despite the threat of financial penalties and foreclosure, a portion of property taxes remains unpaid⁵⁸ and creates a delinquent tax digest that must be serviced. Some government officials attribute large delinquent tax digests to a lack of capacity to collect taxes.⁵⁹ These digests are managed by cities in several ways, which are described in the following section.

⁴⁹ GRAZIANO ET AL., *supra* note 20, app. 2, at 4.

⁵⁰ *See id.* (describing Baltimore properties cycling through tax foreclosure every two years); Dewar, *supra* note 47, at 18 (stating that 23% of tax foreclosed homes in Flint, Michigan, and 17% in Detroit, Michigan were sold again one year later).

⁵¹ *E.g.*, Hamilton v. Royal Int'l Petroleum Corp., 934 So. 2d 25, 27, 29 (La. 2006) (involving a tax sale purchase for less than \$72 and an offer to re-sell it to the prior owner for about \$2500).

⁵² *See* Dewar, *supra* note 47, at 18–19; *see also supra* text accompanying note 47.

⁵³ *See* Poindexter et al., *supra* note 39, at 161.

⁵⁴ *See id.* at 160; Kevin T. Smith, *An Update on Foreclosure of Real Property Tax Liens Under Michigan's New Tax Foreclosure Process*, 36 MICH. REAL PROP. REV. 30, 36 (2009) (describing how 85% of liens (and therefore taxes) were ultimately paid before a property transfer to a new owner was finalized).

⁵⁵ *See* Whitaker & Fitzpatrick, *supra* note 46, at 8 (“Property owners with no interest in retaining ownership have no incentive to pay property taxes.”).

⁵⁶ OFFICE OF THE CONTROLLER, *supra* note 38, at 23, 26, 27.

⁵⁷ *See* Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1266 (2002) (describing how mortgage servicing costs are higher when borrowers default because it “requires more constant vigilance”).

⁵⁸ Poindexter et al., *supra* note 39, at 160 (describing tax delinquency rates).

⁵⁹ *Id.* (describing how city officials in Pittsburgh blamed “inadequate staff and resources devoted to collecting taxes” for the city's large number of property tax liens).

C. Revenue Recovery Through Tax Lien Servicing Strategies

When a local government has a delinquent tax digest, it can provide collection and enforcement services or pay another party to provide the services. The sale of tax liens is one method of paying a third party for services. This strategy provides an additional benefit of generating revenue; however, it is not the sole approach available for government servicing of property tax liens and increasing cash flow.⁶⁰ This section describes three primary tax lien management strategies—government servicing, contracted servicing, and tax lien sales—and highlights critical differences for governments to consider when selecting a strategy.

1. Keeping the Status Quo: Government Servicing

The first and traditional management option is for the local government to service its delinquent tax digest, treating it just like any other government service. The government retains ownership of the liens, enforces the liens, and therefore directly receives all of the collections from property owners, including all interest and penalties. In addition, the government has sole control over all policy decisions regarding property tax foreclosure and tax burden reduction.⁶¹

Local governments also directly incur all costs, which vary across jurisdictions because of the significant variation in tax enforcement procedures.⁶² Administrative costs result from the act of tax collection itself, which may require the employment of tax collection agents.⁶³ These costs are often built into interest and fees associated with a property tax lien.⁶⁴ There also may be costs to the availability of public services. A government that collects its own delinquent taxes must wait until the taxes are paid before it

⁶⁰ See *infra* note 223; see also *infra* Parts II.B, III.

⁶¹ For example, they retain the ability to relieve the tax burden on elderly or disabled property owners or release liens on vacant or abandoned properties to enable their transfer to other parties who might improve them. See *supra* text accompanying notes 36, 43–44.

⁶² See *supra* text accompanying notes 31, 38–41 (summarizing the differing time frames and procedures surrounding tax lien servicing, penalties associated with delinquency, and tax foreclosure).

⁶³ See Poindexter et al., *supra* note 39, at 160 (describing how staff and resources are needed to collect taxes).

⁶⁴ See, e.g., KY. REV. STAT. ANN. § 134.504(4)(d), (7) (West 2010 & Supp. 2011) (administrative cost included in lien value), amended by Act of Apr. 23, 2012, ch. 161, 2012 Ky. Acts 1; LUNDELL, *supra* note 8, at 2.

spends the receipts on public services.⁶⁵ As a result, cash flow may be unpredictable⁶⁶ and local governments must address revenue shortages through an additional strategy, such as the acquisition of debt financing.

2. *Privatized Servicing Through Sale and Contract*

A second option for managing delinquent tax digests is for the local government to treat tax collection as a government service that can be privatized.⁶⁷ Contracted servicing and tax lien sales are both methods of accomplishing this privatization, but they have vastly differing effects. For example, contracted servicing enables more government control and uses a more transparent method of paying third-party servicers than do tax lien sales.

Contracted servicing involves hiring private parties to service the liens but preserves government ownership of the liens.⁶⁸ Because the government owns the liens, it makes all decisions regarding tax foreclosure and the mitigation of tax burdens, just as it would have if it serviced the liens itself. The government also receives all of the collections in excess of the administrative costs of servicing, which are paid in the form of contractor fees that can vary based on the type of liens or collections.⁶⁹ For example, Kentucky pays servicers 20% of face value of the liens they service and an additional 13% of the liens' face value if the servicer has to take court action to file for foreclosure.⁷⁰

Government use of contractors is generally justified by expectations of increased efficiency and revenue.⁷¹ However, the degree to which benefits

⁶⁵ In contrast, by selling tax liens, the local government obtains money before taxes are collected. *See* LUNDELL, *supra* note 8, at 2.

⁶⁶ However, historical data, such as rates of redemption and timing of property owners' payments can be used to project the quantity and date of availability of tax receipts. *See generally* CHAMAN L. JAIN & JACK MALEHORN, *BENCHMARKING FORECASTING PRACTICES: A GUIDE TO IMPROVING FORECASTING PERFORMANCE* 46 (2006) (describing the use of historical data in data forecasting models).

⁶⁷ *See* Christina N. Smith, Note, *The Limits of Privatization: Privacy in the Context of Tax Collection*, 47 *CASE W. RES. L. REV.* 627, 632–33 (1997) (describing the privatization of federal income tax servicing).

⁶⁸ *E.g.*, MASS. GEN. LAWS ANN. ch. 60, § 2C(g)(2) (West 2009) (describing how government gives up ownership when it sells the lien); MISS. CODE ANN. § 19-3-41(2) (West 1999 & Supp. 2010) (describing how contracted servicers merely collect taxes and remit their entire collections, without a reduction for the cost of collection, to the municipality).

⁶⁹ *See, e.g.*, KY. REV. STAT. ANN. § 134.504(7) (West 2010 & Supp. 2011), *amended by* Act of Apr. 23, 2012, ch. 161, 2012 Ky. Acts 1. Some states, such as Mississippi, collect the entire amount of taxes collected and pay the servicer separately. MISS. CODE ANN. § 19-3-41(2) (West 1999 & Supp. 2010).

⁷⁰ KY. REV. STAT. ANN. § 134.504(7) (West 2010 & Supp. 2011), *amended by* Act of Apr. 23, 2012, ch. 161, 2012 Ky. Acts 1.

⁷¹ MIKESELL, *supra* note 11, at 15–17.

accrue depends upon several factors, which include but are not limited to: how a contractor performs in comparison to the government's capacity to perform the same function, whether any administrative cost savings accrue from using a contractor, and whether any additional collections result from privatization.⁷² Servicers who are familiar with state and local laws regarding tax liens and tax foreclosure, who know the local real estate market, and who have developed effective servicing procedures are more likely to be the most efficient and collect the most tax revenue.⁷³ To this end, governments that use contracted servicing can tailor their procurement process to select providers with the greatest experience and history of results.⁷⁴

Contracted servicing also permits the government to control the activity of the third-party servicer through contract terms.⁷⁵ The government can prohibit certain activities and hold the private servicer accountable for meeting the terms.⁷⁶ For example, when the U.S. Internal Revenue Service hired contractors to collect delinquent income taxes, its contract terms limited the types of collection tactics that could be used and established penalties for noncompliance.⁷⁷

Finally, like government servicing, contracted servicing only generates revenue as taxes are paid. Therefore, a local government that uses either method must use a different strategy to generate the funds it needs to meet budgetary demands, assuming that it is impractical to cut services by the amount of outstanding tax receivables.

A third servicing option, tax lien sales, is similar to contracted servicing because the sales transfer responsibility for servicing tax liens from the government to a private party, but they differ in their form of payment to the

⁷² See Ellen Dannin, *To Market, to Market: Legislating on Privatization and Subcontracting*, 60 MD. L. REV. 249, 268–71 (2001) (describing the factors to consider when comparing costs of privatization to costs of government provision).

⁷³ See Poindexter et al., *supra* note 39, at 190–91.

⁷⁴ See GARY GUENTHER, CONG. RESEARCH SERV., RL33231, THE INTERNAL REVENUE SERVICE'S USE OF PRIVATE DEBT COLLECTION AGENCIES: CURRENT STATUS AND ISSUES FOR CONGRESS 10 (2006) (describing an IRS requirement that bidders on a tax collection contract have experience and a high "level of accomplishment").

⁷⁵ See Smith, *supra* note 67, at 638–39 (describing how contracting out provides greater control than does sale of an asset because the government can set contract terms).

⁷⁶ Note, *When Hope Falls Short: Hope VI, Accountability, and the Privatization of Public Housing*, 116 HARV. L. REV. 1477, 1484–85 (2003) (stating that contract law can be enforced by the agency without use of the courts); see Roin, *supra* note 21, at 2006 (describing how governments can allocate risks by setting contractual terms with private providers).

⁷⁷ GUENTHER, *supra* note 74, at 3.

servicer. Instead of receiving a fee, the lien purchaser receives the interest and penalties paid by the property owner to extinguish a lien because the purchaser owns the debt and has the right to collect it.⁷⁸ This debt can amount to a return on investment of as high as 18% annually.⁷⁹ In addition to having this high rate of return, property tax liens are an attractive investment because their super priority entitles their holder to be paid before the holder of any mortgage debt or other subordinate encumbrance on the property. Tax lien sales are distinct from a tax sale of the underlying property and do not vest in the purchaser a possessory right to the property attached to the lien.⁸⁰

The underlying transaction is the sale of future tax receivables as assets, and like any other asset sale, the government gives complete control of the asset (i.e., the lien) to the purchaser.⁸¹ In exchange, the government receives immediate funds that reflect either the face value or partial face value of the lien.⁸² Property tax lien sales also transfer the risk that a debt will never be repaid⁸³: purchasers lose money if an owner does not redeem the lien and if a tax sale of the property cannot generate a purchase price greater than the lien's sale price.

Both individual and institutional investors purchase tax liens, including large banks⁸⁴ and businesses specifically formed for the purchase and enforcement of property tax liens.⁸⁵ The fact that institutional investors have become increasingly involved in tax lien sales underscores the strong financial incentive associated with lien purchases.⁸⁶ The authorization and use of tax lien sales are discussed in the following section.

⁷⁸ The sales vest in the purchaser the right to enforce the lien and accrue penalties and interest. *See, e.g.*, CONN. GEN. STAT. § 12-195h (2011); GA. CODE ANN. § 48-3-19(b)(1) (West 2011).

⁷⁹ *E.g.*, CONN. GEN. STAT. § 12-146 (2011) (18% annual interest).

⁸⁰ *Compare* GA. CODE ANN. § 48-3-19 (West 2011) (tax lien sales), *with id.* § 48-4-78 (tax sales of the underlying property).

⁸¹ Smith, *supra* note 67, at 638.

⁸² *See* LUNDELL, *supra* note 8, at 2; *infra* text accompanying notes 97, 101, 106.

⁸³ *See* OFFICE OF THE CONTROLLER, *supra* note 38, at 26; *see also* Jarrow & Tyagi, *supra* note 6, at 182 (noting that tax liens have “positive net present values even after adjusting for risk”).

⁸⁴ Charles D. Rittenhouse, Comment, *The True Costs of Not Paying Your Property Taxes in Ohio*, 36 U. DAYTON L. REV. 221, 223 (2011) (describing the sale of \$14.7 million in tax liens by Lucas County, Ohio to a subsidiary of J.P. Morgan Chase & Co.); Rob O'Dell, *Bailed-Out Banks Snap Up Tax Liens*, ARIZ. DAILY STAR, Aug. 7, 2011, at A1 (describing the sale of approximately \$14.4 million in tax liens to banks since the 2008 bailout—more than double the pre-bailout sales).

⁸⁵ *See, e.g.*, MUN. ASSET PROVIDERS, <http://www.municipalassetprovider.com/> (last visited Aug. 16, 2012); REVENUE SERVS., LLC, <http://www.revenueserv.com> (last visited Aug. 16, 2012).

⁸⁶ *See supra* notes 84–85 and accompanying text.

3. Property Tax Lien Sales: Enforcement and Revenue Strategy

Property tax lien sales comprise an approximate \$20 billion market.⁸⁷ The sales are more than just a servicing strategy—they are a financing solution. Property tax lien sales are often authorized through state legislation, after which their use is generally elective.⁸⁸ State laws set varying levels of local government discretion regarding how liens are sold.⁸⁹ This variation is particularly visible in the methods of sale, which include auctions and negotiated sales.⁹⁰ An enabling statute may also contain limited guidelines regarding which properties can be sold⁹¹ and who can purchase the liens.⁹²

First, a government can sell liens through traditional auctions⁹³ or virtual auctions.⁹⁴ Auctions generally sell individual tax liens, but some states use auctions to sell liens both individually and in bulk.⁹⁵ Pricing is either set by bidding up the purchase price or bidding down the interest or penalties that lien purchasers can collect from property owners.⁹⁶ Some states require that the auctioned liens be sold for no less than their face value while other states permit liens to be sold at a lesser price.⁹⁷

⁸⁷ Jarrow and Tyagi, *supra* note 6, at 181.

⁸⁸ *E.g.*, CONN. GEN. STAT. § 12-195h (2011); GA. CODE ANN. § 48-3-19(b)(1) (West 2011).

⁸⁹ *Compare* CAL. REV. & TAX. CODE § 4528 (West 1998) (allowing tax collector to sell liens in bulk or individually and through negotiation or auction), *and* NEV. REV. STAT. ANN. §§ 361.7312, .7314 (West 2011) (giving county treasurers full discretion regarding how property tax liens are sold), *with* COLO. REV. STAT. ANN. § 39-11-108 (West 2007) (requiring property tax liens to be sold by auction).

⁹⁰ *See* CONN. GEN. STAT. § 12-195h (2011) (permitting negotiated sales); *infra* text accompanying notes 95–96, 98–101.

⁹¹ KY. REV. STAT. § 134.128(2)(c)(3) (West 2010 & Supp. 2011) (prohibiting purchase of certificates of delinquency for properties under an approved payment plan in good standing), *amended by* Act of Apr. 23, 2012, ch. 161, 2012 Ky. Acts 1.

⁹² *E.g.*, GA. CODE ANN. § 48-3-19(g) (West 2011) (requiring transferees who purchase more than \$2 million in liens per calendar year to have an office in the jurisdiction); 35 ILL. COMP. STAT. 200/21-265(a)(2) (2011) (excluding owners of, or parties responsible for, paying taxes on a property in the county that has been delinquent); KY. REV. STAT. § 134.128(2)(d)(3) (West 2010 & Supp. 2011) (prohibiting purchases by multiple related entities and parties purchasing on behalf of related entities), *amended by* Act of Apr. 23, 2012, ch. 161, 2012 Ky. Acts 1.

⁹³ *See, e.g.*, ARIZ. REV. STAT. ANN. § 42-18106(A)(2) (2006); N.H. REV. STAT. ANN. § 80:80(II-a) (2003); *see also* Alexander, *supra* note 28, at 762 & n.89.

⁹⁴ *E.g.*, COLO. REV. STAT. ANN. § 39-11-108(1) (West 2007); FLA. STAT. § 197.432(1) (2012).

⁹⁵ ALA. CODE § 40-10-182(b) (2011) (both individually and in bulk).

⁹⁶ *Compare* ARIZ. REV. STAT. ANN. § 42-18114 (2006) (bid down interest), *amended by* Act of Apr. 22, 2008, ch. 65, 2008 Ariz. Sess. Laws 1, *with* COLO. REV. STAT. ANN. § 39-11-115 (West 2007) (bid up purchase price).

⁹⁷ *Compare* ARIZ. REV. STAT. ANN. § 42-18114 (2006) (requiring the sale price to be at least face value), *amended by* Act of Apr. 22, 2008, ch. 65, 2008 Ariz. Sess. Laws 1, *with* N.H. REV. STAT. ANN. § 80:80(II-a) (2003) (containing no requirement regarding sale price but allowing government officials to set a

Second, a government can sell liens through negotiated sales, including bulk sales or individual sales.⁹⁸ The sale involves private negotiations of a purchase price and, in some cases, negotiation of the interest or penalties that the investor can charge the property owners.⁹⁹ Although some jurisdictions have a minimum sale price set by state law,¹⁰⁰ investors often purchase liens at a price lower than the face value of the lien.¹⁰¹

In both auctions and negotiated sales, purchasers stand to collect the difference between the purchase price and the lien's face value—which can be as high as 25% to 30% of the lien's face value¹⁰²—plus any interest or penalties that accrue.¹⁰³ In jurisdictions that sell liens for less than their face value, the purchaser can receive an even greater return on investment. In jurisdictions that require tax liens to be sold for face value, the purchaser still collects any interest or penalties that accrue on the lien over the course of the delinquency.¹⁰⁴

A third variation of a tax lien sale is the sale of a large volume of property tax liens and subsequent securitization of that bundle of liens to help finance the sale.¹⁰⁵ Similar to other means of municipal financing, the liens are then used to finance the government through the sale of bonds. For example, New York City sells a bundle of property tax liens to a trust for less than the total face value of the liens and is paid with funds that the trust borrows from

minimum price), and R.I. GEN. LAWS ANN. § 44-5-73(c) (West 2006) (rate may be discounted “to reflect uncollectible factors”).

⁹⁸ See, e.g., CAL. REV. & TAX. CODE § 4528 (West 1998); MASS. GEN. LAWS ANN. ch. 60, § 2C(b)–(c) (West 2009) (bulk sales); see also Alexander, *supra* note 28, at 762 & n.88.

⁹⁹ E.g., MASS. GEN. LAWS ANN. ch. 60, § 2C(c)(2) (West 2009) (stating that tax liens may “be sold either at a discount of not more than 50 per cent of the interest on the receivable or at a premium”).

¹⁰⁰ See *supra* text accompanying note 98. Compare ARIZ. REV. STAT. ANN. § 42-18114 (2006), amended by Act of Apr. 22, 2008, ch. 65, 2008 Ariz. Sess. Laws 1, with R.I. GEN. LAWS ANN. § 44-5-73(c) (West 2006).

¹⁰¹ E.g., CONN. GEN. STAT. § 12-195h (2011) (permitting the municipality to determine the sale price); MASS. GEN. LAWS ANN. ch. 60, § 2C(c) (West 2009) (permitting sale at less than face value); see Alexander, *supra* note 28 at 760.

¹⁰² Poindexter et al., *supra* note 39, at 162.

¹⁰³ See, e.g., CONN. GEN. STAT. § 12-195h (2011); GA. CODE ANN. § 48-3-19(b)(1) (West 2011).

¹⁰⁴ See *supra* note 78 and accompanying text.

¹⁰⁵ E.g., D.C. CODE § 47-1303.04(a)–(c) (2005); N.Y. REAL PROP. TAX LAW § 1190 (McKinney 2000 & Supp. 2003); OHIO REV. CODE ANN. § 133.082 (West 2002 & Supp. 2009); *id.* § 321.341 (West 2005 & Supp. 2009); *id.* § 1724.01(B)(2)(a) (West 2009) (counties containing a county land reutilization corporation—created to facilitate “the reclamation, rehabilitation, and reutilization of vacant, abandoned, tax-foreclosed, or other real property”—can securitize tax liens). Some businesses gear their operations toward securitization services (e.g., “Delinquent Tax and Asset Bonds”). *Delinquent Tax and Asset Bond (DTAB) Program*, MUN. ASSET PROVIDERS, <http://www.municipalassetprovider.com/> (last visited Aug. 16, 2012).

investors.¹⁰⁶ The transaction provides the city with immediate access to funds.¹⁰⁷ The trust then hires a servicer to collect unpaid taxes and any interest or penalties on those taxes.¹⁰⁸ Bondholders who invested in the security then are repaid their investment, plus interest, with the dollars collected by the servicer.¹⁰⁹ The government then receives the excess of the amount collected by the servicers over the amount paid to the investors.¹¹⁰

One of the biggest challenges associated with securitized tax liens is ensuring the quality of the underlying security.¹¹¹ Performance of the security is influenced by the amount of delinquent taxes, interest, and penalties collected; therefore, performance is greater if the securitized liens are reasonably likely to be redeemed.¹¹² If the government securitizes a bundle that has too many liens that are unlikely to be redeemed, the government creates a risk of collecting less than the amount that it owes investors.¹¹³ For example, poor selection of securitized lien pools in the cities of Philadelphia, Pennsylvania and Jersey City, New Jersey prevented investors from receiving a return on their investment.¹¹⁴ As a result, tax lien sales require accurate assessment of the liens' risk of nonpayment. Tax lien sales provide a cash flow solution that government servicing and contracted servicing cannot, but they also create a degree of risk. Because of this risk, the decision to sell tax liens should be based on a determination that the benefit outweighs it. The following section analyzes in further detail the benefits and risks of tax lien sales.

¹⁰⁶ JERILYN PERINE ET AL., CITIZENS HOUS. & PLANNING COUNCIL, *THE INVISIBLE TRANSFORMATION: TURNING DEBT INTO REVENUE* 10 (2010) (summarizing the city's securitization of property tax liens between 1996 and 2008 with data provided by the New York City Department of Housing Preservation and Development).

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 10 chart 1.

¹⁰⁹ *See id.* at 15–16 (reporting that eleven of thirteen trusts had repaid their lenders and the remaining two were projected to do so).

¹¹⁰ *See id.* (noting that New York City reports \$89.3 million in surplus collections for thirteen tax lien securitizations).

¹¹¹ *Cf.* ANN RUTLEDGE & SYLVAIN RAYNES, *ELEMENTS OF STRUCTURED FINANCE* 600 (2010) (describing how tax lien securitization has been largely unsuccessful due to poor planning by governments).

¹¹² PERINE ET AL., *supra* note 107, at 8–11, 16.

¹¹³ *See* OFFICE OF THE CONTROLLER, *supra* note 38, at 26–27 (stating that more than 56% of the portfolio was not collectible and that more than one-third of the properties included in the sale had high lien-to-value ratios); RUTLEDGE & RAYNES, *supra* note 111, at 601.

¹¹⁴ OFFICE OF THE CONTROLLER, *supra* note 38, at 23, 26–27; PERINE ET AL., *supra* note 106, at 24–26; RUTLEDGE & RAYNES, *supra* note 112, at 600–01.

II. COMPARING EFFECTS OF TAX LIEN MANAGEMENT STRATEGIES

The fact that a market exists for tax liens indicates that both buyer and seller benefit. What is less clear is whether what results is a reasonable exchange. The exchange cannot solely be evaluated by looking at the financial impact at the time of the sale because the exchange creates financial, social, and legal risks and benefits. This Comment argues that government officials are making a policy decision when they choose a tax lien management strategy,¹¹⁵ and as such, the decision should incorporate a rational financial analysis of (1) whether the benefits justify the risks and (2) whether the strategy provides the most benefit to taxpayers. This Part describes the factors that should be included in such an analysis and summarizes the differing effects of government servicing, contracted servicing, and tax lien sales. It concludes that, compared to other strategies, tax lien sales create greater externalities: a risk of lower economic rates of return, political accountability challenges, and constitutional and consumer protection concerns.

A. *Diminished Control and Community Costs*

Unlike government servicing or contracted servicing, tax lien sales create negative externalities that increase aggregate social costs. Tax lien purchasers do not compensate local governments for these costs, and therefore community residents and the government itself pay for them. These costs result from both diminished government control over decisions that affect community development efforts and the profit motive of tax lien purchasers. However, the sales also provide some degree of social benefit because the revenue they generate permits the government to continue providing public services, which may partially offset the social costs.

Social costs result from tax lien sales' transfer of authority to initiate tax foreclosure from the government to the purchaser in some jurisdictions.¹¹⁶ This transfer has a significant impact because tax foreclosures present an opportunity for more than just the recovery of delinquent taxes. They also can be used strategically as part of community development efforts, particularly in

¹¹⁵ See NANCEY GREEN LEIGH, BROOKINGS INST., *THE STATE ROLE IN URBAN LAND REDEVELOPMENT* 3–4 (2003) (describing government decisions addressing tax delinquency).

¹¹⁶ Compare GA. CODE ANN. § 48-4-78(a) (West 2011) (tax commissioner initiates), with KY. REV. STAT. ANN. § 131.500 (West 2010), and KY. REV. STAT. ANN. § 134.490(2) (West 2010) (purchaser of lien initiates), amended by Act of Apr. 23, 2012, ch. 161, 2012 Ky. Acts 1.

blighted and depressed areas.¹¹⁷ In some uses, foreclosures can increase the value of surrounding properties or improve the stability of a neighborhood if the foreclosed property is sold to a new owner who continues its upkeep and remains current on tax obligations.¹¹⁸ Further, when used at an early stage of tax delinquency, tax foreclosures can protect property from deterioration.¹¹⁹

However, the use of tax foreclosures also creates a risk of reduced property values and diminished property condition,¹²⁰ particularly in modest-income neighborhoods.¹²¹ The mere act of foreclosure diminishes the values of other nearby properties at a minimum of nearly 1% per foreclosed property.¹²² Weak demand for property in such neighborhoods, which is further compounded by the oversupply of property due to the mortgage foreclosure crisis, impedes the sale of low-value tax-foreclosed properties,¹²³ such as properties with high lien-to-value ratios.¹²⁴ Conversely, risk tends to be lower for tax liens that are attached to properties with low lien-to-value ratios and for liens that have a short history of delinquency.¹²⁵

The type of purchaser also affects foreclosure outcomes.¹²⁶ Low-value, tax-foreclosed property is more likely to either be abandoned or purchased by a speculator that will only strip value from the property, rather than by a new

¹¹⁷ *E.g.*, PERINE ET AL., *supra* note 106, at 8–20 (discussing use of tax lien securitization of certain properties to improve community economic development); *An Overview of Land Banking in Syracuse and Onondaga County*, ONONDAGA COUNTY SUSTAINABLE DEV. PLAN, <http://future.ongov.net/wp-content/uploads/2011/08/An-Overview-of-Land-Banking-in-Syracuse-and-Onondaga-County.pdf> (last visited Aug. 16, 2012) (describing use of a land bank program to manage and repurpose tax delinquent properties).

¹¹⁸ This is more likely in wealthier communities and less likely in an already depressed and blighted area. *See* MALLACH, *supra* note 21, at 6.

¹¹⁹ *See* Alexander & Powell, *supra* note 38, at 3. Properties going through foreclosure are often stripped of their value by their current owners. *Id.*

¹²⁰ *See infra* notes 122–27 and accompanying text.

¹²¹ *See* MALLACH, *supra* note 21, at 6.

¹²² Several studies conducted using different methodologies, years, and locations indicate that property value reductions between about 1% and nearly 9% result from nearby foreclosures. Kai-yan Lee, *Foreclosure's Price-Depressing Spillover Effects on Local Properties: A Literature Review 2–6* (Fed. Reserve Bank of Bos., Discussion Paper No. 2008-01, 2008).

¹²³ *See* MALLACH, *supra* note 21, at 6.

¹²⁴ These ratios compare a lien's face value to a property's market value or assessed value.

¹²⁵ *See* PERINE ET AL., *supra* note 107, at 8–11, 17–18. For this reason, New York City classifies liens that are worth less than 15% of the total property value as good candidates for bulk sale and securitization. *Id.* at 8, 11.

¹²⁶ *See supra* notes 47–51 and accompanying text (describing the range of purchasers who may either improve or harm the property purchased).

owner, developer, or adjacent property owner.¹²⁷ Property abandonment, if it occurs, can lead to increased crime and fire hazard.¹²⁸ In addition, properties with diminished values will have lower tax assessments that reduce the amount of tax owed. This in turn decreases the total tax base and corresponding tax revenues that the government receives in future years.¹²⁹ The failure to pursue a timely tax foreclosure can also reduce future tax revenues if the property deteriorates or is abandoned without a tax-compliant owner.¹³⁰

Although these risks are present in all strategies for managing a tax lien digest, the risk is lesser when government officials control the foreclosure process because their incentives are different than those of a lien purchaser. Government officials serve the interests of their citizens. Therefore, they are more likely to strategically use tax foreclosures for public benefit.¹³¹ Their incentives are (1) to quickly collect tax revenues that are owed;¹³² (2) to collect interest and penalties to the extent needed to compensate for enforcement costs and the cost of receiving delayed payment; (3) to minimize property neglect and abandonment, and the resultant social costs for police and fire services; (4) to minimize adverse externalities on adjoining properties and neighborhoods; and (5) to ensure that tax delinquent properties are transferred to new owners that will pay taxes and use the properties in a manner consistent with public policies.¹³³

Government officials are also uniquely positioned to ensure that tax foreclosures are implemented consistently and quickly enough to be an

¹²⁷ See *supra* notes 47–51 and accompanying text (describing the potential negative consequences that can result from certain types of tax foreclosure sale purchasers).

¹²⁸ John Accordino & Gary T. Johnson, *Addressing the Vacant and Abandoned Property Problem*, 22 J. URB. AFF. 301, 303 (2000).

¹²⁹ See Alan C. Weinstein, *Current and Future Challenges to Local Government Posed by the Housing and Credit Crisis*, 2 ALB. GOV'T L. REV. 259, 267 (2009). For example, Lucas County, Ohio had the most foreclosure filings in the state as of 2011, and as a result, the county auditor predicted that property tax revenues could decrease by 10% due to a reduced tax base. Rittenhouse, *supra* note 84, at 235, 237.

¹³⁰ See Alexander & Powell, *supra* note 38, at 3; Smith, *supra* note 54, at 30 (describing how the length of the previous foreclosure process in Michigan allowed properties “to deteriorate and contribute to urban blight”).

¹³¹ See Roy W. Bahl Jr., *Local Government Expenditures and Revenues*, in MANAGEMENT POLICIES IN LOCAL GOVERNMENT FINANCE 79, 79 (J. Richard Aronson & Eli Schwartz eds., 5th ed. 2004) (“The most important fiscal role of local government is to decide on the level and mix of taxes and expenditures that best match the needs and preferences of the local population.”).

¹³² M.B. Pell, *Fulton: Lien Sales Needed*, ATLANTA J. CONST., Mar. 27, 2011, at B1 (describing how tax commissioners’ goals are to “collect delinquent taxes quickly,” whereas lien purchasers have a financial incentive to collect taxes slowly).

¹³³ See, e.g., *An Overview of Land Banking in Syracuse and Onondaga County*, *supra* note 117.

effective tax enforcement and community revitalization tool because they are charged with implementing tax enforcement procedures.¹³⁴ They are able to implement foreclosures as part of a larger community development effort, in which the foreclosed properties are not always sold to the highest bidder but instead may be transferred to a government or nongovernment entity that has plans to use, improve, or restore the property.¹³⁵ For example, properties can be transferred to land banks, which maintain the properties and dispose of them strategically using the proceeds from property tax interest and penalties.¹³⁶ Other municipalities select certain types of “distressed” properties that need intervention to improve their condition and transfer the properties so that they can be rehabilitated.¹³⁷ Government officials also are enabled by statute to forgive or reduce tax burdens or approve payment plans, which may help disadvantaged populations maintain property ownership.¹³⁸

In contrast, tax lien purchasers are solely motivated by profit and lack the capacity or incentive to incorporate tax foreclosures into an overall community development strategy.¹³⁹ As a result, the party making foreclosure decisions when tax liens are sold (in some jurisdictions) is a private party who is wholly removed from any community development policies or strategies set by government officials.¹⁴⁰ This party only has one incentive—to act in a manner that produces the greatest financial return.¹⁴¹ The purchaser is unlikely to use foreclosure to achieve any public benefit unless required to do so.¹⁴² It would be in the lien purchaser’s interest, for example, to facilitate the slow payment of tax liens so that the debt accrues interest and penalties over a longer period rather than quickly implement foreclosure. During this extended period, the owner may damage or devalue the property, which can reduce the value of

¹³⁴ See *supra* text accompanying notes 30–34 (describing municipalities’ differing tax enforcement procedures).

¹³⁵ See *An Overview of Land Banking in Syracuse and Onondaga County*, *supra* note 117 (discussing how the “Genesee County Land Bank Model” can revitalize a blighted community).

¹³⁶ See *id.*

¹³⁷ See, e.g., PERINE ET AL., *supra* note 107, at 11–12, 20 (detailing a property rehabilitation and transfer program).

¹³⁸ See *supra* note 44 and accompanying text.

¹³⁹ See Gillian E. Metzger, *Privatization as Delegation*, 103 COLUM. L. REV. 1367, 1372 (2003) (describing how privatization creates a moral hazard that private actors will “exploit their position in government programs to advance their own financial or partisan interests,” which may conflict with public policy goals); Poindexter et al., *supra* note 39, at 200 (stating that tax lien purchasers only participate in development efforts if they benefit financially or if there is a framework that requires them to participate).

¹⁴⁰ Cf. Metzger, *supra* note 139, at 1372; Poindexter et al., *supra* note 39, at 200.

¹⁴¹ See Metzger, *supra* note 139, at 1372.

¹⁴² See Poindexter et al., *supra* note 39, at 200.

neighboring property.¹⁴³ Similarly, in a situation where a municipality might transfer ownership to a party who could improve or maintain the property, without fully recovering the tax debt, a lien purchaser would sell the property to the highest bidder, regardless of the bidder's intent for the property.

Unlike government servicing or contracted servicing, tax lien sales create a risk of significant social costs; however, they also create cash flow, which presents a substantial financial benefit.¹⁴⁴ This benefit may partially offset social costs because it allows the government to provide services that otherwise would be unfunded.¹⁴⁵ However, tax lien sales are not the only financing tool available. As discussed in the following section, if other methods of financing can be used alongside a servicing method that avoids social costs and the other risks described in the following sections, the use of those methods should be strongly considered.

B. A Questionable Rate of Return

Because governments are constantly working to do more with limited resources, it is critical that they receive the greatest return from their assets. To do so, governments should be able to compare the costs and benefits of tax lien sales against other options that serve the same purposes. The sale price of tax liens should compensate the government for the discounted present value of the forgone interest and penalties on the lien minus the costs transferred to the purchaser, which include a minimal risk of nonpayment¹⁴⁶ and the administrative cost of collection.¹⁴⁷ However, the multi-purpose nature of a tax lien sale as both a financing strategy and a servicing method makes it difficult to separate each of these components of the sale price from one another. The administrative and financing costs are buried within the tax lien sale price and the future tax collections forgone by a government. As a result, tax lien sales tend to mask the underlying calculus of what a government exchanges for immediate funds and for tax collection services.

First, the dual purpose of tax lien sales as tax enforcement and a revenue strategy obscures the amount that local governments exchange with the

¹⁴³ See Alexander & Powell, *supra* note 38, at 3. See Smith, *supra* note 54, at 30, for a description of the potentially negative impact of a lengthy foreclosure process.

¹⁴⁴ See *supra* note 82 and accompanying text.

¹⁴⁵ See *supra* notes 15–19 and accompanying text.

¹⁴⁶ See *infra* text accompanying notes 153–57.

¹⁴⁷ See *supra* notes 78–83 and accompanying text.

purchaser. When local governments sell their tax liens, the administrative cost that they pay is hidden because the government is not incurring a specific expenditure. However, a cost still exists.¹⁴⁸ The government pays the purchaser for servicing its liens with the right to collect future interest and penalties.¹⁴⁹ Accordingly, an implicit administration cost is embedded within the sale price and the total forgone delinquent tax revenue.

The financing cost of receiving immediate funds is also included within the sale price and the foregone tax revenue, which obscures what the government is giving in exchange. The true price that the government pays for financing is reflected in the purchaser's financial return from the sale (the forgone interest and penalties collected on the liens) minus the implicit administration cost paid. Because the sale price of liens is often either their face value or less, the lien purchaser's return can be significant because it includes nearly the entire upside of the interest that the liens accrue—which can near or exceed 18% annually.¹⁵⁰ Because both financing and administrative costs are so difficult to differentiate from one another, it is difficult to compare tax lien sales to other strategies.

In contrast, government servicing and contracted servicing create costs and benefits that are relatively easy to discern. Because they are the only party involved, local governments that provide their own servicing directly receive the full amount collected from property owners—including all interest and penalties—and they bear all of the costs. These costs are reflected in the government's financial records. Similarly, if governments use contracted servicing, they receive all of the collections in excess of administrative costs and have included the rate they pay for such administration costs in the contract with the servicer.¹⁵¹ Therefore, the amount collected and the amount paid to the servicer could be calculated from financial records. Financing costs would also be transparent if the government borrowed the same amount of funding that they receive from sales because there would be a clear interest rate applied to the principal.

As a result of the hidden costs of tax lien sales, it is difficult to determine what the best sale price is for a particular lien or a set of liens because the

¹⁴⁸ See *supra* Part I.C.3.

¹⁴⁹ See *supra* Part I.C.3. The sale price may, however, account for the present value of the redemption amounts.

¹⁵⁰ See *supra* notes 82, 97, 100–03 and accompanying text.

¹⁵¹ See *supra* text accompanying notes 69–70.

appropriate price will vary by lien. Making such a determination requires a consideration of historical data regarding how many liens are redeemed and when; application of a discount rate for the cost of receiving money later rather than sooner; and a comparison of current costs to what the cost would be to use government servicing and another source of revenue generation. Because tax lien sales transfer a government service to a third party, they only should occur if they provide cost savings or if the services cannot otherwise be provided.

Second, because the amount of interest that governments forgo—and thus the combined servicing and financing expense—is so high, the amount is likely higher than the low cost of government debt financing, even when discounting the value of receiving the interest revenue in the future.¹⁵² Some portion of that forgone interest compensates the purchaser for the risk of nonpayment and the administrative costs of servicing the liens; the remainder is effectively a financing charge paid to the purchaser (and an investor's rate of return on the investment).

However, the risk of nonpayment should be minimal. Most delinquencies are resolved before the final transfer of a property through foreclosure sale,¹⁵³ which indicates that many taxpayers only delay payment and ultimately satisfy their tax obligations. For example, DeKalb and Fulton Counties in Georgia report that they eventually collect 99% of property taxes, and DeKalb County only completed tax sales for approximately 3.5% of delinquent properties in 2009.¹⁵⁴ Similarly, 85% of foreclosed tax liens in Michigan were redeemed after foreclosure but before the property was titled to another party.¹⁵⁵ Delayed payment is not a risk. Rather, it is the ideal circumstance for a lien purchaser because it increases the value of the investment by increasing the interest it accrues. Even if the payment of taxes is delayed until the tax sale of a property, the tax lien purchaser still benefits from such a delay because the sale price includes penalties and interest that have accrued.¹⁵⁶

The few properties with liens that exceed or nearly exceed the property value are the only properties for which there is a true risk of nonpayment.¹⁵⁷ Properties with high lien-to-value ratios are not likely to recover the full debt

¹⁵² See *infra* notes 158–60 and accompanying text.

¹⁵³ Smith, *supra* note 54, at 36; Pell, *supra* note 132.

¹⁵⁴ Pell, *supra* note 132.

¹⁵⁵ Smith, *supra* note 54, at 36.

¹⁵⁶ See *supra* notes 32–37 and accompanying text.

¹⁵⁷ See RUTLEDGE & RAYNES, *supra* note 111, at 601; Smith, *supra* note 54, at 36 (describing how the majority of tax liens are ultimately paid).

because they are worth less than the debt. The true risk of purchased tax liens, then, is *how much* of the tax lien will be paid.

Therefore, depending on administrative costs of servicing, the cost of tax lien sales potentially exceeds the cost of other servicing and financing options, as described in the following example.¹⁵⁸ If a government sells a lien even at its full face value, and that lien accrues interest of 18% annually,¹⁵⁹ it forgoes the opportunity to receive 118% of face value if redeemed after one year, or nearly 140% if redeemed after two years. Even after applying a discount rate to account for the diminished value of collecting the money later in time, only a small portion of the 18% interest forgone would likely be offset. Some portion of the interest that is not offset compensates the purchaser for the low risk of nonpayment and the administrative costs of servicing the liens; the remainder is effectively a financing charge paid to the purchaser (an investor's rate of return on the investment). In comparison, if the government instead serviced its own liens and borrowed funds at a rate even as high as 6% in short term notes,¹⁶⁰ the annual 18% interest accruing on the liens would offset the interest accruing on the principal, creating an effective cost of around 112% of the liens' value.

If governments are indeed missing an opportunity to earn additional revenue, economic theory tells us that there must be a cause. In theory, all prices determined on the market should provide adequate compensation in a sale that is an arm's length transaction.¹⁶¹ One possibility is that the complex calculus of tax lien sales' costs creates information asymmetry, in which purchasers have more precise information about the prices of other liens sold than do government officials. Another possibility is that the governments'

¹⁵⁸ See LUNDELL, *supra* note 8, at 2 (noting that governments selling liens "may receive less revenue than if the lien was [serviced by the government and] redeemed, with interest, by the property holder" and that, "[t]herefore, the effect on revenue is indeterminate").

¹⁵⁹ This example uses the 18% interest rate associated with several states, which may be greater or lesser in some jurisdictions. See *supra* text accompanying notes 33–34. Although lien purchasers in some jurisdictions bid down the interest when purchasing the liens in auctions, this percentage is still available to local governments if they service the liens. See *supra* text accompanying note 96.

¹⁶⁰ To be conservative, this Comment assumes these are taxable securities. Returns for taxable municipal bonds are approximately 6%, whereas tax-exempt tax anticipation notes can have returns closer to 2%. Compare CMTY. CAPITAL MGMT., *supra* note 8, at 6 (describing taxable municipal bond rates of approximately 6%), with BARBARA J. SCHOTT, HARRIS COUNTY, TEXAS COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE FISCAL YEAR ENDED FEBRUARY 28, 2011, at 80 (2011) (citing a return of 1.5%–2.5% for tax anticipation notes).

¹⁶¹ Such a transaction occurs when the buyer and seller of a product act independently and have no relationship with one another, and therefore are acting in their own self-interest.

heightened demand for immediate funds helps increase the price they are, in effect, willing to pay for those funds.

In sum, local governments lack the ability to determine the financial impact of using tax lien sales instead of an alternative servicing or financing strategy. The cost is potentially excessive, similar to those charged to consumers in payday and title lending schemes. With local governments working from such limited resources, it is critical that governments compare the costs of their financing and servicing options *before* they select a method to ensure they are efficiently using those resources. Further, even if tax lien sales were a cost-efficient servicing method, the sales diminish political accountability and create consumer protection and constitutional concerns.¹⁶² As discussed in the following sections, these effects, along with the aggregate social costs of the sales, should give government officials pause when deciding whether to sell tax liens.

C. Obscured Accountability and Debt

Tax lien sales obscure what is, in effect, government borrowing, which impedes accountability and transparency. First, the sales conceal the actual financial condition of a government because they hide from public purview what is, in effect, debt financing. Second, the sales create a buffer that decreases taxpayers' ability to attribute the sales' outcomes to the actions of public officials. Finally, as discussed in the previous section, the sales obstruct the true cost of servicing and financing and make it difficult for both taxpayers and governments to weigh the soundness of officials' decisions to sell the liens.¹⁶³

First, the sale of property tax liens allows local governments to obscure the amount of debt that they would otherwise need to accrue. State and local jurisdictions frequently employ transactions that are similar in substance to incurring debt, yet distinctive enough to be excluded from such restrictions.¹⁶⁴ Similar to the function of debt, tax lien sales exchange future government revenue (delinquent tax collections) for immediate funds.¹⁶⁵ For example, if a

¹⁶² See *infra* Part II.C–D.

¹⁶³ See Roin, *supra* note 21, at 2020–21 (describing how the sale of tax receivables obscures the public's ability to understand and evaluate the costs and benefits of the sales).

¹⁶⁴ *Id.* at 1978.

¹⁶⁵ See *id.* at 1977–78, 1990, 1993, 1997, 2023 (asserting that the sale of tax receivables through the guise of privatization is a form of incurring “nondebt debt”); see also Robert Bifulco et al., *Debt and Deception: How States Avoid Making Hard Fiscal Decisions*, PUB. ADMIN. REV., 2 (Apr. 30, 2012), <http://onlinelibrary>.

local government sells liens that have a \$1.5 million face value for \$1 million, the transaction can be described as the government borrowing \$1 million and paying in interest the \$0.5 million difference between the sale price and face value *plus* future interest payments on the face value.¹⁶⁶ As a result, the government borrows, in effect, money at an interest rate that varies based on actual tax collections.¹⁶⁷ Because this constructive interest rate is not defined before the transaction occurs, the government is unable to compare the rate to other rates on the market and select the most cost-effective financing method. Unlike forms of borrowing that we traditionally identify as debt, which are measurable and transparent, tax lien sales and other debt alternatives receive less attention and have effects that are difficult to measure.¹⁶⁸

Second, the sale of tax liens weakens political accountability, which is a fundamental component of democratic governance¹⁶⁹ and reflects a government's duty to ensure that its actions serve public interests.¹⁷⁰ This duty includes ensuring that the government is not overpaying for the provision of public services such as tax collection.¹⁷¹ Accountability requires some level of transparency so that citizens, lawmakers, and advocacy groups¹⁷² can determine whether public interests have been met and provide "political feedback" through the electoral process.¹⁷³ Tax lien sales place a buffer between elected public officials, such as city council members or mayors, and the actions of lien purchasers that they have indirectly authorized.

wiley.com/store/10.1111/j.1540-6210.2012.02533.x/asset/j.1540-6210.2012.02533.x.pdf (defining government borrowing broadly as "occur[ing] whenever the government forgoes control over some future flow of resources or benefits in order to acquire resources for current use").

¹⁶⁶ Cf. Roin, *supra* note 21, at 1997 (describing how the city of Chicago's sale of future parking meter revenues can be described as the city borrowing "\$1.156 billion, but rather than pay interest on the debt at a set rate, it agreed to pay a contingent rate of interest both measured and secured by seventy-five years of parking meter revenues" (footnote omitted)).

¹⁶⁷ Cf. *id.*

¹⁶⁸ See Bifulco et al., *supra* note 165.

¹⁶⁹ See Jack M. Sabatino, *Privatization and Punitives: Should Government Contractors Share the Sovereign's Immunities from Exemplary Damages?*, 58 OHIO ST. L.J. 175, 186 (1997).

¹⁷⁰ See Bahl, *supra* note 131, at 79 ("The most important fiscal role of local government is to decide on the level and mix of taxes and expenditures that best match the needs and preferences of the local population.").

¹⁷¹ See *id.* at 79–81.

¹⁷² This Comment collectively refers to these parties as taxpayers.

¹⁷³ See TIMOTHY BESLEY, *PRINCIPLED AGENTS? THE POLITICAL ECONOMY OF GOOD GOVERNMENT* 37 (2006) (describing that, for actual accountability to occur, the parties that hold politicians accountable must have adequate information); Roin, *supra* note 21, at 2020–21.

Political accountability requires an ability to attribute a particular action and its outcome to a government official.¹⁷⁴ When a local government services its own tax digest, any decisions that are made are clearly attributable to decisions of public officials because they are based on actions of and procedures set by those officials.¹⁷⁵ As a result, taxpayers can readily make their own judgments about, and provide feedback on, the government's actions and the risks and social costs that result from those actions. In contrast, when a government sells the right to service liens to a private purchaser, it transfers some of these same functions to another party. After sale, a government can only control a private purchaser's actions through statutory and regulatory requirements.¹⁷⁶ Private parties, and not government officials, foreclose on property owners. Taxpayers are unable to hold these individuals politically accountable because they are not elected, though they still may hold the officials who enabled the sales responsible.

Finally, the use of tax lien sales reduces the transparency of outcomes against which taxpayers can measure officials' performance. The availability of sufficient information is critical for ensuring actual, and not merely theoretical, accountability.¹⁷⁷ As discussed, the sale of tax liens involves the constructive payment of servicing and financing fees to the lien purchasers, which are embedded in the sale price of the liens and the forgone future collections of interest and penalties.¹⁷⁸ The dual purposes of tax lien sales make it difficult to separate administrative and financing costs, which hamper the ability of taxpayers to judge whether the payment is reasonable in exchange for the immediate revenue that tax lien sales provide.¹⁷⁹ The

¹⁷⁴ See Sabatino, *supra* note 169, at 186–87 (stating that typically members of the public hold government officials accountable in the electoral process for their decisions).

¹⁷⁵ Municipal governments generally have a council-management structure or a mayor-council structure and are controlled by elected officials (city council members and a mayor, respectively). *Forms of Local Government Structure*, INT'L CITY/COUNTY MGMT. ASS'N (2008), http://icma.org/en/icma/knowledge_network/documents/kn/Document/9135/Forms_of_Local_Government_Structure. These parties consider which strategy to use to service their delinquent tax lien digest and can elect to sell the liens. See *supra* note 88 and accompanying text.

¹⁷⁶ For example, some state statutes set waiting periods before purchasers can contact property owners or begin the tax foreclosure process. *E.g.*, FLA. STAT. § 197.432(13) (2012) (establishing waiting period before purchaser can contact “to encourage or demand payment”); GA. CODE ANN. § 48-3-19(e)(1) (2011) (requiring purchaser to wait until the earlier of either one year after lien purchased or twenty-four months after taxes due).

¹⁷⁷ BESLEY, *supra* note 173, at 37.

¹⁷⁸ See *supra* Part II.B.

¹⁷⁹ See *supra* note 173 and accompanying text; see also Bifulco et al., *supra* note 165, at 2 (stating that “actions that are reported in budget and financial statements in ways that are difficult to assess will undermine

government then receives insufficient public feedback regarding its decision and is unable to determine if it is serving the interests of its constituents.

In contrast, the full costs could be calculated from internal financial records¹⁸⁰ when government servicing or contracted servicing are used.¹⁸¹ Although the cost of paying a contractor may not be known until after contract implementation begins,¹⁸² a government also has clear access to the records necessary to determine cost—its payment records for the contract.

D. Protection of Taxpayer Interests

Tax lien sales may provide less protection of taxpayers' rights than other servicing methods. A government has a responsibility to ensure that the activities it sanctions are protected from fraud or unfair dealing¹⁸³ and to ensure that citizens' constitutional rights are protected. As consumers, property owners should have access to information that enables prompt debt repayment and reporting of any illegal debt collection activity. This information includes the following: (1) when a lien has been sold, (2) who owns the lien and how they can be contacted, and (3) if any terms of the debt have changed. Further, because the government sanctions tax lien sales, citizens' constitutional rights should be protected throughout the sale process.

1. The Profit Motive and Consumer Protection

Tax lien sales create a risk that purchasers may use overzealous collection practices because purchasers are driven by profit.¹⁸⁴ This risk is evidenced by substantial federal regulation of debt collection practices¹⁸⁵ to limit actions

transparency” and asserting that traditional government borrowing methods have greater transparency than alternatives, such as asset sales).

¹⁸⁰ This estimate would primarily include a portion of personal services expenditures for staff members who service liens as well as administrative overhead.

¹⁸¹ See *supra* notes 69–70 and accompanying text.

¹⁸² For example, Kentucky pays its contracted servicers based on the face value of the liens they service and the type of action they have to take to service the liens, which are either unknown or subject to change before servicing begins. See KY. REV. STAT. ANN. § 134.504(7) (West 2010 & Supp. 2011), *amended by* Act of Apr. 23, 2012, ch. 161, 2012 Ky. Acts 1.

¹⁸³ See Note, *supra* note 76, at 1480.

¹⁸⁴ See Metzger, *supra* note 139, at 1372; Peter D. Byrne, *Privatization in the Area of Tax Administration: An Overview* 13–14 (Harvard Inst. for Int'l Dev., Taxation Research Series No. 24, 1995).

¹⁸⁵ See Byrne, *supra* note 184, at 13–14. For this reason, Congress passed the Federal Debt Collection Practices Act to protect taxpayers. See Fair Debt Collection Practices Act, 15 U.S.C. § 1692(a)–(b) (2006) (finding “abundant evidence of the use of abusive, deceptive, and unfair debt collection practices” and inadequacy of existing laws to protect consumers). Because of this risk, Congress limited the practices of

such as excessive contact, threats of arrest, calls to consumers at work, and threats to family members.¹⁸⁶ Adding to this risk, state and federal consumer protection statutes may not apply to property tax lien purchasers' collection efforts. First, the Federal Debt Collection Practices Act (FDCPA) relates to personal debts, and a property tax lien is generally a property debt unattached to a particular individual.¹⁸⁷ Second, the FDCPA applies to debt collectors who are *not* collecting a debt specifically owed to them, and tax lien purchasers have a right to the delinquent tax debt that they are collecting.¹⁸⁸

Tax lien sales also create difficulty for property owners because they do not know who purchased their liens unless the local government or purchaser notifies them, and such notification is statutorily required in few jurisdictions.¹⁸⁹ As a result, property owners may be unable to contact the new lien holder, may not know how to redeem their lien, and may be unable to file a complaint against the lien holder. Some lien purchasers resell the liens they buy, which further impedes property owners' ability to identify who owns a lien attached to their property.¹⁹⁰

2. Tax Lien Purchasers, State Action, and Due Process

Property tax enforcement by lien purchasers also creates uncertainty about the protection of property owners' constitutional rights. The Fourteenth Amendment prohibits *state* actions that deprive individuals of "life, liberty, or

private debt collectors when the IRS privatized delinquent tax collection. See GUENTHER, *supra* note 74, at 3. Congress also enabled the IRS to penalize misconduct by withholding compensation and banning future participation. *Id.*

¹⁸⁶ *E.g.*, Press Release, Ga. Governor's Office of Consumer Prot., Debt Collector Nelson, Hirsch & Associates Enters into \$4.3 Million Settlement with the Governor's Office of Consumer Protection (Nov. 8, 2011) (on file with author). For example, in 2011, the Georgia Governor's Office of Consumer Protection entered into an agreement with a debt servicer that violated consumer protection laws by threatening debtors with arrest, collecting more than the amount owed, and calling debtors up to fifty times a day. *Id.* The servicer agreed to forgo collection of approximately \$4.3 million and pay approximately \$50,000 for civil penalties and investigative and legal expenses. *Id.*

¹⁸⁷ See FED. RESERVE, *Fair Debt Collection Practices Act*, in CONSUMER COMPLIANCE HANDBOOK 1 (2006).

¹⁸⁸ *Id.*

¹⁸⁹ ALA. CODE § 40-10-182(b) (2011) (stating that procedures for tax lien sales shall provide for notifying the property owner that the lien has been sold); ARIZ. REV. STAT. ANN. § 42-18106(A) (2006) (requiring notification of lien sale to property owner).

¹⁹⁰ Some lien purchasers later sell some of the liens to other parties. See, e.g., *Invest in Tax Lien Certificates*, AM. TAX FUNDING SERVICING, <http://www.atfs.com/tax-liens-for-sale.asp> (last visited Aug. 16, 2012).

property, without due process of law.”¹⁹¹ Tax foreclosure sales by local governments are subject to Fourteenth Amendment due process constraints because the sales deprive persons of their rights to property.¹⁹² The Supreme Court has established that to comply with this constitutional obligation a jurisdiction must give a property owner adequate notice prior to conducting a tax sale.¹⁹³

Although private conduct is not expressly governed by the Fourteenth Amendment and generally is not required to protect due process rights,¹⁹⁴ it can be considered state action if the “nexus between the State and the challenged action” is so close that behavior of the private actors is “fairly treated as that of the State itself.”¹⁹⁵ State action may be present when¹⁹⁶ (1) the “coercive power” of the State is used by a private actor,¹⁹⁷ (2) the government encourages the private party’s acts,¹⁹⁸ (3) a private actor performs a “public function” typically reserved to the state,¹⁹⁹ (4) the state and the actor undertake “joint activity,”²⁰⁰ or (5) the government has control over the private actor.²⁰¹

Courts have not yet considered whether tax foreclosure actions by tax lien purchasers qualify as state action, and such an analysis is outside the scope of this Comment.²⁰² If state action does not apply, then constitutional due process

¹⁹¹ U.S. CONST. amend. XIV, § 1 (emphasis added).

¹⁹² *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 798–800 (1983).

¹⁹³ *Id.* at 798. Application of this holding varies widely. Alexander, *supra* note 28, at 750.

¹⁹⁴ *See Flagg Bros. v. Brooks*, 436 U.S. 149, 156–58 (1978).

¹⁹⁵ *Brentwood Acad. v. Tenn. Secondary Sch. Athletic Ass’n*, 531 U.S. 288, 295–96 (2001) (quoting *Jackson v. Metro. Edison Co.*, 419 U.S. 345, 351 (1974)) (internal quotation marks omitted).

¹⁹⁶ *See Stefan J. Padfield, Finding State Action when Corporations Govern*, 82 TEMP. L. REV. 703, 715–21 (2009), for a more detailed analysis of the tests for finding state action.

¹⁹⁷ *Brentwood*, 531 U.S. at 296 (quoting *Blum v. Yaretsky*, 457 U.S. 991, 1004 (1982)) (internal quotation marks omitted).

¹⁹⁸ *Id.* (quoting *Blum*, 457 U.S. at 1004).

¹⁹⁹ *Id.* (citing *Edmondson v. Leesville Concrete Co.*, 500 U.S. 614, 627–28 (1991); *West v. Atkins*, 487 U.S. 42, 56 (1988)); *Marsh v. Alabama*, 326 U.S. 501, 506–07 (1946). This test has been interpreted narrowly. *See Flagg Bros.*, 436 U.S. at 163–64 (noting in dicta that tax collection, education, and fire and police protection are not services exclusively practiced by the state).

²⁰⁰ *Brentwood*, 531 U.S. at 296 (quoting *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 941 (1982)) (internal quotation marks omitted).

²⁰¹ *Id.* (citing *Pennsylvania v. Bd. of Dirs. of City Trusts of Phila.*, 353 U.S. 230, 231 (1957) (per curiam)). However, government regulation of a privately provided service alone is not sufficient to establish state action. *See Jackson v. Metro. Edison Co.*, 419 U.S. 345, 350 (1974).

²⁰² It should be noted, however, that because the tests described above address the relationship between the government and a private actor, courts would be more likely to ascribe state action to contracted servicing than to tax lien sales because contracting creates an ongoing relationship between the government and a

rights may not protect owners of properties for which liens have been sold;²⁰³ if it does apply, then new needs arise. The initial challenge would be to ensure that purchasers are aware of the requisite notice required by due process.²⁰⁴ Creation of such awareness would be less onerous in states that have statutory procedures for tax foreclosure sales that meet due process requirements. But in states that leave a large amount of discretion regarding tax foreclosure to local governments, the responsibility for defining procedures that meet due process requirements would fall to each individual local government, each of which would likely create varying standards.

In addition, if state action applies, there would be a heightened need for implementing additional controls over purchaser-initiated tax sale notices. Providing notice involves an additional cost. Because lien purchasers are profit-driven,²⁰⁵ there is a risk that lien purchasers would forgo providing notice if not required or periodically monitored for compliance. Tax lien sales have a limited structure for controlling the actions of parties servicing the liens²⁰⁶ when compared to contracted servicing, which has a framework for control in the contract itself. For example, a local government can require contractor compliance with due process requirements through terms in the servicing agreement and can monitor the contractor's conduct.²⁰⁷ The government could also use tort law as recourse for noncompliance.²⁰⁸

Although tax lien sales provide an added benefit of increased funding for public services, they also create negative externalities, limit the ability of government agencies to control the community impact of delinquent property taxes, and lack a transparent cost structure through which to analyze their

private actor, as well as a framework for government control (the contract). Tax lien sales eliminate any relationship between the government and the servicer.

²⁰³ Because of a perceived disconnect between the practical realities of privatization and the protection of constitutional rights, some commentators advocate adopting a new constitutional analysis for privatized services. See, e.g., Sheila S. Kennedy, *When is Private Public? State Action in the Era of Privatization and Public-Private Partnerships*, 11 GEO. MASON U. C.R. L.J. 203, 219–23 (2001); Metzger, *supra* note 139, at 1367.

²⁰⁴ For example, if notice of a tax sale is returned to the sender, some form of additional action is required, but courts have not defined precisely what actions are sufficient. C. Jordan Myers, Comment, *Learning to Live with Jones v. Flowers: A "New Wrinkle" for an Old Standard*, 57 EMORY L.J. 463, 493–96 (2007) (stating that "state and local governments must evaluate whether their notice procedures are constitutionally adequate or whether they need to be altered" in the wake of *Jones v. Flowers*, 547 U.S. 220 (2006)).

²⁰⁵ See *supra* note 184 and accompanying text.

²⁰⁶ Unless the purchaser signs a sales agreement with the government, state statutes and local regulations are the only framework for requiring action by the purchaser.

²⁰⁷ See Metzger, *supra* note 139, at 1404.

²⁰⁸ *Id.*

financial impact. These qualities make tax lien sales an acceptable short-term solution to meet cash flow needs but a risky long-term strategy for public budgeting and lien servicing. Part III proposes alternatives to tax lien sales that have less risk and more benefit.

III. MAXIMIZING RETURN AND PROTECTING PUBLIC INTERESTS

An alternative to tax lien sales is to use two different transactions to address budgetary shortfalls: one to generate cash flow and the other to service delinquent liens. Assuming that it is impractical to cut government services extensively to account for low property tax receipts, the most realistic financing method is to borrow.²⁰⁹ Most local governments issue some form of short-term debt to address revenue shortages, including revenue anticipation or tax anticipation notes, which accrue relatively low interest and are secured by specific expected taxes or revenues.²¹⁰ Although governments may also finance services and projects through long-term general obligation bonds, which borrow against all of a government's resources,²¹¹ the debt is more costly and may be subject to constitutional and statutory restrictions, such as dollar limits and pre-approval before debt issuance.²¹² In contrast, short-term debt generally is not subject to such limitations.²¹³ Long-term debt is also undesirable because it is perceived as a signal of fiscal distress.²¹⁴ Because of the limitations and negative perceptions of debt, some governments use activities that are economically similar to debt as debt substitutes.²¹⁵

A type of short-term, tax-backed note, referred to by some as a "delinquent tax anticipation note" (DTAN), can help eliminate or mitigate the risks

²⁰⁹ See Roin, *supra* note 21, at 1975–77 (describing governments' frequent use of debt and subsequent restrictions).

²¹⁰ STEVEN MAGUIRE, CONG. RESEARCH SERV., R41735, STATE AND LOCAL GOVERNMENT DEBT: AN ANALYSIS 2 (2011); *Government Bonds, Market Data*, BLOOMBERG, <http://www.bloomberg.com/markets/rates-bonds/government-bonds/us/> (last visited Aug. 16, 2012) (showing greater yield for the investor, and therefore a higher payout by the government, for long-term municipal bonds compared to short-term bonds).

²¹¹ See *Municipal Bonds*, FIDELITY, <https://www.fidelity.com/bonds/municipal-bonds> (last visited Aug. 16, 2012).

²¹² Roin, *supra* note 21, at 1975–77; see also *Government Bonds*, *supra* note 210 (showing that the rate of return on municipal bonds increases as the term of the bond increases so that longer term bonds have a higher rate of interest that the government has to pay to bond holders).

²¹³ Roin, *supra* note 21, at 1984–85.

²¹⁴ Philip Kloha et al., *Developing and Testing a Composite Model to Predict Local Fiscal Distress*, 65 PUB. ADMIN. REV. 313, 319 (2005).

²¹⁵ Roin, *supra* note 21 at 1977–2001.

associated with using tax lien sales.²¹⁶ DTANs treat the delinquent tax obligations as assets against which funds can be borrowed rather than as an asset to be sold.²¹⁷ This Part argues that DTANs can be used alongside one of three servicing strategies—government servicing, contracted servicing, or consolidated government servicing—to meet both the operational and financial needs of local governments. Then, it suggests contract terms that would allow local governments to exert a similar level of control to that of government servicing. Finally, it suggests that if states continue to allow tax lien sales, they should provide for some level of control over purchasers' actions through local regulations.

A. *Combining Control and Cash Flow*

DTANs are government-issued notes secured by future delinquent property tax collections.²¹⁸ Investors purchase the notes and the sale revenue is used to fund public services. After the government collects delinquent taxes, the investors receive the principal of their investment, as well as a relatively low interest rate.²¹⁹ As described in this section, DTANs provide a cash-flow benefit like that of tax lien sales and alleviate, or at least mitigate, the risks of tax lien sales.²²⁰ Local governments are able to meet their cash-flow needs while maintaining a more transparent expenditure of public funds, allowing the government to retain control over housing policy decisions, minimizing aggregate social costs, and potentially creating additional financial gain and budgeting stability.

First, DTANs provide immediate funds and have the potential to provide a greater return than tax lien sales. By servicing the liens itself, the government benefits from the receipt of all penalties and interest paid by delinquent taxpayers on their obligations.²²¹ The rate at which the government borrows

²¹⁶ See Memorandum from Matt Rubino, Office of Budget & Mgmt., to Comm'rs of Cuyahoga Cnty., Analysis of County Land Reutilization Corporation (Apr. 15, 2009), available at <http://blog.cleveland.com/metro/2009/06/Land%20bank%20analysis.pdf> (describing the use of DTANs).

²¹⁷ See MICH. COMP. LAWS ANN. § 141.2401 (West 2005).

²¹⁸ See *Municipal Bonds*, *supra* note 211.

²¹⁹ See *supra* note 210 and accompanying text.

²²⁰ MICH. COMP. LAWS ANN. § 141.2401 (West 2005) (authorizing the use of delinquent tax-backed securities). Michigan provided for such a strategy and repealed local governments' authority to sell tax liens in 2002. *Id.* § 141.2303 (West 2005 & Supp. 2011) (describing qualifications needed to issue notes secured by tax liens); *id.* § 141.2401; Act effective Apr. 29, 2002, 2002 Mich. Pub. Acts 113 (repealing statute that authorized municipalities to sell tax liens).

²²¹ See *supra* Part I.C.1 (discussing how the government directly receives all of the collections from property owners, including all interest and penalties, when it retains ownership of and enforces the liens).

money, which can be 6% or less,²²² could provide an opportunity for arbitrage because it is substantially lower than the 18% to 30% interest and penalties that accrue on tax liens.²²³ Although a municipality does not collect the full interest and penalties that tax liens accrue, like it would if it serviced the tax digest and did not need a cash advance, it still receives a substantial portion of this revenue, even after paying interest on the principal borrowed.²²⁴ Governments that sell tax liens, however, typically receive none of this revenue.²²⁵ The receipt of additional revenue is better for the government's budget and taxpayers, who benefit from the delinquency of other property owners instead of private investors.

Second, DTANs enable greater government control over the use of tax delinquent property in its overall policy agenda than do tax lien sales.²²⁶ Because their focus is on financing, DTAN-enabling statutes primarily govern the issuance of the notes and not the servicing of liens.²²⁷ Local governments that use DTANs tend to service their own delinquent tax digests²²⁸ and therefore own tax liens instead of transferring them to a private purchaser.²²⁹ As a result, public officials determine when to file for foreclosure and when to modify tax obligations for certain groups of taxpayers.²³⁰ Because government officials retain control, they can be held politically accountable through the electoral process.

In addition, the use of DTANs increases financial transparency, which enhances the accuracy of the price the government pays, allows governments

²²² See *supra* note 160. Although the interest earned on many municipal securities is exempt from federal income taxes, which allows the local government to pay less interest, this Comment does not analyze whether DTANs are or should be taxable or tax-exempt.

²²³ See, e.g., CONN. GEN. STAT. § 12-146 (2011) (18% annual interest); 35 ILL. COMP. STAT. 200/21-15 (2011) (1.5% monthly interest); IOWA CODE §§ 445.39, 447.1 (2011) (1.5% monthly interest that can increase to 2%); MO. REV. STAT. §§ 140.100(1), .340(1) (2011) (up to 10% annual interest and 18% annual penalty); *supra* text accompanying notes 33–34. A 1.5% monthly rate is equivalent to a 19.56% annual rate if compounded.

²²⁴ Memorandum from Matt Rubino, *supra* note 216 (estimating that DTANs would result in \$8 million in delinquency penalties forgone by county).

²²⁵ See *supra* Part II.B.

²²⁶ See *An Overview of Land Banking in Syracuse and Onondaga County*, *supra* note 117, at 1 (stating that DTANs “enable[] the County to maintain local control of the liens while recovering up to 115% of delinquent tax revenue”).

²²⁷ E.g., OHIO REV. CODE ANN. § 133.082 (West 2002 & Supp. 2009) (providing for no additional means of servicing).

²²⁸ *Id.*

²²⁹ See *supra* Part I.C.1.

²³⁰ See *supra* Part I.C.1.

to evaluate the financial impact of their strategies, and further strengthens accountability. By using DTANs, a government pays an interest rate that is clearly established rather than hidden among a litany of other costs.²³¹ The interest rate also is easy to compare to the interest rate of other financing strategies to determine if the government is paying the lowest price.²³² Further, because the government is borrowing funds rather than using a debt substitute,²³³ the government more accurately presents its financial position and the shortfalls resulting from tax delinquency.

For the same reason, DTANs can help minimize aggregate social costs and risks to constitutional and consumer rights because a private party is only involved with *financing* and not *servicing*. Consumer concerns about unfair practices are reduced because the collection of delinquent taxes is not solely driven by a profit motive. Constitutional due process violations are also less likely because government officials should be more aware of their legal obligations.

DTANs are similar to the securitization of bundles of purchased tax liens,²³⁴ except a government that issues DTANs maintains ownership of the liens. One of the biggest challenges associated with securitized tax lien sales is selecting the liens to be included in the sale; similarly, the most important decision regarding DTANs is determining the amount that should be borrowed. Both of these decisions require an accurate forecast of future tax collections, which can be based on historical data regarding which liens are redeemed (rather than foreclosed upon) and how long it will take them to be redeemed.²³⁵ The amount borrowed through DTANs often will be some portion less than the face value of the liens to account for non-redemption of properties that have high lien-to-value ratios.²³⁶ An Ohio statute, for example, mandates that DTAN borrowings must not exceed 90% of total lien face values.²³⁷ Local governments can also limit borrowing by excluding liens with high lien-to-value ratios from the total borrowed.²³⁸

²³¹ See *supra* Part II.B.

²³² See Roin, *supra* note 21, at 2002–04 (describing the transparency of the cost of debt).

²³³ See *supra* text accompanying notes 215–18.

²³⁴ See *supra* I.C.3.

²³⁵ This activity projection can then be used to estimate the expected amount of interest and penalties that will accrue and actually be collected.

²³⁶ See OHIO REV. CODE ANN. § 133.082(A) (West 2002 & Supp. 2009).

²³⁷ *Id.*

²³⁸ See *supra* I.C.3.

Government servicing and DTANS are not feasible options in all jurisdictions because some governments lack adequate infrastructure. As the following section asserts, the DTAN funding mechanism can and should be implemented alongside a lien servicing strategy—other than tax lien sales—that maximizes benefits and minimizes aggregate social costs.

B. Enhancing Outcomes in Diminished Capacity Jurisdictions

Not all municipalities will be able to issue DTANs and service their tax lien digests because many local governments do not have the infrastructure and capacity to do both. Municipalities vary in size and funding levels; therefore, some may not have room in their budgets both to provide necessary services *and* hire staff to service a delinquent tax digest. This lack of capacity is what sometimes drives the sale of tax liens.²³⁹ Jurisdictions that currently use tax lien sales will likely lack this ability, at least in the beginning of DTAN implementation, because they currently rely on another party for lien servicing.

Such jurisdictions should consider the viability of creating a state- or regional-level servicer or using contracts to control the activity of private servicers and to simplify the calculus for measuring cost. This section shows that both options retain government ownership and control over tax liens, similar to that of a government that services the liens itself. They also enable the government to better ensure accountability, adequate revenue returns, and use of sound policy decisions that represent public interests.

The first option is a consolidated lien servicing effort that allows the local government to transfer responsibility for tax servicing to another level of government that is better equipped to handle it, such as a county or state government entity or a regional entity.²⁴⁰ A key principle of local government financing is that services should be provided at as local a level of government as possible, but only to the degree that doing so would allow effective service provision.²⁴¹ If services cannot be provided competently at a particular level of government, they should be provided at a different level of government that can. Some jurisdictions have already recognized and acted upon an awareness of capacity challenges. For example, Michigan shifts the responsibility for tax

²³⁹ See *supra* note 59 and accompanying text.

²⁴⁰ See Bahl, *supra* note 131, at 81.

²⁴¹ John L. Mikesell, *Developing Options for the Administration of Local Taxes: An International Review*, PUB. BUDGETING & FIN., Spring 2007, at 41, 48.

collection from the local government to the county,²⁴² and all tax delinquent properties in Arkansas revert to the state, which then may sell them.²⁴³

Additionally, consolidated tax lien servicing may produce economies of scale and collections that are more efficient. For the same reason, “consolidated service districts” have become common means for providing public services, such as hospitals and parks, because they enable service provision at lower costs.²⁴⁴ Although use of consolidated servicing can result in less local control, a consolidated government entity would likely be more responsive to public interests than would a private servicer that is only responsive to its own profit incentives.²⁴⁵

Another alternative is the use of contractual or statutory²⁴⁶ controls, or a combination of the two. If property tax servicing cannot be competently provided by a government entity, public officials have a responsibility to ensure that they are serving taxpayers’ needs by minimizing costs and maximizing benefits. The use of private parties to service delinquent tax digests may be the most feasible way to enforce property tax obligations in some jurisdictions.

Given the time-consuming and uncertain nature of lawmaking,²⁴⁷ it would be more efficient to implement controls over servicers’ behavior through contract. As discussed below, there are several areas where control over contractors should be improved, and it could be difficult to pass so many statutory changes. Contract-based controls also would provide greater legal recourse than statutory controls because the government can set specific conditions that allow it to cease performance.²⁴⁸ In contrast, statutory controls can only be enforced through the courts. Contracts also would enable the government to control a servicer’s behavior independent of the actions by a legislature whose members are far removed from the interests of a particular community. Further, contractual provisions would be less susceptible to

²⁴² See CHAD FARRINGTON, COLUMBIA MGMT., LOCAL MUNICIPAL CREDIT QUALITY DISSECTED 3 (2011).

²⁴³ ARK. CODE ANN. § 26-37-101(a), (c) (West 2010 & Supp. 2011).

²⁴⁴ See Bahl, *supra* note 131, at 81.

²⁴⁵ See *supra* note 184 and accompanying text.

²⁴⁶ See MASS. GEN. LAWS ANN. ch. 60, § 2C(c)(1) (West 2009) (establishing factors considered when deciding whom to sell tax liens to, including “qualifications and experience” and having a “regular place of business” in the jurisdiction).

²⁴⁷ ANN BOWMAN & RICHARD KEARNEY, STATE AND LOCAL GOVERNMENT 129–33, 143 (8th ed. 2011) (describing “multiple opportunities for delay and obstruction” in the legislative process).

²⁴⁸ See Roin, *supra* note 21, at 2006 (describing opportunities to minimize risk in contracts for privatized services).

change by a third party, such as a state legislature, so long as they comply with state law.

By using contracted lien servicing rather than tax lien sales, the government would control the foreclosure process.²⁴⁹ Contractors would not have the right to initiate foreclosure unless specifically authorized through an agreement. Consequently, the government alone would decide the types of properties that should be incorporated into the redevelopment efforts of land banks or other entities; it also would determine the types of taxpayers who should have their tax obligations mitigated. This control would help minimize aggregate social costs and better enable a consistently applied property tax enforcement strategy to encourage taxpayer compliance. In addition, the use of contracted servicing would enable governments to strategically structure relationships to their benefit and ensure certain outcomes are achieved.²⁵⁰ Governments that use contracted servicing also can enhance accountability by specifying terms, penalties, and oversight in the agreement.²⁵¹

Contracts used for lien servicing should address several factors to overcome some of the risks outlined in this Comment. First, the contracts should include consequences to private servicers for undesirable outcomes of their servicing efforts or non-compliance with contract terms. The government should ensure that it is able to terminate an agreement for consumer rights violations and constitutional due process violations.²⁵² Such provisions would provide greater assurance that taxpayer interests are protected. The contract bidding process should also exclude parties who have been tax delinquent in the past or have abandoned a property.

Second, local governments should consider a multi-year partnership with fewer servicers. With a longer term arrangement, a government would be able to maintain consistency in servicing procedures and outcome reporting. A longer term agreement also creates an incentive for the servicer to address public interests because that provider becomes known by the public, which increases the government's ability to monitor the provider's activity from time to time.²⁵³ Similarly, by having a relationship with the servicer, a government

²⁴⁹ See *supra* notes 175–76 and accompanying text.

²⁵⁰ See Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 608 (2000).

²⁵¹ *Id.*

²⁵² See GUENTHER, *supra* note 74, at 3 (discussing the IRS's ability to revoke contracts with servicers who violate federal law or contract terms).

²⁵³ See Roin, *supra* note 21, at 2027 (stating that “[a] longer-term contract may be necessary to ensure that the private actor has the incentive to do its part of the bargain in the way that most benefits the public”).

may be able to convince a servicer to participate in community development planning as a condition for future contracting work. Further, a long-term contract may make the servicer work more efficiently in a particular community, which could lead to increased collections.²⁵⁴ Servicers generally are more effective when they understand the local real estate market and related state and local laws.²⁵⁵

Additionally, servicing contracts should be written in a manner that ensures high-efficiency collections and protects taxpayer interests. Governments should consider structuring their bidding process such that only providers with experience and success at tax lien servicing are selected.²⁵⁶ Although a more efficient collection would generate less tax revenue due to lesser accruals of interest and penalties, taxpayers and communities would benefit from quick resolution of debts. Taxpayer protection would further improve if servicing contracts required servicers to provide property owners with their name and contact information so that property owners can make contact if needed.²⁵⁷ Taxpayers may also benefit from contracts that establish standards for conduct between a servicer and a property owner.²⁵⁸

Lastly, at a minimum, local governments that conduct tax lien sales should also incorporate regulatory controls as part of their sale process. Some governments may not be able to implement DTANs without a state statute in place that enables their use.²⁵⁹ Local governments should develop regulations that target some of the same items that this Comment proposes be included in contract terms to the degree possible without conflicting with state law.

CONCLUSION

The first priority for local governments is to maintain service provision in the face of revenue shortfalls. This priority is sometimes well served in the short term by tax lien sales. However, when the sales are instead used as part of a long-term revenue strategy, the government has a responsibility to ensure that the cost and impact of the practice is justified, just as it has regarding any

²⁵⁴ Poindexter et al., *supra* note 39, at 190–91.

²⁵⁵ *Id.*

²⁵⁶ See GUENTHER, *supra* note 74, at 8.

²⁵⁷ See *supra* Part II.D.1.

²⁵⁸ See, e.g., GUENTHER, *supra* note 74, at 3.

²⁵⁹ For example, some short-term notes are exempt from debt limitations. Roin, *supra* note 21, at 1984–85.

other privatized service or tax expenditure. This responsibility becomes even stronger when the underlying strategy produces significant risks to public interests.

This Comment argues that a rational financial analysis should accompany a local government's selection of a strategy for addressing property tax revenue shortfalls, and that the widespread use of tax lien sales without such an analysis is irresponsible and potentially costly. One of a local government's most important roles is to squeeze the most benefit it can from limited resources and balance current and future revenue needs. However, local governments appear to be rejecting a proactive approach to public finance in favor of a reactive approach to quickly obtain access to funds.

The opacity and complexity of property tax lien sale costs impede public accountability. This Comment argues that the practice creates several additional unnecessary risks, including community externalities, reduced rates of return on property taxes, and diminished consumer and constitutional protections. These risks can have a serious impact on the fiscal health of the municipality and taking such a gamble is imprudent. While methods other than tax lien sales are not certain to reduce tax delinquency or provide a greater rate of return, there are very good reasons to believe that they will. As a result, local governments should consider exchanging tax lien sales for DTANs—and at a minimum, they should institute additional controls over costs and community outcomes of tax enforcement.

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