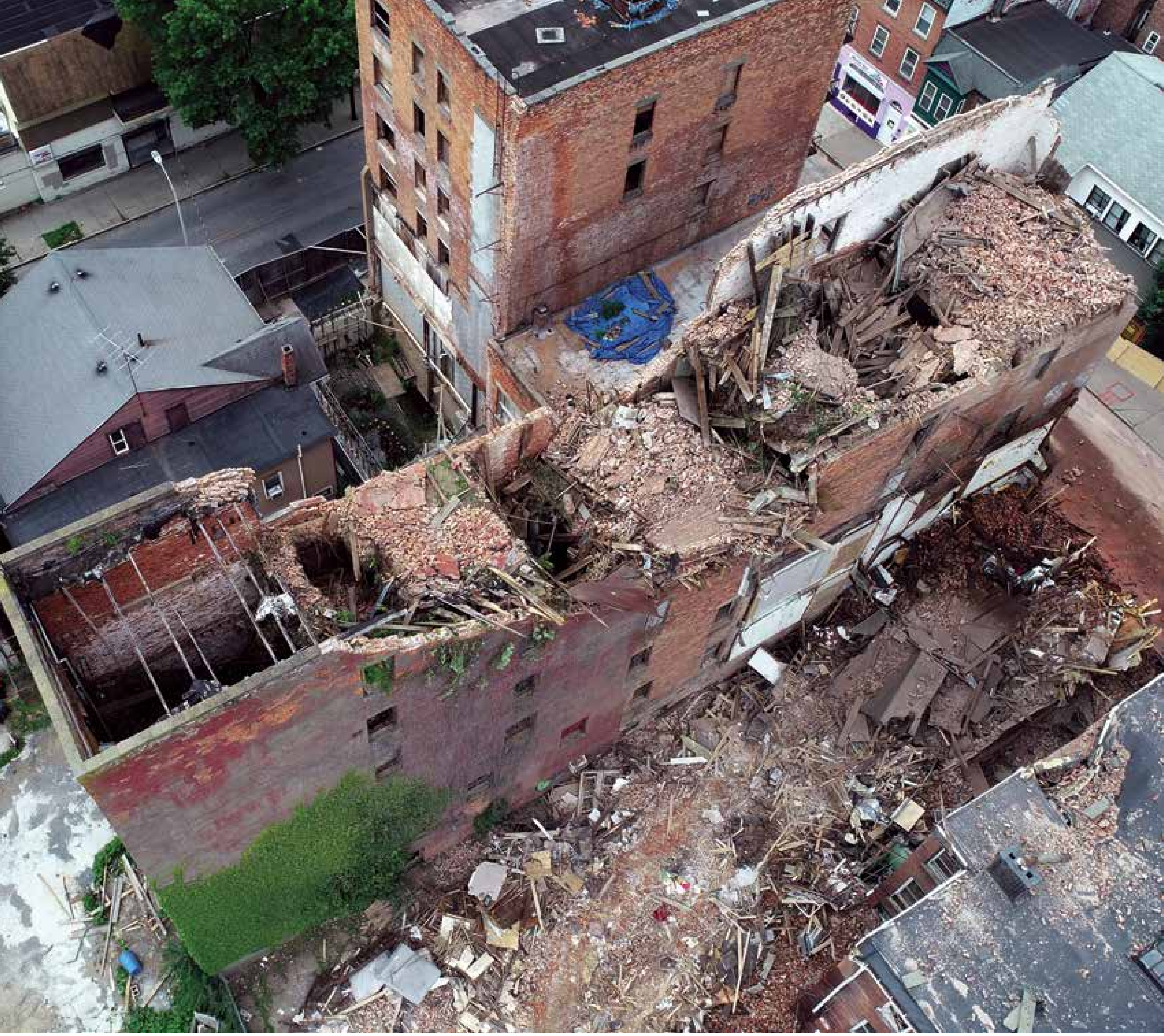


GOING … GOING … GONE
TAX LIEN AUCTIONS, HIDDEN COSTS, AND MISSED OPPORTUNITIES FOR THE CITY OF POUGHKEEPSIE

Joshua Simons

DISCUSSION BRIEF #21 | FALL 2018

THE BENJAMIN CENTER
SUNY NEW PALTZ
FOR PUBLIC POLICY INITIATIVES

Photo on cover: Demolition crews work to take down a collapsed building at 17 Academy Street in Poughkeepsie June 20, 2018.
Peter Carr & John Meore/*Poughkeepsie Journal*

Photo at right: 18 Reade Place / Joshua Simons

How much is the two story, two family house in this picture worth?

How much is the two story, two family house in this picture worth? It's on the South Side of the City of Poughkeepsie, across the street from Vassar Hospital. The city assessor says $132,700. But just a few years ago, in 2011, Bonita West LLC bought it for $4,825. Bonita West is a company in the business of purchasing tax liens at auction. In the City of Poughkeepsie, business is good.

The story of 18 Reade Place in the City of Poughkeepsie is an example of how the city government's unique method of collecting delinquent taxes disproportionately disadvantages minorities, the poor, the aged, and the infirm. It is the story of how an elderly woman with dementia who had lived in the house since 1950 lost her home, and the equity she had in it, because she failed to pay $4,242 in property taxes in 2011.

Herman and Marie Rowe bought 18 Reade Place in 1950. Herman was a painter first hired by New York Central Railroad to help paint the Poughkeepsie Rail Bridge in 1936; he married Marie in 1939. After military service in WWII, Herman came home, took up his old job and joined the Local 155 Painter's Union (he later became its president). After Herman passed away in 2007 Marie stayed in the house in which the couple had raised their three children, checked in on regularly by her daughter Kathleen who lived nearby.

2011 Tax, Interest and Fees for 18 Reade Place	
City, County, and Library Taxes	$2,332.61
School District Tax	$1,910.30
City Interest & Penalties	$325.57
City Fees	$160.59
School Tax Late Fees	$95.51
Total	**$4,824.58**

By 2011, Marie's dementia was impacting Marie's ability to manage her finances herself and she neglected to pay her property taxes by the February 15 deadline. By December 1, 2011, her taxes still unpaid, the City of Poughkeepsie placed a lien on the property and announced that the lien would be sold at auction on December 15. That's when Bonita West LLC bought it for $4,825 (the taxes owed plus penalties, interest, and fees). This gave Bonita West the right to attempt to collect the debt, plus 12 percent interest annually.

For two years, the debt and interest remained unpaid. Marie's daughter Kathleen said that she did not know that her mother didn't pay the taxes—it just slipped through the cracks. By the time Kathleen found out, it was too late. The deed to the property was already transferred to Reade 18 LLC, another company set up by the owner of Bonita West LLC, which was created specifically to seize and resell the property. Marie Rowe had lost the home that she bought with her husband, the place where she raised her children, and had lived in most of her life. When this happened, her grandson who lived upstairs was evicted as well.

Marie Rowe not only lost her house; she also lost the equity in it. Reade 18 LLC went on to sell the property

WHY DOES THIS MATTER?

- Traditionally marginalized communities bear the brunt of this system. Many people who owe residential property tax debts in the City of Poughkeepsie are poor. Often they are members of racial and ethnic minority groups. Then interest is added. Too often they end up without a place to live, and—adding insult to injury—without the accumulated value of those homes (most families' only major asset) after the debt is paid.
- Since, under its current system, the property is transferred without the involvement of the courts, a case could be made that it violates the due process clause of the U.S. constitution.
- Since the tax liens are almost always purchased for far less than the property is worth, automatically transferring the property to the party that purchased the debt is clearly unfair. Furthermore, the statutory basis for the practice is unclear.
- Many housing strategies, such as those laid out in the 1998 City of Poughkeepsie Comprehensive Plan, require the city to intervene, acquire vacant property, and facilitate its redevelopment or rehabilitation. But without tax foreclosure proceedings the city lacks the necessary tools and processes to intervene in this way.
- In 2015, the NY State Attorney General explored the potential of providing millions of dollars to the City of Poughkeepsie. He had received the funds from the settlement of a major financial crisis-related lawsuit to establish a land bank to address the vacant and abandoned property problem. Because the city opted out of the established standard procedure set out in state law, it is not defined as a "foreclosing government unit." As a result, Poughkeepsie is ineligible to create a land bank. The NYS Attorney General has just announced another $500 million settlement over the Bank of Scotland's misconduct leading up to the 2007 Financial Crisis, and enabling legislation was recently amended to increase the number of land banks in the state to thirty-five. If Poughkeepsie wanted to create a land bank, it would have to act relatively quickly to change how it deals with property owners who fail to meet tax obligations.

for $115,000 to Vassar Brothers Hospital, making the company roughly $110,000 on the deal. Had Marie Rowe lived anywhere else in Dutchess County the property would have gone through a tax foreclosure process and, she or her family would have had the opportunity to go to court to redeem her home. Instead, her Legal Aid attorney was forced to tell her there was nothing that could be done. The City of Poughkeepsie doesn't use the tax foreclosure system to collect delinquent taxes though. Instead, it utilizes a tax lien auction system that has a feature well outside the norm: It bypasses an adjudicated process and transfers deeds directly to the purchaser of the lien if the debt is not repaid with interest and fees in two years.

This study examines the differences between the conventional *in rem* procedure for tax foreclosure and the tax lien auction system utilized by Poughkeepsie, demonstrating that the negative impacts of the tax lien system can be overcome if it is replaced with the widely-used *in rem* option already specified in law. This will bring in more tax revenue without raising taxes, be far more equitable, and allow for policy interventions that could help to revitalize the city and address long standing problems with vacant and abandoned properties. First, a general overview of how property tax collection in New York State (outside New York City) is presented in order to provide needed context.

A TALE OF TWO SYSTEMS

In New York State, counties, cities, towns, villages, school districts, fire districts, and selected other special districts levy property taxes but they don't all collect them. There are exceptions but, in general, towns collect taxes for themselves, counties, and fire districts. Cities collect their own and county taxes and sometimes those for school districts within them. Most school districts and villages collect for themselves. The City of Poughkeepsie collects taxes for itself, the Poughkeepsie school district, and the county.

Once received, revenues are distributed among the taxing governments. Towns and school districts keep all that is owed them and turn the county's share over to it, along with a record of what's not yet paid; it is generally the county's job to "hold the tax warrant" and collect all of these "delinquent taxes." (The county also charges fees and interest during the time taxes are late).[1] Cities can choose, if they wish, to do things differently. Poughkeepsie, like most cities, gives the county its full share, and has to "hold the warrant" and go after the uncollected (delinquent) taxes itself. It also does this for the school district.

This practice for cities dates back to the late 1800s when the cities in New York were the wealthiest governments in the counties, and when the counties provided far fewer services. At that time as well, the county governments were commonly headed by a board of supervisors made up of the town supervisors of all of the towns, and supervisors from the city who often served a dual role of aldermen/city councilors and county supervisors. The City of Poughkeepsie began the practice of guaranteeing the property tax levy in the charter revision of 1874.

What happens if you don't pay your property taxes? The answer depends on which government "holds the warrant." If it is the county, the New York State *in rem* procedure for the collection of delinquent taxes is used (The Consolidated Laws of New York, Real Property Tax, Article 11, Title 3). Most cities in New York have also opted to utilize the *in rem* procedure. This involves placing a "lien" on the property after the taxes have been owed for two years and then petitioning for tax foreclosure.[2]

Tax foreclosure proceedings are similar to mortgage foreclosure proceedings (See *Figure 1*, Page 4). A lawsuit is filed in court, a notice of foreclosure on the property is filed and published in the newspaper, and the case proceeds in the court until a settlement is reached, the tax lien has been paid with interest and penalties, or the property has been foreclosed upon. If there is a foreclosure, the property is either sold at auction or, in some cases, the municipality takes possession of it.

The City of Poughkeepsie does not utilize the tax foreclosure system. Instead it employs tax lien auctions to collect delinquent taxes (See *Figure 2*, Page 5). When a party does not pay their taxes in Poughkeepsie, a lien is placed on the property. After a period of time, that lien is sold at auction. The city collects the sale price of the lien and the purchaser is then owed the defaulting owner's delinquent taxes, plus 12 percent interest annually. This 12 percent interest rate is how the purchasers of the lien make money when the debt is paid.

If the owner's debt (plus interest) is not paid within two years, the Commissioner of Finance transfers ownership of the property to the party that bought

Figure 3. City of Poughkeepsie Tax Lien Process Timeline

YEAR ONE			YEAR TWO	YEAR THREE
JANUARY 1 **The Start of a New Year:** tax roll is created and tax warrants issued.	**FEBRUARY 15** **City and County Taxes are Due:** Taxes are paid after this time are subject to late fees. School taxes are collected separately in the autumn.	**DECEMBER** **If by Dec. 1 the taxes remain unpaid,** a lien is put on the property and, if not satisfied, sold at auction on or around Dec. 15.	**JANUARY TO DECEMBER** **Purchaser of the Lien Collects Debt:** The purchaser of the lien is entitled to collect the unpaid taxes plus 12% annual interest in Year 2.	**JANUARY TO DECEMBER** **Purchaser of the Lien Collects Debt:** The purchaser of the lien is entitled to collect the unpaid taxes and interest from Years 1 & 2, plus 12% annual interest for Year 3. If by the end of Year 3 the taxes, interest and fees are not paid, the city issues the lien holder a deed to the property.

Once the purchaser of a lien is granted the deed to a property, they must buy out other lien holders on the property or risk losing the property in the same manner the following year to another lien holder.

Figure 1. Tax Foreclosure

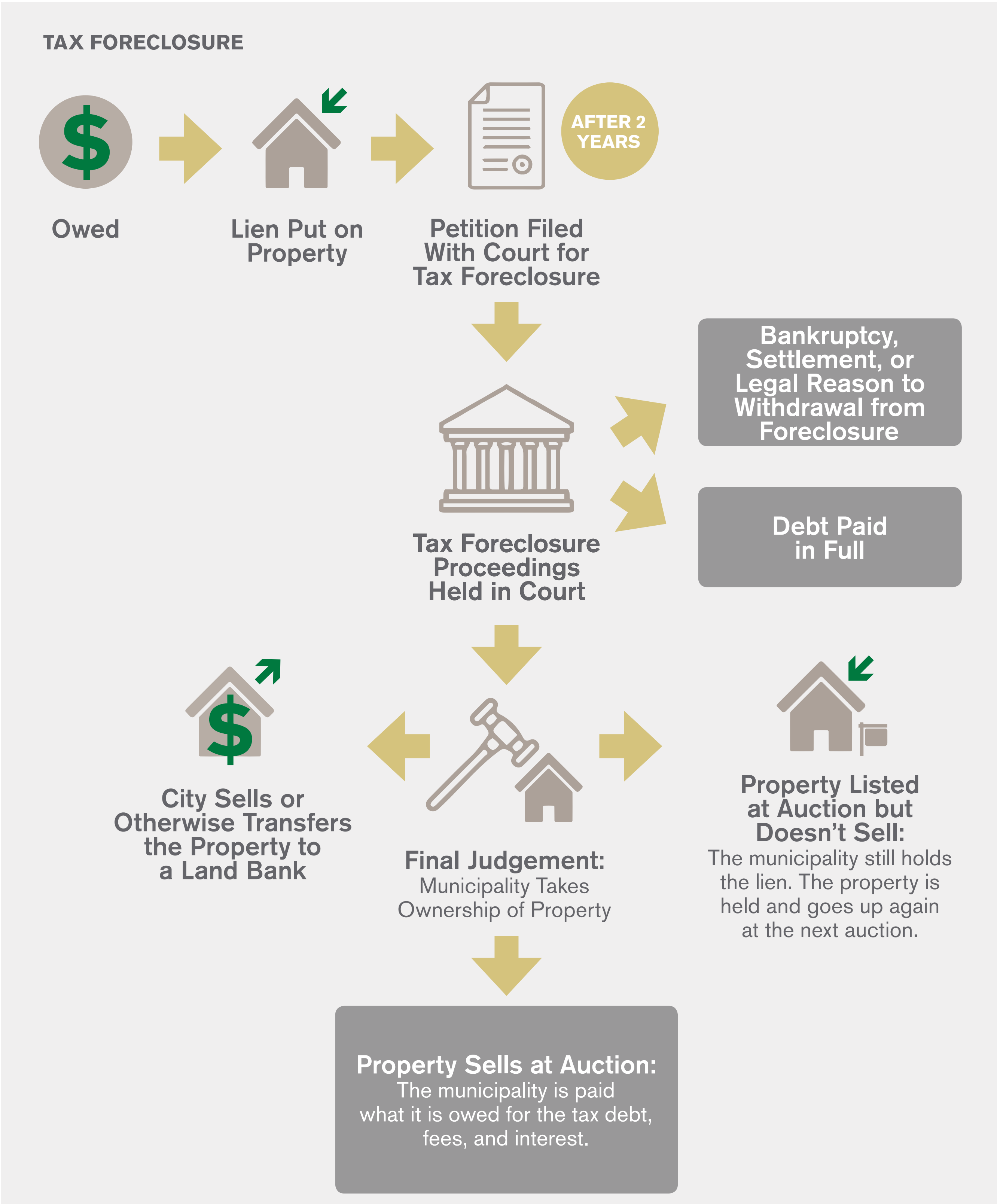
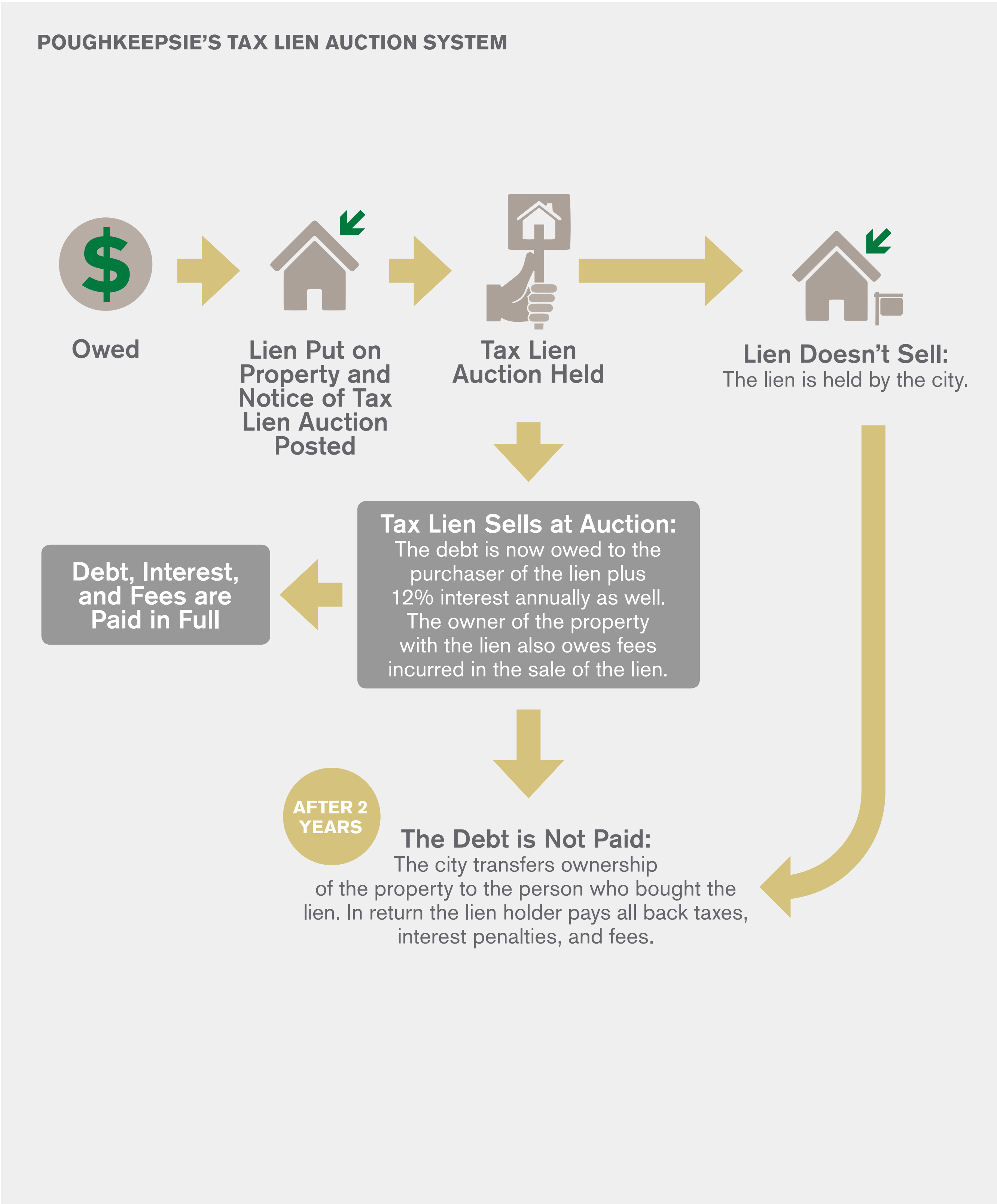


Figure 2. Poughkeepsie's Tax Lien Auction System



the tax lien (See *Figure 3* for a timeline of the process). Some other municipalities in New York (most notably New York City) sell tax lien certificates instead of initiating tax foreclosure proceedings. Unlike Poughkeepsie, however, these other municipalities require the person purchasing the lien to initiate foreclosure proceedings against the property owner if the debt is not paid. That is, the property still goes through an adjudicated procedure of tax foreclosure but, rather than the municipality petitioning for foreclosure, the party that bought the lien initiates foreclosure. The City of Poughkeepsie differs in that it skips the legal proceedings and adjudication entirely, and authorizes the Commissioner of Finance to directly transfer the deed to the property to the lien holder.

LEGAL MUDDLE

Poughkeepsie's Administrative Code provides for the sale of properties to collect delinquent taxes, not the sale of tax liens. This provision predates the incorporation of the city and was included in the original 1854 City Charter. To be clear, the law that is on the books now is at least 164 years old and likely codifies a practice that dates to the first half of the 19th century when Poughkeepsie was a village.

This provision was moved from the city charter into the Administrative Code when the code was created following the 1994 charter revision. Further muddying the issue, the City of Poughkeepsie has a law on the books adopted in 1977 that adopts the *in rem* procedure for tax foreclosure specified in state law.[3] In 1993, the city adopted a law to "opt-out" of this procedure in favor of the one the city was using, sales of tax liens. It thus appears that between 1977 and 1993 the city was selling tax liens at auction without repealing the 1977 law. The argument could be made that the 1977 law did not have the authority to contradict the charter provisions then in place (now in the Administrative Code). But it could also be argued that the charter provisions were no longer in force because the city never took possession of properties on which taxes were owed and it may not sell something that it doesn't own, the lien notwithstanding.

> "…had the house sold for $102,000 at a tax foreclosure auction and not transferred through the sale of the lien, the owner would have received roughly $95,000 after the debt to the city was satisfied…"

Further complicating the matter is the issue of bankruptcy protections and the question of whether the direct transfer of the property to the purchaser of the lien is fraudulent. In 2013, the United States Bankruptcy Court Southern District of New York published an opinion on a motion for relief from stay regarding a residential property at 22 Bain Avenue.[4] The property owner's tax lien had been sold at auction and the property transferred to the buyer of the lien after he had filed for bankruptcy. As a portion of his motion, the owner sought to vacate the transfer of the property as fraudulent as the lien was sold for $4,892.37 and the home was valued at $102,000. The court did not rule on validity of the property transfer because a determination of fraudulence could not be made in the context of a lift-stay proceeding. However, the proceeding does highlight the fact that, had the house sold for $102,000 at a tax foreclosure auction and not transferred through the sale of the lien, the owner would have received roughly $95,000 after the debt to the city was satisfied: a sum that would go a long way in dealing with his recovery from bankruptcy.

Poughkeepsie's tax lien system has an established timeline of three years (the year the taxes are owed plus the two years in which the property can be redeemed). The total debt over three years, including the 12 percent annual interest rate, is very unlikely to exceed the value of the property. By one calculation, the total tax rate of all taxing jurisdictions and additional fees would have to exceed 29.63 percent of the property value annually for this to be the case.[5] Poughkeepsie currently taxes homestead properties[6] at 1.33 percent and non-homestead properties at 1.77 percent of full assessed value (excluding exemptions). The bottom line: Poughkeepsie's lien sales system is virtually guaranteed to be a very lucrative system for lien buyers.

EVALUATING POUGHKEEPSIE'S TAX LIEN SYSTEM

Identifying goals makes evaluation of the City of Poughkeepsie's Tax Lien Auction system possible. The system should: efficiently and economically collect revenues to pay for needed services; ensure equitable treatment of citizens as this is done, and; work toward the physical revitalization of the city. In short, how does the system fare in answer to four questions: Is it efficient? Is it economical? Does it help revitalize the city? And, is it equitable?

Maximizing Revenue

The primary goal for the tax lien auction is to collect needed revenue in order to provide services. In 2015 (the single year for which we have complete data), of the 336 liens that were offered at auction, only 215 sold; the city retained the liens for the remaining 121 properties. The private market for tax liens is very efficient at determining which owners are likely to pay off the lien with interest and fees. Of the 215 liens, 92.6 percent of them paid off the debt within the redemption period. In comparison, of the 121 liens that did not sell at auction 57.9 percent paid the debt before the redemption period ended. The total of the unpaid liens held by the city in 2015 was $374,000 representing a systemic loss of 11.78 percent.

This is just the baseline loss; it does not factor in the opportunity cost. By selling the tax liens to private parties, the City of Poughkeepsie foregoes interest on the money it is owed. In 2015, private parties were paid $247,370 in interest on the liens that the city sold at auction in 2015. So, if this was a typical year (and there is no reason to believe that it wasn't), the tax lien auction system foregoes over a half million dollars in potential revenue: the $374,006 it failed to collect plus the $247,370 in interest it failed to earn. In years where the liens are not paid back at such a high rate (as was the case in 2014), investors stand to ultimately make even more on their investment since they take ownership of the properties and can then sell them.

Recently, the city has expressed an interest in bundling the tax liens and selling the bundle to a single buyer. Poughkeepsie's tax liens have been bundled and sold to a single buyer. (This diminishes competition, as potential buyers have to have enough capital to purchase all the liens.) Even if the bundled liens are sold at their face value (an unlikely scenario), bundling the liens would remedy the 11.78 percent system loss previously mentioned, but not the loss of potential interest and fees.

By comparison, the tax foreclosure system used by Dutchess County government collects delinquent taxes for all of the towns and villages in the county. In doing so, the county charges 12 percent annual interest on the taxes owed, plus fees associated with the collection of the debt.

Some argue that there is value in the tax lien system because it provides the city with revenue covering delinquent taxes all at once; this may help with cash flow. But the cost is foregone fees and interest. For lottery winners, accepting less money in a lump sum is tempting; for a municipality it is shortsighted.

Revitalization

The collection of delinquent taxes can be used as a policy tool to address vacant property and nurture revitalization. The tax lien system does nothing to address these issues. In fact, it may actually be detrimental to the city's revitalization efforts and perpetuate vacancies in contradiction to the city's other efforts. One indication of this is that some properties change hands through the tax lien system multiple times. From 2007 to 2017, 11 percent of the property transfers were of properties that had been transferred at least once before during the same time period.

The top of 19 Academy St. in the City of Poughkeepsie collapsed dropping debris and causing damage at other properties. Ryan Santistevan/*Poughkeepsie Journal*

There are two prominent examples that illustrate how the tax lien auction system has either failed to advance the city's efforts for revitalization, or threatened one of the most significant advances in the past thirty years.

Neglect: In 1990, Lucky Platt Center Associates, a company that intended but failed to develop the Lucky Platt Building and parts of the surrounding neighborhood, neglected to pay $1,587 in taxes and late fees on 19 Academy Street. This was a seven story building built by Manning Cleveland in 1919 that was vacant and had fallen into disrepair. The lien was offered at auction but, due to the condition of the property and the fact that the owners were unlikely to pay off the lien since they had abandoned the property, the city held the lien.

In 1993, the city took possession of 19 Academy Street after the owners failed to redeem the vacant and abandoned property. The city owned it for thirteen years until 2006 when it was sold for $5,000 to Valiotis Efstathios, the developer who renovated the Lucky Platt Building. Efstathios, in turn, sold it in 2009 for $10,000 to 19 ACAD ST LLC. 19 ACAD ST LLC owned the property for eight years but failed to develop it. In 2017 the property was sold to its current owner POK ACADEMY LLC (AKA Urban Green Equities) for $50,000. On June 18, 2018, 19 Academy Street collapsed; it was without a roof, and had been structurally weakened through decades of neglect. It is unknown what, if any, upkeep to the property was performed by the city in the thirteen years that it was the owner. It is also unknown how frequently or how recently the building had been inspected by the city, or the results of any inspections performed, as the city has not made this information available.

A little-known dramatic example, with a happier outcome: In 2004 a small not-for-profit called Walkway Over the Hudson failed to pay $151.19 in property taxes. The lien did not sell at auction and was held by the city. After two years passed, the taxes, interest, and fees remained unpaid and the city transferred the deed to the property to itself. Happily, the property, valued at $8.47 million dollars, was promptly sold back to Walkway Over the Hudson. But for a brief time in 2007 the City of Poughkeepsie owned the asset essential to the Walkway's success, the rail bridge. What if someone else had purchased this lien in 2004? The failure to pay $151.19 in taxes, and the automated nature of the tax lien system, may have stopped the walkway project in its tracks.

Missed opportunity: The New York State Attorney General has set aside funds for land banking gained from settlements with banks and financial institutions for their role in causing and deepening the housing crisis and recession of 2007. State law requires that land banks be created by a “foreclosing government unit” as defined as a “tax district” in subdivision six of section 1102 of the Real Property Tax Law.[7] As noted, a 1993 local law opts the City of Poughkeepsie out of Article 11 of the real property tax law and so legally it cannot be a “foreclosing government unit.” Because of this, the City of Poughkeepsie has missed out on receiving millions of dollars from the New York State Attorney General to finance land banking. Due to recent changes in the land banking enabling law, the number of land banks allowed within the state has been increased to twenty-five, opening up a new round of applications for the creation of land banks. This is an opportunity that the city could seize upon, but it would need to abandon the tax lien auction system to do so.

Many housing strategies, such as those laid out in the 1998 City of Poughkeepsie Comprehensive Plan, require the city to intervene, acquire vacant property, and facilitate its redevelopment or rehabilitation. Vacant properties are frequently tax delinquent and, without a tax foreclosure proceeding, the city lacks the necessary tools to take ownership of these properties. The 1998 comprehensive plan states:

The City’s Administrative Code incorporates an outdated tax forfeiture procedure that does not provide a basis for a clean title policy. The procedure interferes with the efficient disposition of properties and increases the costs and risks associated with a purchase of tax forfeit parcels. The City should consider the adoption of the statutory in rem *procedure, and the compliance with procedures necessary to ensure clear title for purchasers or the transfer of tax enforcement activities to the County.*

“Who benefits from this system and, more importantly, what are the social costs? The current method of delinquent tax collection in Poughkeepsie in fact carries great social costs; social costs that have a disproportionate negative impact on racial and ethnic minorities, the poor, and the aged.”

EQUITY

It is not enough to ask if the Poughkeepsie tax lien system maximizes resources or if it is the best approach to realizing the city’s policy goals. The system must also be fair to the citizens of the city whose lives are touched by it: We must also ask ‘for whom’? (Fredrickson, 2005) Who benefits from this system and, more importantly, what are the social costs? The current method of delinquent tax collection in Poughkeepsie in fact carries great social costs; social costs that have a disproportionate negative impact on racial and ethnic minorities, the poor, and the aged.

This study examined the 208 instances where the owner failed to redeem the property after two years and the deed to the property was transferred to the party that purchased the tax lien at auction between 2007 and 2017. Of that group, we also looked at a subset: the seventy-one properties where the owner lived at the property address.[8]

Two distinct groups generally owe delinquent taxes. The first are developers, investors, and speculators who acquire property either for income, or for the purposes of property speculation (to “flip,” and then fail to pay the taxes on the properties). The second group are residents who occupy the properties and own them outright, either by having paid off a mortgage or by inheritance. On average, owners who lost their homes to tax lien sales from 2007 to 2017 were sixty years old. Ten people who lost their homes were over the age of eighty (*See Figure 4*).

Of the 208 properties transferred, 80 percent were residential and, of those, most were multi-family or apartment buildings (*See Figure 5*). Sixteen percent were commercial properties; a cluster of those were within the Main St.–Academy St.–Cannon St.–South Hamilton St. block of the Central Business District in the heart of the city (*See Map 1,* Page 11*)*. Over the decade covered, only two properties were zoned industrial. The fewest property transfers in a single year was six (in 2007). The most transfers in a single year was forty (in 2014). (*See Figure 6*, Page 12).

To determine who is most affected by tax lien property transfers, we mapped the location of the 208 properties, and overlaid them with the minority majority census blocks using data from the 2010 decennial census. We found that 76 percent of the properties transferred after the redemption period are located in minority majority census blocks (*See Map 1*). This negatively impacts these neighborhoods—a fact most obvious when people lose the properties that they live in. When considering only the owner occupied properties, 72 percent were in minority majority census blocks (*See Map 2*, Page 13). By comparison, only 35 percent of the census blocks in the city are minority majority.

Even if the owner does not live in a transferred property, 80 percent of these are residential (*See Figure 4*), most are multi-family and apartment buildings. New owners may or may not have to honor the tenants' leases. Moreover, as a matter of practice, rental agreements other than leases would be very difficult to enforce on the new owner. At the very least, this situation causes uncertainty to tenants in these properties; at worst, it can lead to eviction.

Figure 4. Age of Owners Who Lost Homes to Tax Lien Sales 2007–2017 (Average Age=60)

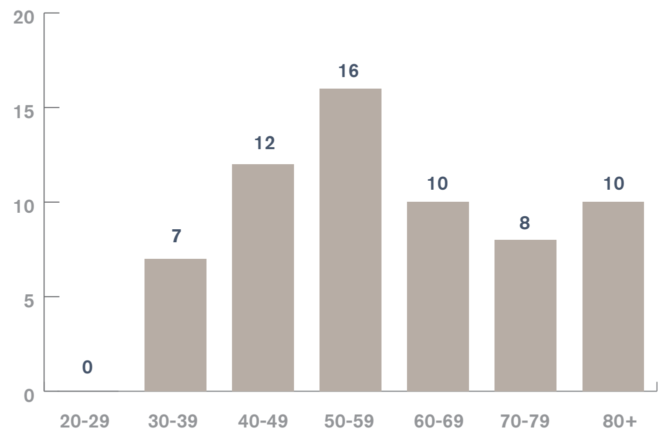
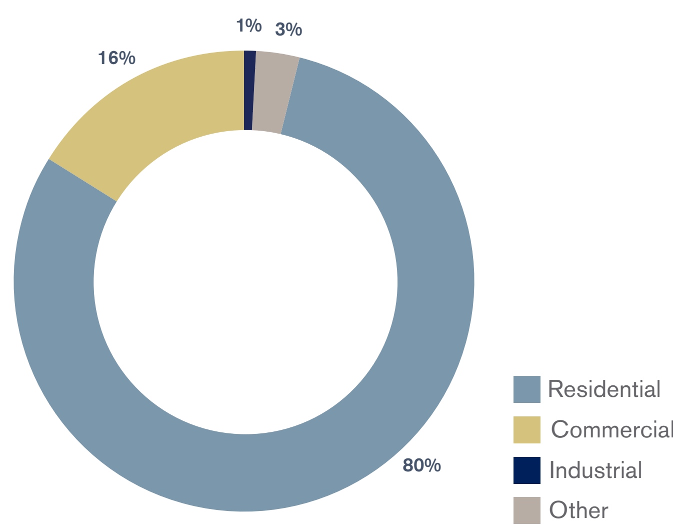


Figure 5. Zoning of Transferred Properties



Map 1. City of Poughkeepsie: Deeds Transferred from Tax Lien Sales 2007–2017 and Minority Majority Census Blocks

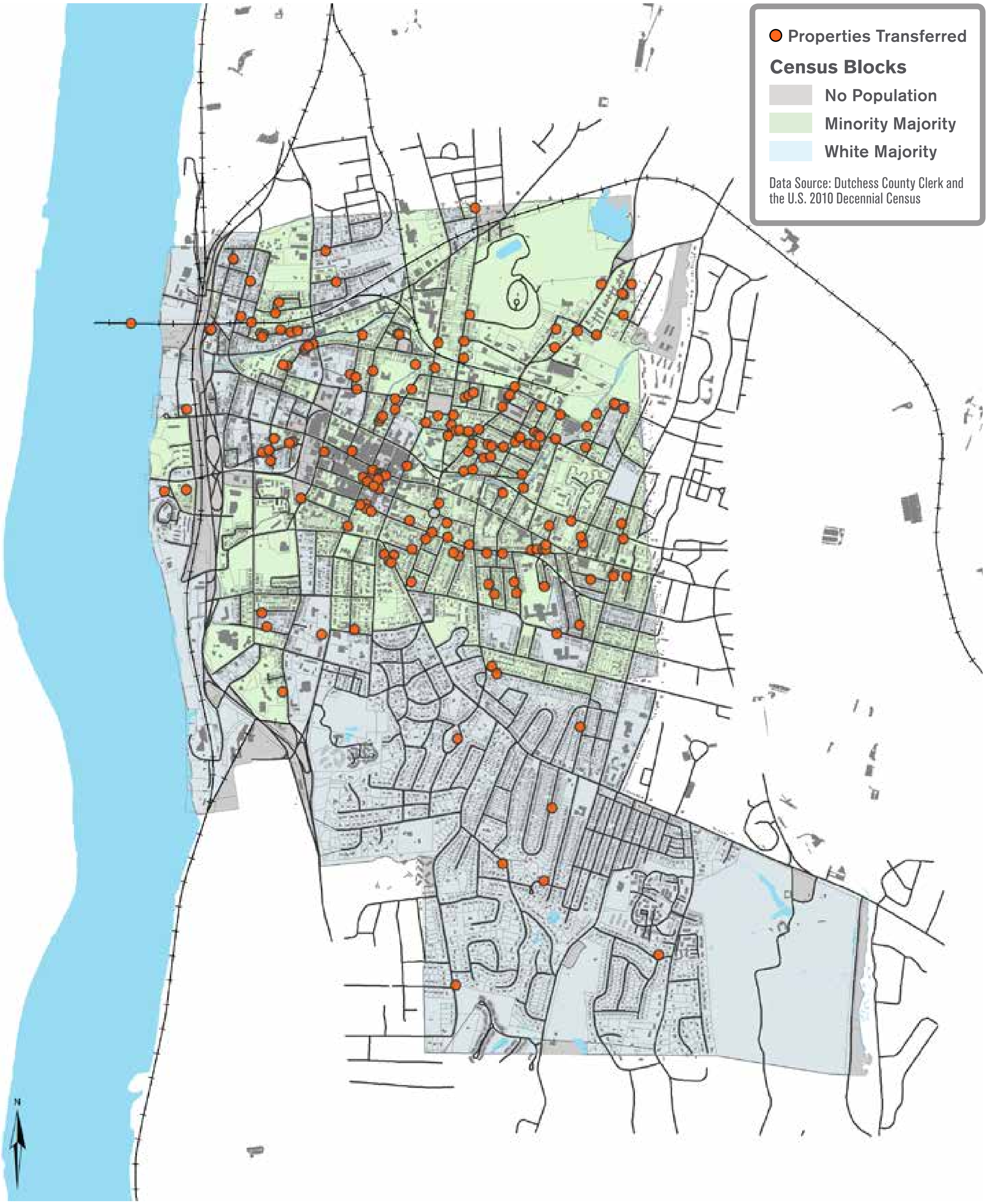
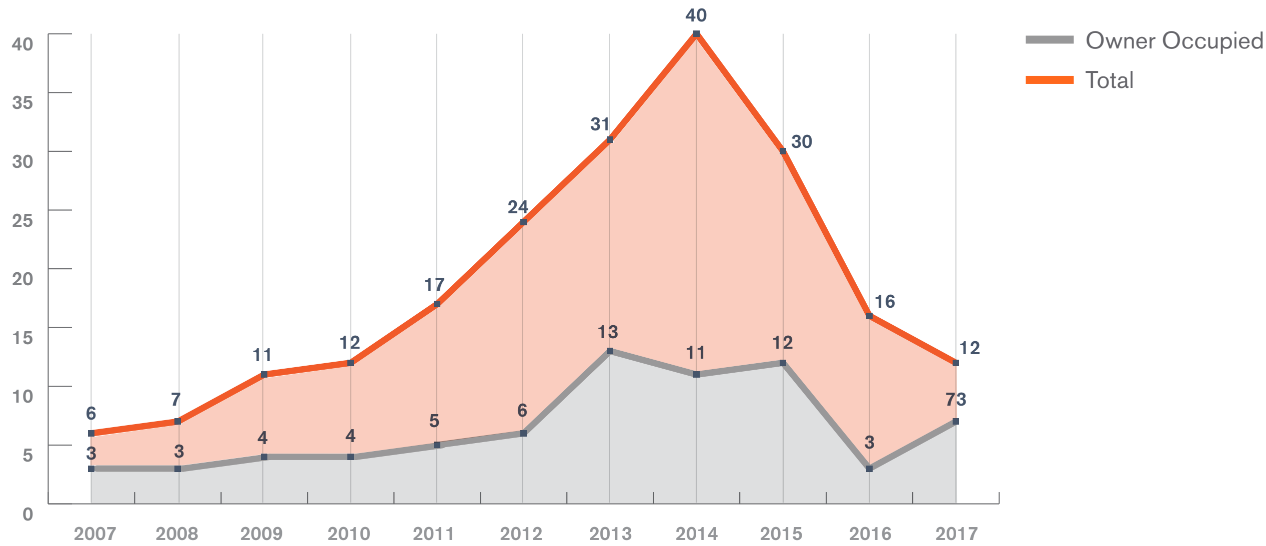


Figure 6. Deeds Transferred Per Year 2007-2017

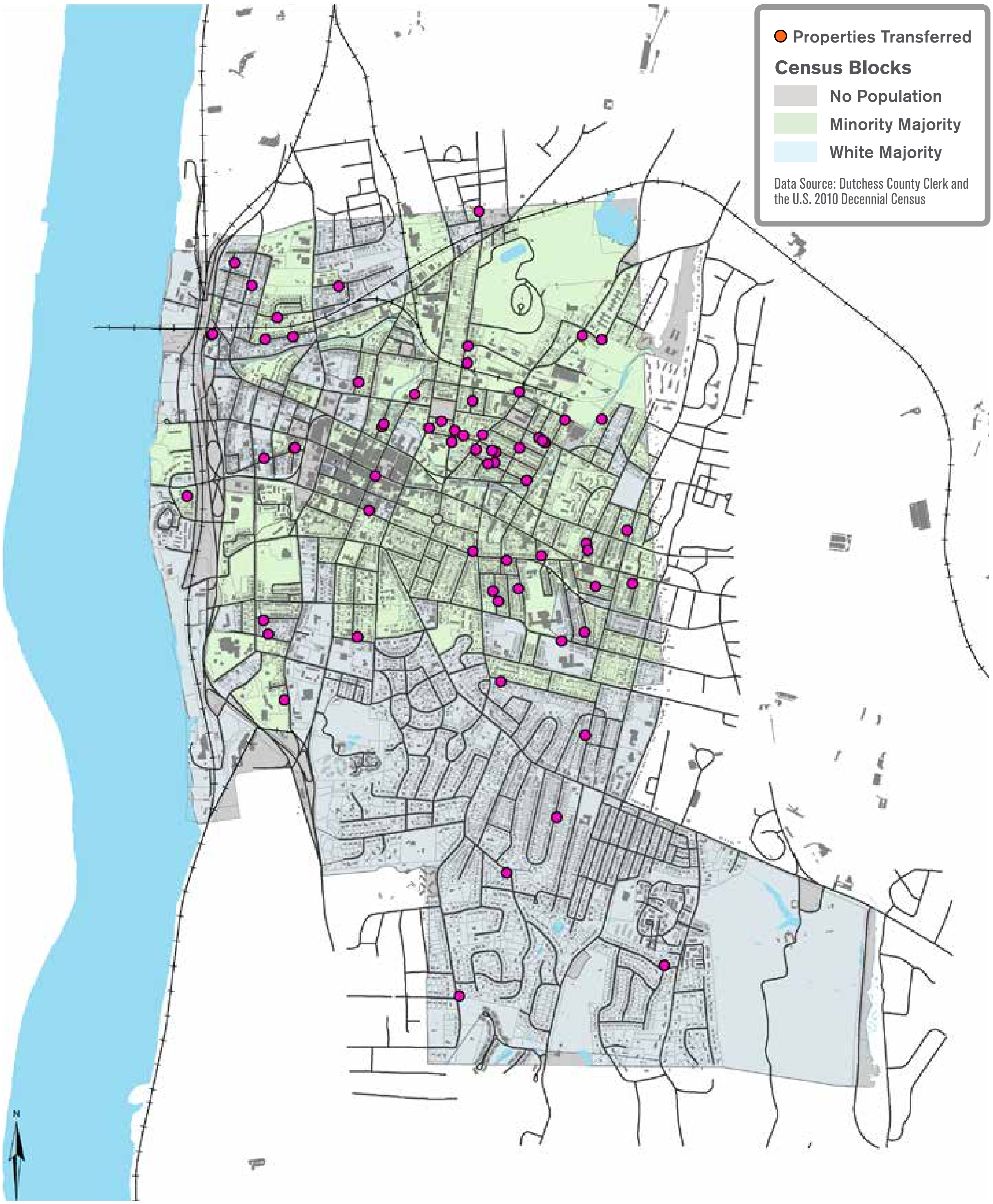


The current tax lien auction system in the City of Poughkeepsie does not offer any consumer protections to the people affected by tax delinquency. Although there is no indication that this is the current practice, there is very little that would protect against predatory fee structures should the purchaser of the lien choose to impose them. In other places where tax lien auctions have had devastating effects on marginalized populations, there is still the requirement that the tax lien purchaser petition for tax foreclosure after the redemption period has ended. It does not appear to be the case now but, should the City of Poughkeepsie begin to feel the pressures of gentrification, the tax lien auction system could serve as a tool for real estate speculators to take possession of properties at low cost and displace people from minority neighborhoods.

In Poughkeepsie, the tax lien system is used as an investment tool. The data suggests that the primary motivation for investors is to purchase liens on properties that are likely to pay off the taxes, fees and interest and, as a last resort, take possession of the property and either sell it or utilize it as an income property. Since the private market is very good at assessing this risk, tax lien investors shy away from properties where the owner is unlikely to repay the lien or where taking possession of the property could pose a liability to the investor. This is often the case with abandoned buildings that may require demolition or vacant lots where the cost of development makes a return on investment unlikely. In those instances, the city is forced to hold the lien since the lien does not sell at auction. If the owner fails to redeem the property (likely for the same reasons that investors were hesitant to buy the lien), the city assumes the risk and liability for these troubled properties.

When a lien is purchased at auction, as long as the property has not been abandoned by the owner or is not in dangerous or otherwise undesirable condition, the risk to the buyer is very low. The worst case scenario for the purchaser is that they make a 12 percent annual return on their investment. The best case scenario is that they take possession of the property. After they receive the deed to the property from the city, it is their responsibility to clear the title. This often means finding out what other liens are on the property and buying out the other lien holders. Since data on the other liens at the time of transfer is unknown, the following figures are for the gross return on investment from the purchase of the lien and do not include the additional costs of satisfying other liens. As was noted earlier, however, the sum of all of the liens almost never exceeds the value of the property.

Map 2. City of Poughkeepsie: Owner Occupied Deeds Transferred from Tax Lien Sales 2007–2017 and Minority Majority Census Blocks



RETURN ON INVESTMENT

From 2007 to 2017, 208 properties were transferred to the purchaser of tax liens. (The Poughkeepsie Rail Bridge and the land underneath it were excluded as their liens sold for a combined $1,786.99, and their full market value is upward of $29.5 million. Including these two properties would greatly skew the results.)

- In the case of properties that were sold after the deeds were transferred, the liens were purchased for a total of $581,192. The properties were then sold for $7,767,102. This is a 1,336 percent return on investment.

- The liens sold on all properties that were transferred generated $1,322,090. The 2018 full market value of those properties was $21,035,480. This represents a significant shift in property ownership in the city.

- Of the owner occupied properties transferred, the liens totaled $266,507; of those that sold after transfer the total of the liens was $174,040. The total sale price of those that sold was $3,034,010, representing a 2,843 percent return on investment. The total 2018 market value of homes that were lost to the tax lien auction system over the decade was $6,359,900.

While the City of Poughkeepsie has an incentive to utilize delinquent tax collection as part of an overall revitalization strategy, no such incentive exists for lien purchasers whose sole motivation is profit. Most of the lien purchasers do not live in the city and have little interest in achieving any public benefit: they are looking for the best return on their investment. In cases where they fail to collect the debt and have to take over the property, a lien purchaser will sell the property to the highest bidder regardless of their intent for the property.

THE CASH FLOW PROBLEM

While the tax lien auction system does not maximize revenue for the city, and comes with significant missed policy opportunities and social costs, the system does create cash flow. If the city were to change its method of collecting delinquent taxes it would, in the short term, defer receipt of revenue until the outcome of foreclosure proceedings. Within a year or two, the tax foreclosure revenue would normalize and property tax collections would not only plateau but may even increase as there are consistently liens on properties that the city is unable to sell at auction. Once the city actually took ownership, these properties might be transferred to a land bank or incentivized for redevelopment.

At this moment, the exact scope of the cash flow problem arising from changing the lien auction system would cause is unknown. The tax auctions are conducted in a fairly opaque manner. The city does not release the results of the auction publicly. Anecdotally, a figure of $2 million is used. If all the liens on all of the parcels that were listed in December of 2017 (the most recent auction) were sold at auction, the total revenue from the sale would have been $2,544,616. The number of liens sold at these auctions varies. Some years bring in more revenue than others. The proceeds of the auctions are not budgeted for separately, nor are the results of the auction reported in the annual budget.

> Land banks focus on remedying neglected properties. These abandoned properties have adverse effects on the surrounding areas and are a significant barrier to revitalization.

It is important to emphasize, however, that the financial problem arising from switching to the standard tax foreclosure system is a short-term and temporary cash-flow problem. It simply means that back taxes owed on properties in the city will not be paid immediately through lien auctions proceeds but, rather, after the tax foreclosure proceedings conclude.

And there is a major potential offsetting financial benefit. If the city could adopt the statutory *in rem* procedure for tax foreclosure, it would be eligible to receive funds from the Attorney General to start a land bank. Land banking has been used as an effective tool to combat the blight arising from vacant properties in other cities such as Albany and Newburgh.

LAND BANKING

A land bank is a not-for-profit created by one or more governments to acquire properties and facilitate their rehabilitation and sale. Land banks are used as a part of a larger revitalization strategy focused on blighted, abandoned, and tax delinquent properties. Currently there are eighteen land banks throughout New York State. Since 2013, the New York State Attorney General has provided them $30 million in funding. Recent changes in the enabling legislation allow for the creation of seven additional land banks. If the City of Poughkeepsie wants to form a land bank, it should act quickly to apply.

Land banks focus on remedying neglected properties. These abandoned properties have adverse effects on the surrounding areas and are a significant barrier to revitalization. Some of these effects include: decreased property values, decreased tax revenues, increased risks to public safety and public health, increased police, fire, and health care costs to mitigate those risks, increased cost of code enforcement, and all of the social costs associated with urban blight.

After acquiring title to problem properties, a land bank's goal is to return those properties to productive use. Land banks in New York have special powers granted to them by New York State Law that make them highly effective at eliminating the legal and financial barriers that make blighted properties unmarketable. If the building on the property cannot be rehabilitated, the land bank may pay to have it demolished and the site remediated. The goal of a land bank is to acquire properties that are a barrier to revitalization.

New York's oldest land bank (established in 2012) is located in the City of Newburgh. Since its creation, Newburgh Community Land Bank has acquired 101 properties (ninety from tax foreclosure) and sold over sixty properties. Of the sixty properties they sold, four were apartment buildings, twenty-nine were multi-family residences, fourteen were single family residences, and four were mixed-use buildings. As a result of these sales, fifty-one low, very low, or extremely low income rental units were created along with twenty-four market rate units. All of these properties were previously vacant and abandoned. The Newburgh Community Land bank has spent $4.1 million on the rehabilitation of abandoned and vacant properties, leveraged $15 million of purchaser investment funds, and returned $3.3 million of assessed value back to the tax rolls. Land banking could be a powerful tool for the City of Poughkeepsie to use in its overall revitalization strategy but, in order to be eligible to create a land bank, the city would have to move away from its use of tax lien auctions.

POTENTIAL SOLUTIONS

The tax lien auction system is inefficient, limits revenues from delinquent tax collection in favor of short-term lump sum payment, disproportionately affects communities of color, the elderly, and the infirm, and carries with it significant social costs. The current tax lien auction system benefits investors, not the city or its residents. Two of the following solutions would eliminate the system and implement one that uses the tax foreclosure system prescribed in state law to collect delinquent taxes. This would be fairer to the owners of properties, as it would enable negotiation within the framework of an adjudicated process that affords more flexibility in the repayment of taxes. A third option explores the potential of modifying the existing system.

How the city choses to move away from the current system hinges largely on how much control it desires to maintain over delinquent tax collection and if it intends to create policy interventions to address vacant and abandoned properties. The following solutions require that the City of Poughkeepsie Administrative Code Article XIV, sections 14.19 through 14.32 be repealed. For each, additional laws will also need to be repealed and others will have to be passed.

HAVE THE COUNTY GUARANTEE THE LEVY

This solution is the simplest and it will guarantee that the City of Poughkeepsie will always receive 100 percent of its property tax levies. It builds upon an existing system, minimizing cost and disruption. It can therefore be seamlessly implemented and will not disrupt revenue collection. Insofar as there are liens that remain unsold, or the liens that are sold are auctioned for less than the tax debt and fees, this option will increase revenue for the city without increasing taxes.

> "The tax lien auction system benefits investors, not the city or its residents."

For cities, the choice to guarantee the levy is a local one; Poughkeepsie does so in the city's Administrative Code, Article XIV, sections 14.12 and 14.13. If these sections were repealed, and the Administrative Code amended with language similar to the City of Albany Charter, Article VI, section 605, the city would no longer guarantee the levy, the county would. If this were the case, the county would then pay the city for any uncollected taxes and the county would pursue the collection of delinquent taxes through tax foreclosure, as it does for all of the towns and villages in the county. In this scenario, the city should also repeal the Code of Ordinances Article I, section 2.4 (that adopts the state *in rem* procedure for tax collection) as it would be obsolete.

This solution would eliminate the tax lien auction system and ensure that the city is always made whole. If its adoption were properly timed, the transition to this new system would be seamless and would also eliminate the administrative cost of collecting delinquent taxes. There are two drawbacks to this approach. The first is that it gives away the city's right to collect the tax debt and, more importantly, the interest on that debt. The county currently collects 12 percent interest and is almost entirely guaranteed to collect the debt and interest through tax foreclosure proceedings. The second drawback is that the city would lose local control over land use for tax delinquent properties. This means that any revitalization strategy that utilizes tax delinquent properties would rely on Dutchess County for that portion, including land banking. There is the possibility of collaborating with the county to do so but that collaboration is not guaranteed and this solution cedes local control over the matter.

MODIFY THE EXISTING TAX LIEN SYSTEM

A third option is to modify the current system to mitigate its negative consequences, and potentially to reap additional benefits for the city. In order to protect property owners from having their equity stripped from them, any such modification must require that a petition for tax foreclosure be filed at the end of two year redemption period. In addition to this, consumer protections against predatory collections practices and fee structures must be put into place; otherwise there is a perverse incentive to inflate the debt owed on liens that are unlikely to be repaid before initiating tax foreclosure proceedings. Additionally, regardless of what system the city chooses to use, or what modifications are made, the city's laws should be changed to clearly define the system for delinquent tax collections.

The city's administration know that reform is needed but views the tax lien sale system as the best tool to address the city's vacant and abandoned property issue. Through the Mayor's Anti-Blight Task Force, it is s currently exploring a plan for vacant and abandoned properties. It also intends to modify the method of notifications to property owners by printing Tax Collector Notice of Lien entries in both English and Spanish, notifying property owners after the lien sale indicating that the owner may lose the property and identify appropriate resources for assistance, and to require lien buyers to send at least one notice to the owner at his/her last known address, via certified mail, return receipt requested.

The city will also proposes that an installment payment plan, subject to approval by the Tax Collector, be made available for owner-occupied tax delinquent properties. If such a plan is agreed upon before a lien is placed on the property, and the payments made, the city would not assign a lien on the property. The city would also permit payment plans after the lien sale.

The anti-blight elements of these reforms, not be possible through the *in rem* process, would seek to address the some 600 vacant and abandoned properties in the city. A legal certification process for vacant and abandoned buildings would be created, and the redemption period for those properties would be reduced from two years to one. The argument for this is that the longer the tax collection process is on these properties, the longer they remain vacant and abandoned. Lien purchasers would be required to upkeep the properties during the redemption period by mowing grass, removing rubbish, boarding up doors and windows, etc., all work that is currently done at the city's expense.

In order to accomplish the anti-blight proposals, the City Administrator recommends bundling the tax liens, and selling all the liens to a single purchaser via a contractual RFP process. There is also the suggestion that through this process the city would negotiate with the lien purchaser to target properties to be transferred directly to non-profits, such as Habitat for Humanity and Hudson River Housing, after the redemption period.

The carving out of vacant and abandoned properties is an idea with merit. These are often the least desirable in the city, and there are significant impediments to selling them on the market.

The proposed changes to the tax lien auction system have never been tried, and if implemented would be the first of their kind. It is impossible to compare how well these proposed modifications would work, when compared to adopting the tax foreclosure system and creating a land bank.

ADOPT THE *IN REM* PROCEDURE LOCALLY

This is the best solution to situate the City of Poughkeepsie to institute a land bank. It would allow the city to both collect interest on delinquent property taxes and would retain local control of the tax foreclosure process. This solution would create a gap in revenue collection, though the potential for short-term revenue shortfalls can be mitigated at small cost through the issuance of tax anticipation notes.

In order for the city to adopt the *in rem* procedure of tax foreclosure set forth in The Consolidated Laws of New York, Real Property Tax, Article 11, Title 3, it would have to repeal the appropriate sections of the Administrative Code listed above, and move the Code of Ordinances Article I, section 2.4 into the administrative code. This would eliminate the tax lien auction system and initiate use of the tax foreclosure system. Corporation Council (the city attorney) would have to then begin to petition for tax foreclosure after the prescribed period of time and would represent the city's interest in tax foreclosure proceedings. At the end of the fiscal year, instead of putting tax liens on delinquent properties up for auction, the Common Council, by the tax anticipation note resolution procedure defined in The Consolidated Laws of New York, Local Finance, Article 2, Title 3, Section 39, should issue tax anticipation notes equal to the value of the liens. It should be noted that the city should not issue anticipation notes for the projected interest on the tax debt. This will ensure that the revenue recuperated through tax foreclosure will always exceed the value of the anticipation notes.

Once the *in rem* procedure is adopted, enabling legislation for creating a land bank and applying for funding from the New York State Attorney General can be explored.

CONCLUSION

The current tax lien auction system in the City of Poughkeepsie does not maximize tax revenues or open up policy options for renewing the city. Meanwhile, it has a disproportionate negative impact on racial and ethnic minority communities, the elderly, and the infirm. It denies the city the option to address its issue of vacant abandoned property and hampers the city's revitalization efforts. It is ineffective, and unjust. Though largely invisible and not easily calculated, the harm it has caused is palpable and surely massive to those who lose their homes. It is a system that benefits private investors at the cost of the public interest.

Each of the suggested reform options have pros and cons. Turning the delinquent tax collections to the County has the benefit of insuring the *in rem* process will be used, does not present any cash flow problems, and relieves the city of the administrative burden of delinquent tax collection. At the same time, ceding this authority to the county foregoes the city's opportunity to collect interest on the taxes owed, and more importantly gives up local control of land use regarding tax delinquent properties. Both this option and adopting the *in rem* process locally would not allow the city to address vacant and abandoned properties as quickly as potential modifications to the current system, though the effectiveness of those modifications is unknown.

At minimum, to be fair modifications to the existing tax lien auction system would have to include consumer protections for owners and a requirement that tax foreclosure proceedings be initiated after the redemption period either by the city, or the lien purchaser (possibly excluding vacant and abandoned properties if viable). The notification modifications the administration proposes are a good practice, and the anti-blight portions of their plan would allow for quick action by the city. However, if the city choses to modify the existing system, it will not be eligible to form a land bank, nor will it be able to receive state funding to do so. And, as noted, this approach is untested. Poughkeepsie would be the first to ever attempt it.

Adopting the *in rem* process locally allows the city to charge interest on delinquent taxes, insures that if a property owner loses the property to tax auction it is done through an adjudicated process. In addition this option would allow the city to form a land bank and receive millions of dollars from the state to redeem vacant and abandoned properties. Adopting this process locally does however present short term cash flow issues, and in the transitional years short term financing through tax anticipation notices would be required.

The city has struggled for at least 20 years to move away from tax lien auctions. Historically fear of short-term decreases in revenue and an estimated $2 million temporary cash flow gap has paralyzed public officials from addressing the problem. The city must now act to build a better path to a better future.

Endnotes

[1] Westchester is a major exception. There the county is paid its whole levy by the towns, which then must collect delinquent taxes.

[2] A tax lien is a public record filed with the county that says you owe the government money and must pay it before you can sell your property. Foreclosure is a legal process through which an owner who cannot or will not pay his or her debt gives up rights to a property.

[3] Poughkeepsie Code of Ordinances, Chapter 2, section 2-4; NYS RPT Article 11, Section 3.

[4] United States Bankruptcy Court Southern District of New York 12-38028(cgm)

[5] This calculation is illustrative and not definitive. It assumes the worst-case scenario where taxes are not paid in the initial year, and remain unpaid annually through the redemption period of two years after the lien is sold. It compounds interest annually and does not pro rate daily, weekly, or monthly. The 29.63 percent figure would have to be inclusive of interest and fees. The interest is known, but the fees are not and, for simplicity's sake, the fees are included in the hypothetical total of the liens and interest is applied to them. This calculation is for the annual total of liens in three consecutive years. The first year has the lien for that year's taxes owed (including fees as described above), in the next year 12 percent is added to the initial money owed, and in the third year 12 percent of the previous year is added. The second year's lien would be for the initial taxes owed in the second year plus 12 percent interest for the third year. The third year's lien would only be for the taxes owed in the third year because at the end of that year the redemption period for the first lien will have ended and the deed to the property will have been transferred to the purchaser of the first lien. The formula for this calculation is: $(x+.12x)+((x+.12x)(.12))+(x+.12x)+x=1$

[6] The homestead tax system allows the city to levy different tax rates for homestead (residential) properties than on non-homestead (primarily commercial) properties. For more information: https://www.kingston-ny.gov/filestorage/8463/8511/8682/8694/Impact-of-Kingston-Homestead-Tax-Study-March2014.pdf

[7] NY CLS N-PCL § 1602

[8] It should be noted that in two of the seventy-one cases the property owner of record was recently deceased at the time the taxes were due. It is unknown what arrangements were made for the property except to say that the deeds were still in the deceased owner's name.

Biography

Joshua Simons is Senior Research Associate at The Benjamin Center. He specializes in geographic information systems (GIS), redistricting, policy analysis, and data visualization. He holds a Bachelor of Arts in Political Science from SUNY New Paltz, magna cum laude (2008), a Master of Public Administration degree from Marist College, summa cum laude (2016), and is a member of the Pi Alpha Alpha Honor Society.

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