



ADVISORY

A GFOA *advisory* identifies specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. It is *not* to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure.

Evaluating the Sale and Securitization of Property Tax Liens (1997) (DEBT)

Background. Governments sell or securitize property tax liens to eliminate backlogs of accumulated delinquent tax receivables and convert those receivables into cash. Tax liens, which are attached to properties for nonpayment of property taxes or other assessments, may be bundled and sold directly to investors through a bulk-sale process. They also may be sold to a trust, where the payment stream is securitized. Bonds backed by the delinquent taxes are then sold to investors and the proceeds of the issue are paid to the government that sold the tax liens.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments contemplating the sale or securitization of property tax liens undertake a careful analysis of benefits and risks both in the current fiscal year and over the long-term. When evaluating the sale or securitization of tax liens, governments should:

1. Ensure they have legal authorization to enter into these types of transactions and understand any conditions or limitations imposed by state or local law.
2. Be clear about the public policy objectives to be achieved, such as improving collections or avoiding costs associated with the ownership of the property on which taxes are owed.
3. Evaluate whether changes in the collection process could reduce the occurrence of delinquencies.
4. Use sale proceeds for non-recurring purposes, particularly if the amount of the sale or securitization is large. Governments using a tax lien sale or securitization as a one-time mechanism to address a current year budget gap should assess the short- and long-term implications for the government's credit quality. They also should consider how gaps will be closed in later years and whether structural budgetary balance is able to be achieved without future tax lien sales or securitizations.
5. Determine that the net return after taking account of transaction costs is acceptable in terms of alternative approaches, including retaining ownership of uncollected receivables.

Once a decision has been made to sell or securitize tax liens, governments should:

6. Examine the lien pool carefully to ensure properties will be acceptable to investors. Lien-to-value ratios of various classes of property, the age of the liens, historical redemption rates in the community, property types, and the number of environmentally impacted properties are among the factors that should be considered.
7. Review statutory cure periods established to permit owners to pay delinquent revenues to ensure that an appropriate balance is struck between government policy objectives and acceptability to investors.
8. Select legal and financial advisors and other service providers with demonstrated experience with these transactions.

9. Select a servicer with a proven track record if such a firm is being used to collect delinquent taxes. Rating agency approval of the servicer is typically required, and will be based, in part, on the record of the servicer. Among the qualifications that should be evaluated are:
 - knowledge of state and local law;
 - due diligence capabilities in the lien selection process;
 - adequacy of the servicing system, including recording, auditing, and financial reporting procedures; and
 - historical performance in servicing liens, including procedures for workouts and foreclosures.
10. Recognize the community relations impact of establishing a private collection mechanism. Governments should take steps to maintain good relations among all affected parties, such as designating an ombudsman or instituting a formal complaint process through which problems that may arise are addressed.

References

- “Tax Lien Securitization: Putting Non-Performing Assets to Work,” *Government Finance Review*, GFOA, June 1996.
- “Municipalities Turn to Property Tax Lien Sales,” *Standard & Poor’s CreditWeek Municipal*, March 25, 1996.

Approved by the GFOA’s Executive Board, 1997.