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What the tax lien lending industry is doing to consumers

By Olivia Carmichael Solis

Imagine, it's property tax time and a family in a lower income neighborhood is faced with losing their home because they can't pay their taxes. They receive what they think is a godsend from a company — a letter with a promise: "We will quickly get your taxes paid so you'll no longer incur the large penalties, interest and attorney collection fees charged by your county. It's simple. We pay the taxes. You pay us back over time."

Seems too good to be true? Unfortunately, for many families across the state, there is no happy ending. The high-interest loans (averaging 12.80 percent in 2013), coupled with exorbitant fees (an $8,000 tax bill can reach almost $12,000 in a year), translate to foreclosure for the family that tried to catch up with their payments, but found they'd walked into a trap.

According to Texas Consumer Credit Commissioner Leslie Pettijohn, in testimony before the House Business and Industry Committee in May, the number of property tax loans has steadily increased. In 2008, a total of 12,078 of these loans were made; in 2013, there were 15,738 loans made.

There were $201 million in property tax loans written in Texas in 2013, up from $119 million in 2008. More than 8,100 loans totaling nearly $81.5 million were at least 90 days delinquent.

The reason for the almost 70 percent increase in property tax loans written is a no-brainer. The tax lien lenders have nothing to lose — and quite a lot to gain. The tax lien lender has lien priority, so if the property goes under foreclosure, the tax lien lender is paid first, regardless if there is an existing mortgage on the house.

"Tax lien loans really only help one entity: the tax lien lender, who has nothing to lose because if the homeowner is unable to repay the loan, they are first in line to receive payment when the house is foreclosed," said Ford Sasser, president and CEO of Rio Bank in McAllen.

And now that they've experienced success on the residential side, tax lien lenders are heavily pursuing the commercial side of property tax lending. The reason for this is two-fold: one, federal law now requires more mortgages to be escrowed (Dodd-Frank Act) and, two, commercial tax bills are much higher than residential tax bills, so it's much more lucrative.

In 2008, 841 commercial property tax loans were made; however, by 2013, that number had risen to 2,150.

At the September TBA Board of Directors meeting in Irving, bankers expressed concern over the rise of commercial property tax loans. David Lacy, president and CEO of Community Bank & Trust in Waco, reported that one of his commercial customers took out a loan for property taxes and put it into a multi-year payout. The customer would have planned to do it again next year had the bank not protested. Paying taxes like this results in lost equity and is bad for the borrower as well.

Lacy explains that commercial property tax loans have a greater financial impact for banks and create additional issues that don't exist in residential property tax loans.

"On the residential side, we have historically underwritten credit so that there is a monthly escrow of taxes," Lacy says, "And in the state of Texas, there is personal liability on the specific home loan. As we move into the commercial end of it, fewer loans are escrowed and some loans — not many — lack personal liability."

History of the industry

Tax lien lenders maintain that they are a valuable industry that has been providing options for property owners for 80 years. They point to a law passed during the Great Depression that allowed a third-party to pay off a homeowner's property taxes with his or her consent. The law was never intended to spawn an industry that preys on desperate homeowners.

The fact is this is not the entrenched industry property tax lenders would have legislators believe. More than 50 percent of all property tax lenders were formed in the past five years.

From 1993 to 1995, most property tax lien transfers involved transfers from taxing units to the property tax owner's family members or employers, according to a 2011 Property Tax Lending Study commissioned by the Finance Commission of Texas and prepared by the Office of Consumer Credit Commissioner.

In 1995, the Texas Legislature made significant changes to the Texas Tax Code, which made property tax transfers more viable, including permitting non-judicial foreclosures, increasing the interest rate permitted to 18 percent per annum and allowing property tax lien transfers to foreclose within one year.

Subsequent Texas Legislatures made additional changes. In 2007, for the first time, property tax lenders were required to obtain a license from the Office of Consumer Credit Commissioner, which regulates the tax lien lenders.

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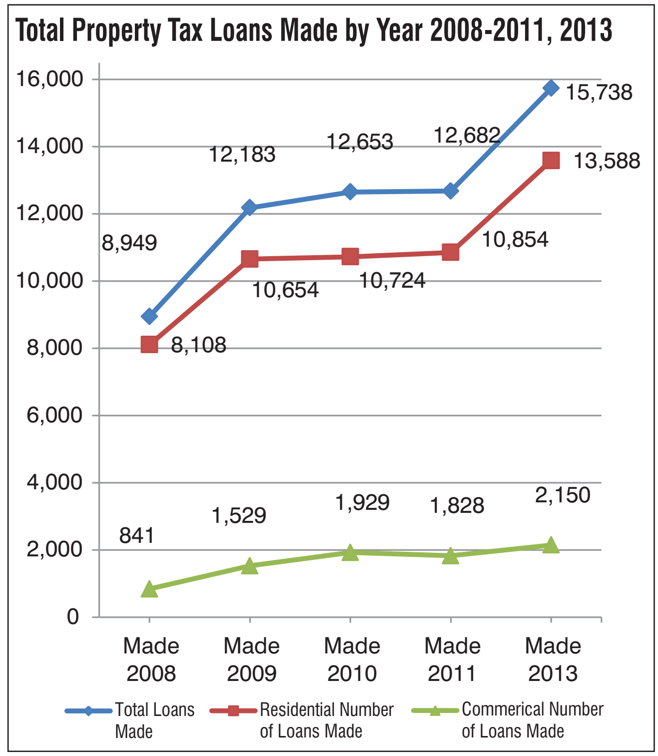


During the 83rd Texas Legislature, legislation was enacted that imposed new requirements on property tax lenders. Specifically, SB 247:

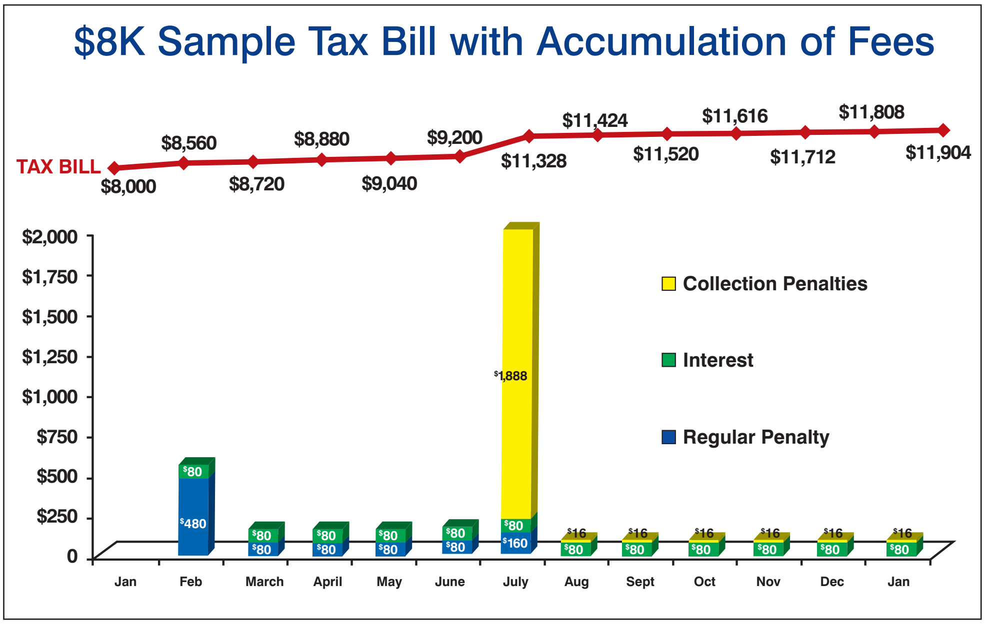
- Requires property tax lenders to use judicial foreclosure for property tax loans closed on or after the bill's effective date;
- Prohibits deceptive or misleading advertising and requires property tax lenders to disclose certain additional information if they disclose a rate or charge in an advertisement.
- Imposes new requirements for payoff requests sent by other lienholders and payoff statements provided by the property tax lender.
- Prohibits property tax loans in certain situations — where the borrower is 65 years of age or older and can claim a tax exemption or where the taxes are neither due nor delinquent.

While SB 247 reduced some of the deceptive and unfair lending practices of tax lien lenders, it did not go far enough. Plus, some tax lien lenders aren't following the rules, particularly when it comes to providing payoff statements — a point echoed by many Texas bankers.

"Despite what tax lien lenders say, their industry is not well regulated and doesn't always follow truth in lending practices," said Vic Pierson, president of Moody Bank in Galveston. "If this industry were regulated like banks are and if they made their lending decisions based on a customer's ability to repay, many of these loans would not be made."

The Texas Bankers Association is hoping the 84th Texas Legislature, which convenes in January, will make additional corrections.

Texas bankers are understandably concerned about the proliferation of tax lien lenders. The topic was heavily discussed at the September Board of Directors and Government Relations, Community Bankers and Bank



Leadership Council meetings.

After meeting to discuss priorities for the upcoming legislative session, the bankers requested that TBA staff pursue the following:

- A 12-day cooling off period for homeowners to consider the ramifications of their transaction and a pre-closing notification of the first lienholder.
- The ability of a preexisting lienholder to pay off a tax lien loan as soon as they learn of its existence. Currently, banks do not have the ability to pay off a tax lien lender until the note is delinquent for 120 days.

The bankers indicated that with prior notice, they can make an informed business decision on whether they want to advance the funds needed for a property owner to pay the taxes at the prevailing rate of the preexisting mortgages.

A three-pronged approach

TBA is tackling the problem on three fronts — on the federal level, in the Texas Legislature and in the news media. In March, 10 bankers accompanied the TBA Legislative Team and met with Richard Cordray, director of the Consumer Financial Protection Bureau, in his offices. Tax lien lending was one of the issues TBA brought to the table.

The bankers pointed out how many property owners in Texas have been negatively impacted by this industry and warned that tax lien lenders are seeking to expand their business model from Texas and Nevada to other states. They compared tax lien lenders to payday lenders, an industry that the CFPB has been scrutinizing of late.

In addition, TBA prepared a brochure specifically for the CFPB entitled "Property Tax Loans: The Cycle of Unfair Lending" that presented facts and statistics and illustrated the vicious cycle consumers find themselves in when they take out these loans. "Texas bankers and mortgage lenders are united with consumer and small business advocates in calling for more diligent and comprehensive regulation of property tax lenders and their lending practices," the brochure stated.

While no promises were made, Cordray and his staff listened, asked questions and indicated they would look into the matter.

Tax lien lending was also brought to the attention of the Texas Congressional Delegation during the Government Relations Summit in March.

In addition, TBA is addressing the issue with the news media. TBA has been placing ads in the widely read "Texas Tribune" that link to a page on TBA's website entitled "Learn the truth about property tax lending." The page includes a downloadable version of a brochure that details the negative effects of this type of lending.

A news release was distributed in July to the Texas news media that poses the question, "Are You Walking into a Trap?" The news release included a quote from Rep. Rene Oliveira of Brownsville, chairman of the House Business and Industry Committee. "Property tax lending really puts a burden on banks, not just to make good loans, but to monitor tax situations to protect their investment," Oliveira stated.

TBA's actions have definitely been noticed by the tax lien lending industry. After TBA sent out the July news release, one tax lien lender responded with a letter to all TBA directors.

Jack Nelson, co-founder of Propel Financial Services, the largest tax lien lender in Texas, objected to TBA's description of the industry as "payday lenders" and requested a meeting to "present more facts and industry data to you as well as to answer any questions or address any concerns you may have about our industry." The TBA staff will be arranging a meeting shortly.

Propel, whose portfolio of property tax loans was worth $213 million in 2013, said in the letter, "I do not think your attacks on our industry are justified or believe it to be a good use of your limited resources to pass further legislation around our industry."

The bankers serving on the TBA Board of Directors and councils think otherwise and have made the issue a top priority for the 84th Legislative Session.

The battle is far from over. If the 2013 session is any indication, the tax lien lenders will be putting on their gloves and fighting to protect their multibillion dollar industry. The banking industry will be ready.