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BILL ANALYSIS

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Senate Bill 532 (as reported without amendment)
Sponsor: Senator Jack Brandenburg
Committee: Finance

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RATIONALE

Legislation enacted in 2012 allows a bank or other lending institution to retain the principal residence exemption (PRE) on foreclosed property for up to three years, if the property was exempt immediately before the foreclosure and other conditions are met. Under this exemption, a principal residence is not subject to the taxes levied by a local school district for school operating purposes (which are typically 18 mills), if the homeowner files an affidavit with the local tax collecting unit and meets eligibility criteria; the property then is taxed at the "homestead" rate. As a rule, when the person no longer owns or occupies the property as his or her principal residence, the exemption must be rescinded and the property will be taxed at the nonhomestead rate. This occurs when a home mortgage is foreclosed, unless the foreclosing lender retains the PRE. If it does so, however, the lender still must pay an amount equal to what would be levied if the exemption had not been retained.

Apparently, very few lenders retain the exemption because they do not receive a direct financial benefit from doing so. This evidently can make it difficult for some would-be purchasers to qualify for a mortgage on a foreclosed home. In most cases, if a purchaser is obtaining a mortgage and escrowing taxes, the escrow amount for property taxes is based on the rate of taxation at the time of the purchase. Therefore, if the bank does not retain the PRE and is paying the nonhomestead rate, the borrower must qualify at that rate, even if he or she would be able to claim the exemption after the purchase.

It also has been pointed out that, if a financial institution does retain the PRE but still must pay an amount equal to school operating taxes, that amount is in addition to other costs of foreclosure, which are ultimately passed on to the lender's customers.

To address these issues, it has been suggested that foreclosing financial institutions should be able to retain the PRE without having to pay an additional amount equivalent to school operating taxes.

CONTENT

The bill would amend the General Property Tax Act to delete requirements that a bank or other lending institution pay what it otherwise would have paid in school operating taxes, as well as an administration fee, if it retains the principal residence exemption on foreclosed property.

The Act allows a bank, land contract vendor, credit union, or other lending institution (referred to below as a "bank") to retain the PRE on property that the bank owns as a result of a foreclosure or forfeiture of a recorded instrument, if the property had been exempt immediately before the foreclosure. The property must be for sale, must not be occupied by or leased to anyone other than the person who claimed the PRE immediately before the foreclosure or forfeiture, and must not be used for any business or commercial purpose. To retain the exemption, the bank must file a conditional rescission form with the local tax collecting unit and annually verify to the local assessor that the property meets those criteria.

If a bank retains the exemption, it must pay an amount equal to the additional amount it would have had to pay in school operating taxes under Section 1211 of the Revised School Code if a PRE had not been retained. The payment must be collected by the local tax collecting unit at the same time and in the same manner as taxes are collected under the Act, and must be distributed to the Department of Treasury for deposit into the State School Aid Fund.

In addition, the bank must pay an administration fee equal to the property tax administration fee imposed under Section 44 of the Act. (Section 44 allows a local tax collecting unit to add and keep a fee of up to 1% of the total tax bill for taxes paid before February 15 of the following year, and allows additional amounts for delinquent taxes.)

The bill would delete the requirements that a bank, land contract vendor, credit union, or other lending institution retaining the PRE pay the amount it would have had to pay under Section 1211 of the Revised School Code and pay an administration fee.

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ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Although the Michigan economy is recovering from the 2008-2009 recession, and the number of foreclosures is declining, there is still a significant number of houses in foreclosure. According to the Michigan Association of Realtors, approximately 30,000 homes foreclosed by banks and other lenders were listed for sale in the last year. It not in the interest of financial institutions to own these homes, and allowing lenders to retain the principal residence exemption is one way to help consumers who wish to buy them. Requiring lenders that retain the PRE to pay the same amount they would have to pay without the exemption, however, apparently has discouraged them from pursuing this option. The bank or credit union gets no monetary relief and in fact incurs an additional administrative burden.

By removing the requirement that lending institutions pay the amount of school operating taxes, plus an administration fee, if they retain the PRE, the bill would give them an incentive to do so. This would increase the number of individuals who could qualify for a mortgage when taxes are escrowed. Since a borrower must be able to pay taxes at the rate the current owner is paying, even the borrower would pay only the homestead rate under the PRE, some borrowers might have trouble qualifying. Also, new Federal regulations require higher income-to-debt ratio, making it more difficult for some people to secure a mortgage. While many potential home-buyers are creditworthy, they still have a lot of unsecured debt. Reducing the amount a borrower must escrow and be qualified to pay is one way that could provide some relief.

In addition, the bill would lower the costs placed on mortgage lenders during the foreclosure process. These typically include back taxes, insurance, administrative expenses, and legal fees. In addition, lenders often must pay significant cleanup and repair costs to return a house to marketable condition. Because these costs are ultimately are passed on to their customers, lowering the costs would benefit consumers.

Finally, putting foreclosed homes back into the hands of individual owners, rather than investors, would help rebuild strong neighborhoods, schools, and communities.

Opposing Argument
The legislation allowing lenders to retain the PRE on foreclosed homes also changed the deadline for a homeowner to file an affidavit claiming the exemption, and added a second deadline. These changes were designed to prevent individuals from having to pay property taxes at the nonhomestead rate for part of a year, until they could claim the PRE. This legislation was a product of negotiations with the interested parties and has been in effect only since May 1, 2013.

Response: If banks and other lenders are not retaining the PRE because it offers them no benefit, that aspect of the legislation would appear to be ineffective.

Opposing Argument
The additional amount that a foreclosing lender must pay if it retains the PRE is directed to the School Aid Fund. This holds the Fund harmless from the loss of an equivalent amount of school operating taxes. Under the bill, the Fund would no longer receive this revenue during the time the lender owned the foreclosed home. Together with other enacted and proposed measures, this legislation would erode the School Aid Fund, as well as local unit revenue, and could add up to a significant loss over time.

Response: If a person who claimed the PRE did not lose his or her home to foreclosure, the property would continue to be taxed at the homestead rate. Requiring the foreclosing bank to pay what amounts to the nonhomestead rate actually creates a windfall to the School Aid Fund that would not occur if foreclosure did not take place.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would increase School Aid Fund expenditures by an unknown amount and/or reduce revenue to local school districts by an unknown amount. The value of property that is currently under foreclosure and that could be affected by the bill is not known, although in the 12 months ending in August 2013, foreclosures had been completed on 59,535 homes in Michigan. Assuming an average taxable value of $40,000 for these homes, the bill would reduce local revenue generated by the 18 mills of property tax by $42.9 million if a bank or other lending institution retained the principal residence exemption on all of these homes. School Aid Fund expenditures would need to be increased to maintain current per-pupil funding guarantees. To the extent that per-pupil funding allowances were affected by the changes, revenue to local school districts would be reduced.

Local unit revenue also would be reduced by an unknown amount, due to the loss of administration fee revenue on the affected amounts. Using the example above, the reduction would total a maximum of $0.4 million.

Fiscal Analyst: David Zin

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