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Learning from Springfield

An Asset Management Approach to Tax Title Collection

by David Panagore

POLICY BRIEF

Introduction

Like most municipalities, Springfield relies in large part on local property tax revenue to deliver services. However, collecting property tax became a challenge when, in 2004, the City was struggling to avoid financial collapse. Its woes were not due just to a lagging economy and shrinking property values. Many residents and businesses, in every neighborhood and across diverse populations, stopped paying property taxes. The City's cash position undermined its financial position as it teetered towards bankruptcy. The following policy brief highlights Springfield's recent strategy to develop a comprehensive approach toward property tax collection that reduces tax delinquency, collects outstanding debt and fosters long-term economic growth.

Since 2004, the City has closed approximately 4,000 unpaid accounts, and has collected $24 million.

In 2004, Springfield was owed $52.6 million in uncollected tax liens with nearly $7.8 million in accrued interest on 7,058 unpaid accounts. Since 2004, the City has closed approximately 4,000 of those accounts, and has collected $24 million. Springfield cancelled $2 million in overdue debt, and $32 million still remains outstanding today, including roughly $6 million newly accrued.

When the City developed its approach to property tax collection, its goals were to improve neighborhoods, municipal finance and confidence in city government. To accomplish its goals, the City launched an interdepartmental effort to enforce the law and collect money owed.

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The effort required: 1) coordination across city departments; 2) incentives to collect old debt; 3) multiple law firms to handle the foreclosure process; 4) the use of both RFPs and auctions; 5) strong relationships with the land court that processes all such foreclosure actions; 6) community involvement; 7) property improvement; and 8) reform of tax revenue budgeting. In implementing these requirements, the City learned to view itself as a geographically based real estate operation driven by revenues from property taxes and interested in both short term collections and long term value. The City viewed this process as an exercise in asset management.

While Springfield undertook a number of actions to turn around its finances, the efforts to collect delinquent property taxes and increase the collection rate were critical to the City's long-term viability. Springfield needed to demonstrate to tax payers that compliance with the law would not be the exception and that for those avoiding their legal obligations, there would be strong penalties and repercussions. In carrying out these activities it established four goals: 1) reducing blight in the neighborhoods; 2) revitalizing and strengthening neighborhood communities; 3) returning feasible and compliant properties to the tax roles to generate more tax revenue; and 4) increasing owner occupancy.

Background

Sometimes called the "City of Homes", Springfield is the state's third largest city, with more than 150,000 residents and nearly 60,000 households. A leader in the state's manufacturing economy a century ago, over the last four decades Springfield has seen the shuttering of one large company after another. As the City's economy declined, so too did its fiscal health. In the face of this ongoing fiscal crisis, the Commonwealth of Massachusetts granted control of city government to the Springfield Finance Control Board in 2004. One of the Control Board's first tasks was to address decades of tax delinquency.

A major source of revenue for cities and towns in Massachusetts is the property tax. The City of Springfield's Assessing Department estimates the market value of each and every parcel of property in the City for the purposes of assessing taxes. Based on the Assessing Department's estimate, the City mails bills for taxes four times per year. The bills are sent 30 days prior to the date they are due. Unpaid accounts accrue interest. Any taxes that remain unpaid at the end of the fiscal year are certified to a tax title account and the interest rate increases.

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At this point in the process, the City can issue a tax taking, also known as a tax lien, on the property. The tax lien is recorded at the Registry of Deeds. Tax liens run with the land, so the owner of the property is liable for payment, not necessarily the same person who incurred the original debt. The tax lien is a claim of ownership by the City that the taxpayer maintains the right to redeem. After a six-month waiting period, if the tax is still not paid, the City can file a complaint in the Land Court to foreclose the rights of redemption. If other methods of tax collection fail, the city can foreclose the tax title by selling the property.

In short, the collection process can include sending a preliminary notice to the owner, a final notice, placing advertisements in papers if the outstanding tax remains unpaid, filing the lien, filing a complaint to foreclose the lien six months later, performing a title search, sending a citation via certified mail, and holding a public hearing.

The Problem: $52.6 million in uncollected tax liens

In 2004, Springfield undertook a massive tax title collection initiative to reverse the trend of tax delinquency in the City. With around 44,000 freestanding units in the city in 2004, Springfield had $52.6 million in uncollected tax liens, including nearly $7.8 million in accrued interest and constituting 7,058 unpaid accounts. Some liens dated as far back as 1950, yet in 2004 Springfield had only one attorney working only one third of the time on collection of delinquent taxes. There were 193 uncollected tax liens dating from before 1980. Between 1980 and 2004, Springfield saw a huge increase in uncollected tax liens, jumping by 6,685.

> The City's focus on moving in quality, financially stable tenants helped neighbors retain the value of their property, encouraging them to stay in the neighborhood.

The large number of uncollected liens in Springfield was not concentrated in any particular neighborhood. It was also not concentrated in areas with high rates of poverty. Springfield experienced an instance of what is called the free-rider problem, which takes place when individuals determine that there is no effective penalty for non-compliance, that they can in effect ride free, letting others bear the cost of providing the service in question. Landowners, perhaps rightly, perceived that tax compliance was not being enforced and an increasing number of them decided not to pay taxes.

To rectify its finances and restore confidence, Springfield had to address its own negligence in collecting tax liens. The amount of administrative work it would take to close the cases appeared monumental, but Springfield had to overcome the perception that tax payment is optional. If it failed to, tax delinquency would remain as pervasive as it had been over the past few decades. In 2004, City officials saw fixing the tax collection process as essential to the community's long-term sustainability.

An Asset Management Approach

Springfield took the approach that simply selling assets as quickly as possible to any willing buyer was not the best long-term approach. By focusing on which new tenants were being brought into the newly sold delinquent properties, Springfield was able to carry out a targeted increase in owner occupancy. In evaluating purchasers, the city ensured the purchaser did not owe taxes to the city and the purchaser's permits were in order. In the cases of properties on which repairs would be required prior to occupancy, a right of reverter was inserted in each sale requiring that the repairs were completed within one year. If the purchaser failed to obatin a certificate of occupancy within a year, the City had the right to take the property back, guaranteeing a speedy return of the property to productive use. With an RFP, the city was also able to look at the experience of the purchaser, their plan for the site, and the purchaser's track record with land purchases in the City. With an auction, the city would verify the purchaser was financially capable at the time of purchase. It was believed increases in owner occupancy would lead to a greater commitment to the neighborhood, more foot traffic, and greater investment value for properties in the City.

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neighborhood. Simply selling to the highest bidder for a low quality project might have reduced the overall value of the city's "portfolio". By increasing home ownership, the City believed that the longer term value of property in the surrounding area would increase, adding value for neighboring owners, increasing tax revenues for the City, and contributing to a vibrant and stable neighborhood.

In essence, a city is similar in many ways to a shopping center. Like a shopping center, a city needs solid tenants - people with an interest in the collective success of the property. Its "rent", taxes, must be uniformly applied and collected and its tax liens are like a mortgage, or security, ensuring payment. Collection, while difficult, will result in the return of property to viable use so that it once again becomes a beneficial part of the whole. Short-term tax collection gains are less important than long-term revenue. Likewise, shopping center developers will forego short-term gain, recognizing that consistent long-term tenants are worth their weight in gold.

The Process

With each property, there are three phases a city must go through: the collection, the disposition of real estate, and the legal work. To help navigate the first phase, Springfield hired an outside firm, a professional third party collection service. Hiring an outside firm for collection was, however, only one of eight requirements the city needed to implement in its tax collection efforts. (See p. 2)

1) Coordination Across City Departments

The City established an interdepartmental team, consisting of officials from the collector's office, the treasurer's office, the assessor's, code enforcement and the planning and housing departments. The team was overseen by officials of the Finance Control Board. Meeting regularly, the team engaged in a continuous evaluation of the performance of each department, the retained collection agency, and the overall operation. The team was able to identify and resolve bottlenecks as they arose.

> Carrying out the disposition process with the community allows the city to incorporate the community's values in the RFP so that it not only supports the process, but is also able to assist in bringing in new, viable tenants.

In addition, as allowed by state law and at the discretion of the community, no tax scofflaw could receive a permit of any kind from the City until such taxes were paid. The constant engagement of the code enforcement and housing departments ensured that there was a single joint policy for departments working on tax collection efforts.

2) Using Incentives to Collect Old Debt

Beyond describing the scope of services, one of the most critical elements of any public procurement is determining exactly what is being bid on and then crafting a request that will allow for comparing bid prices across proposals. The City segregated the receivables by the age of the debt on the basis that old receivables would require greater effort to collect. The City determined the age of all debt in the portfolio, then included estimated quantities in each age category such that the bidders were required to calculate their percent bid (they bid a percent of the funds actually obtained as their remuneration) upon a dollar figure for the term of the contract to result in a single figure that was in fact the bid price.

In the RFP for collection services, the critical element was establishing the actual bid price page.

Using estimated quantities, the City was able to compare the pricing of the RFP submissions by requesting bids on a percent of funds collected, segregating the accounts by the age, as outlined above. The City was able to, in effect, offer financial incentives to the contracted firms for the collection of older debt, again, based on the understanding that older debts are more difficult to collect than newly owed ones.

3) Multiple Law Firms to Handle the Foreclosure Process

Once the process had moved past the initial collection phase and the City determined that it would begin filing tax lien foreclosure actions in mass quantities in the Land Court, Springfield retained multiple law firms, up to five at a time. The City evaluated the time and cost associated with each firm, and would move new firms in and underperforming ones out, creating competition between the firms and ensuring the process was as efficient as possible. The City also evaluated collection rates, legal rates, and the process to ensure the selling of properties was occurring quickly enough.

The City initially segregated the disposition and the management of the foreclosure process from the collection process in order to retain control over sensitive functions. In retrospect, the functions should have been packaged together, incorporating appropriate management controls. The City could have outsourced the whole process, not just the collection function, to a firm. At the time the City went out to bid, it was unclear what sort of management controls were needed, and the City had concerns about handing over disposition carte blanche. The division of responsibility was time consuming and bureaucratically complex. The City might have been better served by a single point of control and single data basis approach rather than handing control back and forth between collection and disposition firms. After a time the City management learned what sorts of controls it wanted in place to ensure that the City had final say on the purpose, price and disposition. The City eventually did subcontract out the administrative portion of the activity.

4) Use of Auctions and RFPs

To handle its backlog of foreclosed parcels and those resulting from these new foreclosure actions, Springfield has used both an auction and an RFP process to sell off properties, each process having its own benefits. To facilitate the process, Springfield developed criteria for putting a particular property to RFP or auction. The City staff spent about 45 days reviewing individual parcels to establish criteria for deciding which properties would go to RFP and which to auction. Having that clear criteria thereafter significantly expedited the disposal process.

If the property was in a neighborhood of critical concern, the property would go to RFP, as an RFP allows for a more qualitative, thorough evaluation of the potential purchaser because, according to state law, price is a factor but may not be strictly determinative. In addition, unoccupied commercial and vacant development parcels, including multi-family rental properties, would be disposed of by RFP. If the property was in a stable community, or it was an occupied commercial property, it would go to auction. As Figure 1 on the next page illustrates, an auction process is a 45-day process whereas an RFP process takes twice that time. Properties that the city wanted to sell off quickly were then put to an auction.

Figure 1

Process	*Time (days)*
Retain Collection Agency	0-90 days
Due Diligence	90-180 days
Retain Legal Firms	180-225 days
Tax Lien Filing	225-255 days
Foreclosure Process	*From time Lien is Filed*
Auction	45 days
Disposition and RFP	90 days

5) Strong Relationships with the Land and Housing Courts

The City developed a strong relationship with both the land and housing courts. Springfield brought in lawyers and code-enforcement officials who were familiar with the courts. City officials sat down with the Land Court staff to present their plan for the properties and coordinate efforts. The Land Court and city officials made the issue a priority, both committing resources to resolving cases. Without the strong commitment of the Land Court, the City's progress on the issue would not have been possible.

6) Community Involvement

Carrying out the disposition process with the community allows the city to incorporate the community's values in the RFP so that it not only supports the process, but is also able to assist in bringing in new, viable tenants. The City identified community representatives in seventeen neighborhoods who would provide recommendations to the City on which purchasers would most benefit the neighborhood.

7) Property Improvement

Springfield spent considerable time cleaning foreclosed properties and resolving complicated zoning and land use problems to enhance resale value. Springfield officials went before the Zoning Board Authority, and before the planning board, to make foreclosed properties as attractive to potential buyers as possible.

> In order to further secure the City's financial future, the Control Board stopped the policy of budgeting at 100% of projected property taxes.

Predominantly the zoning work involved obtaining variances or combining titles on two adjacent lots. Rarely, but occasionally, it involved changing the zoning, if it was clear that the existing zoning was not appropriate, although there were not many instances when the underlying zoning was blatantly inappropriate. Though some communities might consider adopting MGL Chapter 40R Zoning Overlays in conjunction with such a program over a given area, Springfield planners did not find this necessary. Springfield focused on marketability, reducing process costs and risks for the developer, rather than getting into larger community issues and concerns about proper zoning per se, which would have been time consuming and a drain on resources.

8) Reform of Tax Revenue Budgeting

To further secure the City's financial future, the Control Board stopped the policy of budgeting at 100% of projected property taxes. Under state law, cities and towns can effectively claim that they have 100% collection rate because once the property tax lien is placed on a parcel of land, which may occur at the end of the fiscal year in which the tax was due, it is as per state law, "deemed collected". This legal fiction has some validity as the lien may be foreclosed, the property seized and sold, and the taxes then paid. However, when there is systemic failure to pay taxes, the deemed collected approach pales in comparison to an actual weak cash position. For example, Springfield used to have a 93% collection rate, yet budgeted effectively at 100%.

Thus, the Control Board required that the City not budget all of its projected tax revenue. Instead, the City began to budget at a percentage of the total amount of potential property taxes. This simple conservative budgeting technique helped secure the city's short-term cash position.

Results and Findings

In 2004, there were around 7,000 open accounts in Springfield; the city has since closed 4,000. Of the $52 million in outstanding tax liens in 2004, the city has, to date, collected $24 million. Springfield cancelled $2 million in overdue debt. Today there is still $32 million in outstanding debt.

The city is now a large landlord, owning nearly 413 properties. Of those, 301 are residential and 112 are commercial. The city has initiated 42 successful closings through RFP. Of those, nine closings occurred in 2005, 17 closings in 2006, and 22 closings in 2007. Nearly 56 properties are under agreement, 25 through auction and 31 through RFP. Since 2006, Springfield has acquired 281 foreclosed properties in total.

It is still too early to judge long-term outcomes for the neighborhoods, especially as the nationwide crisis of rising foreclosures unfolds. In general, however, increases in owner occupancy rates and reductions in the number of blighted properties benefit neighborhoods and it is on these goals that the City of Springfield was focused.