CITY OF PHILADELPHIA
PENNSYLVANIA

OFFICE OF THE CONTROLLER

Promoting honest, efficient, and fully accountable government

DEPARTMENT OF REVENUE

Delinquent Real Estate Taxes:
Changes Required To Improve Collectability

November 2013

City Controller
ALAN BUTKOVITZ

CITY OF PHILADELPHIA

OFFICE OF THE CONTROLLER
1230 Municipal Services Building
1401 John F. Kennedy Boulevard
Philadelphia, PA 19102-1679
(215) 686-6680 FAX (215) 686-3832

ALAN BUTKOVITZ
City Controller

November 12, 2013

Clarena I. W. Tolson, Commissioner
Department of Revenue
Municipal Services Building, 6th Floor
1401 John F. Kennedy Boulevard
Philadelphia, PA 19102

Dear Commissioner Tolson:

Pursuant to Section 6-400(d) of the Home Rule Charter, the Office of the Controller conducted an evaluation of the City of Philadelphia's real estate tax collection and enforcement process. The purpose of the evaluation was to assess the collection and enforcement process and make recommendations for areas identified as needing improvement. A synopsis of the results of our work is provided in the executive summary to the report.

Our findings and recommendations are included in the attached report. We believe that the recommendations, if implemented by management, will improve the efficiency and effectiveness of the city's real estate collection and enforcement process.

We would like to express our thanks to you and your staff for the outstanding courtesy and cooperation displayed during the conduct of our work.

Very truly yours,

ALAN BUTKOVITZ
City Controller

cc: Honorable Michael A. Nutter, Mayor
Honorable Darrell L. Clarke, President
and Honorable Members of City Council
Members of the Mayor's Cabinet
Honorable Jewell Williams, Sheriff
Shelley R. Smith, City Solicitor
and other members of the Mayor's Cabinet

DEPARTMENT OF REVENUE
DELINQUENT REAL ESTATE TAXES
EXECUTIVE SUMMARY

Why The Controller's Office Conducted The Evaluation

Pursuant to Section 6-400(d) of the Philadelphia Home Rule Charter, the Office of the Controller (Controller's Office) conducted an evaluation of the City of Philadelphia's real estate tax collection and enforcement process in response to a series of newspaper articles that criticized the city's poor collection efforts. Our objectives were to: (1) determine if the city's real estate tax collection rate was better or significantly worse than those of other comparable cities; (2) identify the cause(s) if the collection rate was found to be significantly worse; and (3) recommend ways to improve real estate tax collection efforts.

What The Controller's Office Found

- Of the eight peer cities we selected for our study, Philadelphia, with a collection rate of 87 percent, outpaced only Detroit in its ability to collect real estate within the fiscal year of the tax levy. Additionally, when we averaged one year collection rates for the last nine years, every city in our study outperformed Philadelphia. We estimate that due to the gap between the city's collection rate and that of its peers the City and School District have lost approximately $25 million and $35 million, respectively in both fiscal years 2011 and 2012.

- Problems were found in every phase of the city's tax collection and enforcement process: efforts to prevent delinquency have been inadequate; payment agreements have been idiosyncratic and difficult to enforce once a property becomes delinquent; and once a property is moved from delinquency to foreclosure, there is an inordinately lengthy and unpredictable process before the property is transferred to more responsible ownership.

- In Philadelphia, the process of bringing a delinquent tax property through Sheriff Sale and then to new ownership can take nearly 2½ years and sometimes reportedly upwards to six years, one of the worst records of any large American city. In recent years, approximately 200 properties per month have been sold at Sheriff Sale; at this rate, it will take over 40 years to clear the already-existing delinquent property inventory. Without a credible and timely threat of foreclosure, Philadelphia will continue to have one of the lowest property tax collection rates of any of its peer cities.

- Of Philadelphia's 99,000 properties with property tax liens at the end of fiscal 2012, we estimate that approximately 65,000 properties with liens valued at $204.8 million are of sufficient quality to reasonably expect redemption via a negotiated bulk tax lien sale. Within the smaller universe of investor-owned residential properties, there is about $27.4 million in quality liens.

What The Controller's Office Recommends

The Controller's Office has developed a number of recommendations to address the above findings. Some of the more significant recommendations include: (1) increasing efforts to contact property owners when their taxes become past due; (2) reporting past-due property owners to credit bureaus; (3) investing in productivity enhancing technology for the Sheriff's Office so that Sheriff Sales happen expeditiously and predictably; and (4) considering a negotiated bulk tax lien sale of its quality liens to generate additional revenue for the City and School District and to reduce the city's large lien digest.

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Background

In the past 20 years, the City of Philadelphia's tax receivables have become a major problem, with nearly $1.2 billion in arrearages among the categories of tax and fees. Delinquent real estate taxes of $465.6 million constitute the lion's share of the receivables. These sobering statistics have produced calls for a variety of reforms, from more aggressive real estate tax collection and enforcement efforts on the part of various city agencies to wholesale outsourcing of these functions. They have also prompted a series of newspaper articles criticizing the city's poor real estate tax collection efforts. To address these issues, the Controller's Office performed an evaluation of Philadelphia's delinquent real estate tax collection process. The objective of our evaluation was to determine if the city's real estate tax collection rate was better or significantly worse than those of other comparable cities; identify the cause(s) if the collection rate was found to be significantly worse; and recommend ways to improve real estate tax collection efforts.

Real Estate Billing, Collection and Enforcement Process

The city's real estate taxes are levied on January 1st of each year. The city's Office of Property Assessment (OPA) is responsible for annually determining the value of properties within the city, and submitting a certified list of property assessments to the Revenue Department. The Revenue Department is responsible for billing and collecting real estate taxes based on OPA's valuations. Taxpayers are given a one-percent discount if they pay their bill on or before February 28th. The gross amount of the tax is due on March 31st of each year. If the property owner fails to pay the required tax by March 31st, the property becomes past due on April 1st, and interest begins to accrue.[1]

In mid-April, the Revenue Department initiates collection efforts on past due accounts. An overdue tax bill is sent out to the property owner. Due to the high volume of these bills, they are mailed out in batches over a 50-day work cycle. The Revenue Department continues to repeatedly mail out these overdue bills on a rotating basis about every 70 days. In addition, the Revenue Department contracts with a collection agency and a law firm to conduct aggressive collection efforts against the property owners. These collection efforts, which include collection calls, commence in June. For taxpayers who wish to cooperate but do not have the full amount due, a payment agreement can be set up to pay the past due tax in installments.

On December 31st, the city considers the property owner delinquent and starts the process of filing a lien on the property. Once a lien is placed on a property, lien collection is contracted out to two private firms. These two firms plus the Revenue Department's Real Estate Tax Unit split responsibility for taking properties to Common Pleas Court to get a Writ of Execution, which in turn, orders the Sheriff to take a property to auction. The city will then set an opening bid and the property needs to be advertised three weeks prior to the sale. When the property is sold, the buyer has 30 days to settle, but can request an additional 30 day extension. If the buyer does not complete the "terms of sale" within the given time period, the buyer then forfeits the property and loses a 10 percent deposit previously paid on the day of the auction. If the property does not sell during the initial round, it will get postponed for 30-60 days and this process repeats itself twice. After three tries without a bid, the property will get withdrawn and a "stayed" status will be placed on the property.

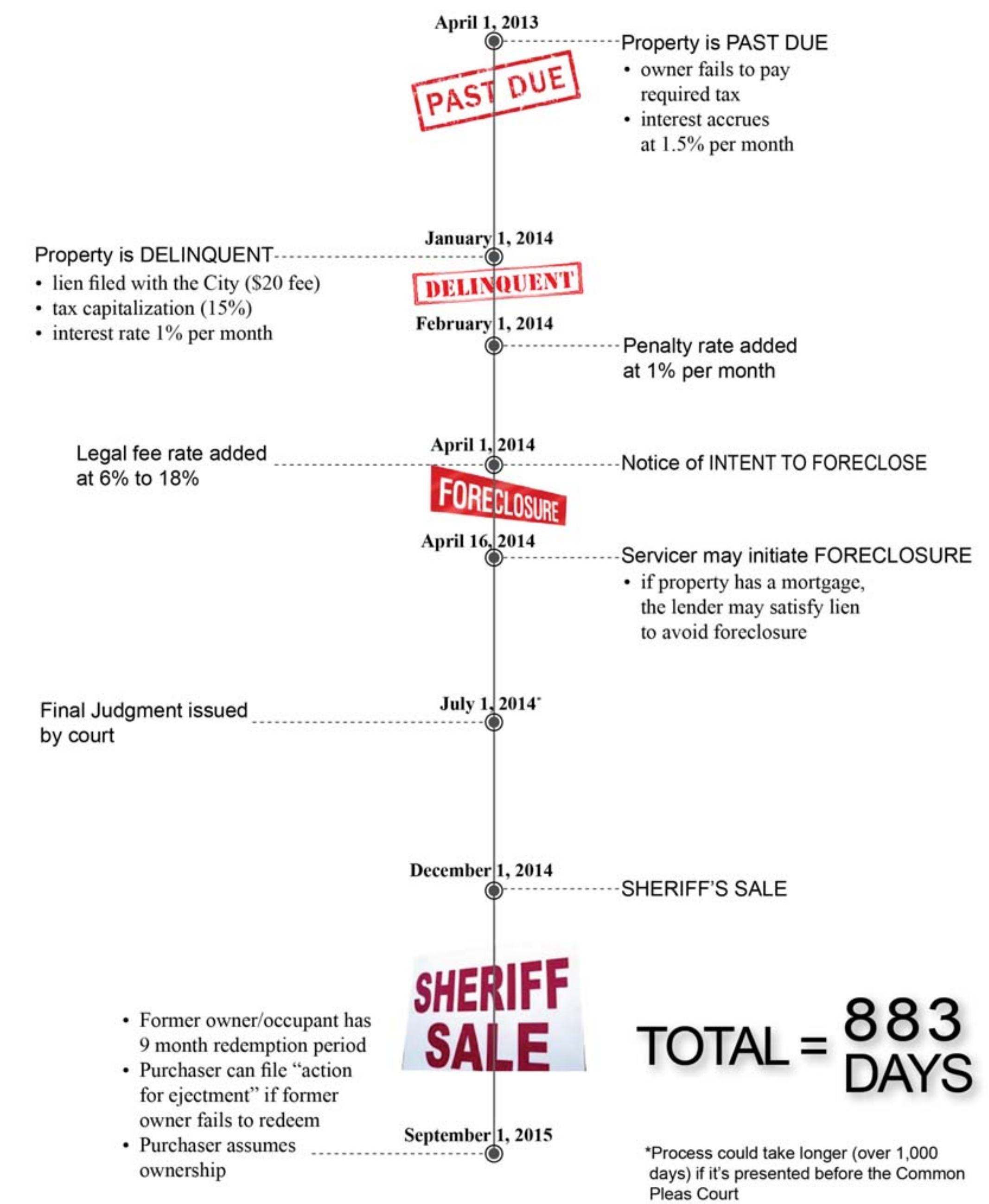
[1] Interest accrues at the rate of 1½ percent per month from April through December in the year the tax is due. On January 1 of the following year, an additional 15 percent of the tax is due penalty of 1 percent on the first day of each subsequent month from February through August, along with interest at the rate of .75 percent per month, or part thereof and an additional penalty of 1 percent on the first day of each subsequent month from February through August.

When a sale transaction is completed, the Sherriff's Office is required to distribute the sale proceeds in a specific order to satisfy all city liens with delinquent taxes covered first. However, the city provides for post-foreclosure sale redemptions. This provision allows the owner to occupy and redeem the property if they satisfy all tax arrearages within nine months of the Sheriff Sale. If the tax liability is not paid during the nine month redemption period the purchaser could have the owner ejected and take possession of the property.

The city's typical real estate tax delinquency timeline is shown on the next page.

Illustration 1: Typical Real Estate Tax Delinquency Timeline

EXAMPLE: 2013 Real Estate Tax Payment Due March 31, 2013



REFORMS NEEDED TO IMPROVE COLLECTABILITY OF REAL ESTATE TAXES

Of the eight peer cities we selected for our study, Philadelphia, with a collection rate of 87 percent, outpaced only Detroit in its ability to collect real estate taxes within the fiscal year of the tax levy. Additionally, when we averaged one year collection rates for the last nine years, every city in our study outperformed Philadelphia. With an average annual tax levy of roughly $500 million for the city and $700 million for the school district, we estimate that the gap between the city's collection rate and that of its peer cities has resulted in the city and school district losing approximately $25 million and $35 million, respectively in both fiscal years 2011 and 2012.

Our observations have disclosed that the city has not taken adequate initiatives to prevent delinquencies from occurring in the first place. Moreover, once property owners become delinquent, the process used to enforce collections has been flawed, and the process for foreclosure and sheriff sale has been plagued by such an inordinate length of time that many taxpayers no longer view it as a credible threat to losing their properties. With more aggressive and sophisticated collection programs and the strategic use of tools such as a negotiated bulk tax lien sale, significant benefits to the city's finances could be achieved.

Peer Cities Outperform Philadelphia in Collecting Real Estate Taxes

To determine whether Philadelphia's real estate tax collections were better or worse than those of other comparable cities, we selected eight major cities and compared their percentage of real estate taxes collected within the fiscal year of levy to Philadelphia's collection rate. We found that Philadelphia's collection rate of 87 percent was significantly lower than all but one of the peer cities. As shown in Table 1, most peer cities collected at least 93 percent of property taxes within the fiscal year of levy and several come closer to 98 percent.

Table 1: Peer city collection rates within year of tax levy

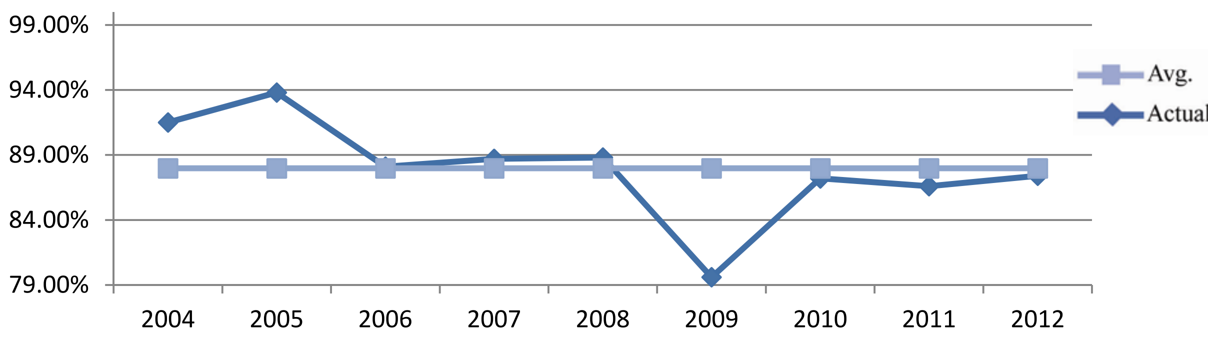
City	One-year Collection Rate (FY 2012)	One-year Collection Rate (FY 2011)
Boston	98.44%	98.86%
Atlanta	98.13%	97.63%
Houston	97.80%	97.71%
Baltimore	91.60%	96.50%
Chicago	Not available	94.73%
Los Angeles	93.56%	95.55%
New York	91.79%	91.90%
Philadelphia	**87.40%**	**86.60%**
Detroit	83.68%	79.92%

Source: Prepared by the Controller's Office based on data taken from each city's Comprehensive Annual Financial Report

The city's low collection rate has had a major impact on both the City and School District of Philadelphia's operations. With tax levies for 2012 and 2011 of roughly $500 million for the City and $700 million for the School District, the 5 percent gap between the city's collection rate and that of its peers represents an additional $25 and $35 million that could have been added to the respective City and School District coffers in both fiscal year 2012 and 2011.

Philadelphia's collection problems are long-standing and seem to have gotten somewhat worse in recent years. During the mid-late 1990s, the city's fiscal year collection rate was 98 percent; for the last nine fiscal years (2004 to 2012) this collection rate dropped to an average of just 88 percent as shown in the below Figure 1.

Figure 1: Philadelphia's Average and Actual Collection Rate within the Fiscal Year of Levy 2004 to 2012



Source: Prepared by the Controller's Office based on data taken from the City of Philadelphia's Comprehensive Annual Financial Report

When we compared Philadelphia's nine year average collection rate of 88 percent to its peer cities, we found that every city in our study outperformed Philadelphia. The nine year average collection rates for each city are shown in Table 2 below.

Table 2: Average collection rates Fiscal Years 2004 - 2012

City	Average Collection Rates for fiscal years 2004 to 2012
Boston	98.44%
Houston	96.99%
Atlanta	95.56%
Baltimore	95.09%
Los Angeles	93.90%
Chicago	92.84%
New York	92.37%
Detroit	89.63%
Philadelphia	**87.97%**

Source: Prepared by the Controller's Office based on data taken from each city's Comprehensive Annual Financial Report

While each peer city shares some of Philadelphia's characteristics, there is no "one size fits all" solution for the city's unique needs. Several factors set Philadelphia apart: it has the highest rate of homeownership among the peer cities, 60 percent; it has one of the highest proportions of homes with no mortgage, 40 percent; it has very high rate of intergenerational property transfers and very long ownership tenures; and it has the second highest rate of poverty. These factors combine to create a need for a tax collection and lien management system that balances the city's budgetary needs with the social costs of blighted, vacant, and otherwise neglected properties.

Collection and Enforcement Process Flawed

We found problems in every phase of Philadelphia's tax collection and enforcement process: efforts to prevent delinquency have been inadequate; once a property becomes delinquent, payment agreements have been idiosyncratic and difficult to enforce; and once a property is moved from delinquency to foreclosure, there is an inordinately lengthy process before the property is transferred to more responsible ownership. These problems have allowed the city's tax receivables to accumulate for years with little or no enforcement action. At June 30, 2012, over 99,000 (roughly 17 percent) of the city's 579,000 properties were tax delinquent, and real estate tax arrearages totaled $465.6 million.

Pre-delinquency Collection Efforts Have Been Inadequate

Until recently, the city made no attempt to send out late notices to property owners after the March 31st due date to inform them that they are past due and that the city will lien their property if payment is not received before December 31st. Property owners were only notified that they were delinquent in January of the following year, a full nine months after the March 31st due date.

Although Philadelphia has a high proportion of homes with no mortgages, it had not established any programs to work with lending institutions to educate property owners who are on the verge of paying off their mortgages on the importance of continuing to pay their property taxes. Furthermore, there was no attempt to educate all property owners whose property taxes are not paid via an escrow account, about their responsibilities and the systems available for paying their property taxes. In addition, the city had no requirements to report seriously past-due — beyond 90 days — property owners to credit bureaus.

Payment Agreements Have Been Ineffective

The city's payment plans were ineffective and cost-prohibitive for many citizens. They did not provide for monthly installment payments for low income and financial hardship homeowners. Without a reasonable and feasible approach for paying their tax deficiencies, the tax debt for these low income and financial hardship homeowners was allowed to accumulate for years.

Foreclosure Efforts Have Been Untimely

The Sheriff's Office has historically been inefficient and technologically inept. The process takes about 2½ years (sometimes reportedly upwards to six years) from the date a property is considered delinquent through a Sheriff Sale, and subsequent new ownership. This timeline is one of the worst records of any large American city. In recent years, about 200 properties per month have been sold at Sheriff Sale; at his rate, it will take nearly 43 years to clear the already-existing delinquent property inventory. One of the primary delays that often occur within the Sherriff's Office is receiving timely information on the outstanding lien liabilities placed on the property by the city.

We compared the city's Sheriff Sale process with the eight peer cities we surveyed. As shown in Table 3 below, the foreclosure process and timeline varies considerably in each of the cities we surveyed; the general parameters are established by state law. There is a close correlation between one-year property tax collection rates and the overall length of the foreclosure process. Additionally, those cities that allow post-foreclosure sale redemption tend to have the lowest collection rates. In the lowest performing cities, Detroit and Philadelphia, foreclosure sales are handled by elected officials rather than agents of the courts. The positive relationship between tax collection rates and expeditious foreclosure processes probably derives from the greater degree of predictability that a delinquent property will change hands if delinquencies are not rectified.

Table 3: Foreclosure Process and Timelines

City	Process	Sale	Conducted By	Typical Timeline	Redemption	2011 Real Estate Collection Rate
Baltimore	46 days	30 days	Court	1.5 months	Court decides	96.50%
Atlanta	37 days	32 days	Trustee	2 months	None	97.63%
Houston	27 days	N/A	Trustee	3 months	None	97.71%
Los Angeles	117 days	21 days	Trustee	4 months	None	95.55%
Boston	75 days	41 days	Court	6 months	None	98.86%
Detroit	60 days	30 days	Sheriff	8 months	30-365 days	79.92%
Philadelphia	**270 days**	**N/A**	**Sheriff**	**11 months**	**9 months**	**86.60%**
Chicago	300 days	N/A	Court	12 months	90 days	94.73%
New York City	445 days	N/A	Court	15 months	None	91.90%

Source: Adapted from "Foreclosure Laws and Procedures by State," RealtyTrac.com, http://www.realtytrac.com/foreclosure-laws/foreclosure-laws-comparison.asp.

Tax Lien Sale Strategies Could Improve Collections

Our study also included an analysis of the collection and tax lien management strategies used by Philadelphia's peer cities. These methods are presented in Table 4 below and a discussion of their advantages and disadvantages can be found in Appendix III.

Table 4: Collection and Tax Lien Strategies Used by Peer Cities

City	Tax Lien Sales	Tax Deed Sales	Foreclosure and Auction	Tax Lien Securitizations	Land Bank	Third-Party Servicing
Boston					√	
Houston		√				√
Atlanta	√					
Baltimore	√				√	
Los Angeles		√				
Chicago	√					
New York City				√		
Detroit			√			
Philadelphia			√			√

Source: Compiled by the Controller's Office based on interviews with key revenue personnel and web sites of cities indicated

Generally speaking, there are two distinct approaches to tax lien management. The first is the traditional, in-house (public) method, in which a municipality maintains ownership of the liens, uses its staff to enforce the liens, and therefore, retains all the proceeds from collections. At the same time, it incurs all the costs. The second general approach is to privatize lien enforcement via either third-party service contracts or actual sale of liens to private investors. This generally transfers the costs of enforcement to a private entity, while at the same time, foregoing a share of the proceeds, as well as a greater or lesser degree of control over the fate of the properties underlying the liens.

The city currently utilizes a mixed public and private approach to lien collection. It has contracted with two private law firms to assist its Law Department in the collection of liens, which at the end of 2012 totaled over 99,000 properties. Much has been written in the press about this undeniably large figure, representing roughly 17 percent of the parcels in Philadelphia's property inventory of 579,000 properties.

As of the date our work was being performed, there was $9.3 billion[2] worth of tax delinquent properties in Philadelphia, representing nearly half-a-billion dollars in potential revenue from tax delinquents.

Lien Quality and Collectability Assessments

We performed an assessment of the city's 99,000 tax liens to determine what proportion of the liens could generate revenue to the city using lien sale strategies at its disposal, such as individual tax lien sales, bulk tax lien sales or tax lien securitization. Our methodology included evaluating the quality of the city's tax lien digest (how likely a particular lien or set of liens will be redeemed, that is, will pay off the delinquent tax burden plus interest and penalties, without going through the expensive and time-consuming foreclosure process). We used two common lien measurements (1) the Lien-To-Value Ratio (LTVR) - the ratio of the outstanding tax debt (the lien) to the assessed value of the property,[3] and (2) the age or "vintage" of the lien, in other words, how long has a particular property been tax delinquent. Generally, the lower a lien's vintage and LTVR, the more attractive it is to investors. A detailed discussion of our assessment methodology is contained in Appendix IV.

We found that about 65,000 of the city's liens would be attractive to investors because they have been delinquent for less than eight years and have a LTVR of 20% or less. These "top tier" liens by property type are presented in Table 5 below. We estimated that the city might expect to raise approximately $204.8 million of the total delinquent property tax balance if all top-tier liens in all property categories were included in a tax lien sale. Within the much smaller universe of investor-owned residential properties, there is about $27.4 million in quality liens.

Table 5: Top Tier Liens by Property Type

Property Type	LTVR	Lien Amounts (in millions)
Residential	<=20%	$132.7
Commercial	<=15%	19.1
Multi-Family	<=20%	23.6
Mixed Use	<=15%	11.9
Industrial	<=15%	8.1
Land	<=15%	9.4
Total		$204.8

Source: Prepared by the Controller's Office

Tax Lien Sale Considerations

We considered the advantages and disadvantages of the various methods the city could use to sell its tax liens (individual tax lien sales, bulk tax lien sales, and tax lien securitization) and, in our opinion, an annual negotiated bulk tax lien sale (see section D in Appendix III) probably poses the least risks and promises the most predictable returns. Bulk lien sale agreements should contain provisions that return unredeemed liens to a city-run land bank as proposed in City Council Bills 130156 and 130157.

We do not believe city management should pursue individual tax lien sales or tax lien securitization because of the variability of the lien pool; Philadelphia's distinction as a city with a massive vacant and abandoned property problem, and Philadelphia's failed attempt at tax lien securitization in the mid 1990s. Additionally, in both individual tax lien sales and securitizations, there can be a serious misalignment

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[2] Based on market values assessed by the Office of Property Assessment for tax year 2014.

[3] In computing the LTVR, we used the 2014 market values as determined by the city's Office of Property Assessment.

between the profit motivations of individual or institutional investors and the public policy goals of the city, with real danger of exacerbating an already dire abandoned and blighted-property problem.

Conclusion

Philadelphia's issues with property tax collection and lien management led us to conclude that the status quo is not acceptable: the city is losing tens of millions of dollars in revenue due to inefficient processes and a culture of noncompliance. We believe that more aggressive and sophisticated collection programs combined with limited and strategic use of tools such as a negotiated bulk tax lien sale could provide significant benefits to the city's finances in the short term. To capture longer term benefits, however, the city will need to increase its capacity to collect revenue on a timely basis, place a far greater emphasis on delinquency prevention than it has in the past, and streamline the foreclosure process to stem the rapid growth of its tax lien digest.

Subsequent to our review, the city has taken actions to address many of the findings addressed in our report by:

- Using one of its contracted law firms, as well as a collection agency, to perform pre-delinquency out-reach efforts for property owners whose taxes are past due, and

- Executing an Ordinance (Bill No. 120054) which requires the Revenue Department to (1) send past-due notices within 60 days to all taxpayers who did not remit their property tax payments by March 31 of a given tax year, and send an additional notice 90 days after the initial warning notice; (2) authorizes installment payment agreements based on the taxpayer's monthly household income; and (3) establishes enforcement actions for non-compliance.

In addition, we would like to acknowledge the city's efforts in the passing of legislation by the Commonwealth of Pennsylvania's General Assembly that allows the city to place liens against properties located in other jurisdictions owned by delinquent Philadelphia taxpayers.

Recommendations

To prevent delinquency from occurring in the first place and to improve collections within the first year that taxes are levied, we recommend that the Revenue Department:

- Improve its contractor efforts to contact past-due property taxpayers in the period between April 1 and December 31. While we support the policy change implemented by Council Bill 120054 regarding the mailing of 60 and 90 day past-due notices to taxpayers, we believe that a more immediate outreach via telephone would provide an additional level of delinquency prevention.

- Work with lending institutions to educate property owners who are on the verge of paying off their mortgages of the importance of continuing to pay their property taxes.

- Make a concerted and targeted effort to educate all Philadelphia property owners whose property taxes are not paid via an escrow account about their responsibilities and the systems available for paying their property taxes. Allow these property owners to pay their taxes monthly, while charging them a processing fee for each payment.

- Develop a user-friendly system for enrolling post-mortgage property owners in property tax payment plans, including auto-pay options.

- Timely report delinquent property owners to credit bureaus.

To remove the barriers in accessing appropriate payment agreements for low-income taxpayers and offer taxpayers reasonable and feasible approaches for repaying their tax delinquency, we recommend that Revenue Department management effectively implement the monthly installment payment agreement provisions of City Council Bill 120054 in a timely manner. The Controller's Office will evaluate the Revenue Department's compliance with those provisions in future engagements.

To establish a real and credible threat of foreclosure in the minds of delinquent taxpayers, we recommend management of the Sheriff's Office:

- Invest in productivity enhancing technology, which will provide automated links to the city's lien data base, so that Sheriff Sales take place expeditiously and predictably, and sales proceeds are distributed in a timely manner.

- Work with city management to explore the possibility of shortening or eliminating the post-sale redemption period so that delinquent properties actually change ownership.

To clear the city's large tax lien digest and generate additional revenue for the City and School District, we recommend that city management:

- Annually assess its tax lien digest to identify a pool of redeemable quality liens, and consider the feasibility of redeeming those liens through a negotiated bulk tax lien sale.

- Include in bulk lien sale agreements provisions that return unredeemed liens to a city-run land bank such as that proposed in City Council Bills 130156 and 130157.

APPENDIX I: OBJECTIVES, SCOPE, AND METHODOLOGY

The Controller's Office performed an evaluation of the City of Philadelphia's delinquent real estate tax collection process. Our objectives were to: (1) determine if the city's real estate tax collection rate was better or significantly worse than those of other comparable cities; (2) identify the cause(s) if the collection rate was found to be significantly worse; and (3) recommend ways to improve real estate tax collection efforts.

To satisfy our objectives we (1) gained an understanding of the laws and regulations for billing, collecting, and enforcing real estate taxes; (2) examined the procedures followed by city agencies and outside contractors involved in collection and enforcement activity, and (3) obtained historical tax collection rates and strategies for the city as well as for other peer cities.

To gain an understanding of the laws and regulations, and procedures used by city agencies and contractors related to real estate billing, collection and enforcement, we:

- interviewed the city's Revenue Commissioner and personnel from the city's Revenue and Law Departments and the Sheriff's Office as well as representatives from two outside law firms that are performing collection work for the city; and

- performed walkthroughs of the procedures.

To ascertain if the city's collection rate is comparable to other peer cities we:

- selected eight major cities that we believe are comparable to the city; and

- obtained and analyzed historical tax collection data contained in the Comprehensive Annual Financial Reports of the city and the eight other cities we selected.

To determine the cause (s) of the city's poor collection rate, we:

- reviewed and compared the collection practices used by the city with those used by the other cities we surveyed; and

- evaluated the effectiveness of the collection and enforcement process; and

- analyzed the city's tax lien digest, assessed the city's lien quality and evaluated various lien management strategies.

We performed our work from December 2012 through October 2013.

TOTAL TAX AND FEE DELINQUENCIES AS OF JUNE 30, 2012

Tax Type	Tax Due	Interest Due	Penalty Due	Other Due	Balance Due	Years
Amusement	$571,589	$207,738	$660,703		$1,440,030	1987-2012
BIRT (formerly-BPT)	$198,556,298	$70,606,331	$123,664,943		$392,827,572	1982-2012
BRI	$374,732				$374,732	1978-2012
Earnings	$15,734,043	$6,542,560	$10,939,194		$33,215,797	1969-2012
Hospital	$1,585,630	$174,697	$257,725		$2,018,052	2011-2012
Hotel	$1,019,585	$331,077	$627,823		$1,978,485	1988-2012
Liquor	$21,720,680	$4,037,579	$8,657,373		$34,415,632	1995-2012
Net Profits Tax	$17,451,300	$6,445,277	$10,839,496		$34,736,073	1979-2012
Parking	$2,260,961	$814,270	$1,383,207		$4,458,438	1987-2012
Police	$4,114,060	$3,419			$4,117,479	2006-2012
Real Estate	$434,167,918	$9,945,233	$1,902,602	$19,546,890	$465,562,643	1972-2012
Realty Transfer	$2,128,038	$780,513	$1,288,802		$4,197,353	1985-2012
SCE	$22,351,255	$6,927	$12,014	$380	$22,370,576	2010-2012
School Income Tax	$2,700,347	$1,059,959	$1,736,585		$5,496,891	1992-2012
Tobacco	$8,522	$451	$905		$9,878	2010-2012
UO-Landlord	$8,577,813	$3,362,275	$5,735,990		$17,676,078	1988-2012
UO-Tenant	$7,031,604	$1,374,454	$2,217,000		$10,623,058	1988-2012
Valet Parking	$442,679	$124,944	$243,032		$810,655	2006-2012
Vehicle Rental	$7,399	$1,482	$2,247		$11,128	2002-2012
Wage	$108,019,559	$34,544,257	$60,069,946		$202,633,762	1979-2012
TOTALS	**$848,824,012**	**$140,363,443**	**$230,239,587**	**$19,547,270**	**$1,238,974,312**	

REAL ESTATE TAX DELINQUENCY, 1997-2012

YEAR	ACCTS	TAX LEVY	PRINCIPAL	INT DUE	PENALTY	OTHER	BALANCE	% DQ	COLL-RATE
1997	19,984	$336,200,000	$5,444,247	$391,726	$32,604	$724,235	$6,592,812	1.96%	98.38%
1998	21,368	$338,600,000	$5,990,975	$329,183	$24,032	$596,729	$6,940,919	2.05%	98.23%
1999	22,812	$343,600,000	$6,661,319	$315,709	$25,430	$627,317	$7,629,775	2.22%	98.06%
2000	24,073	$349,300,000	$7,108,941	$306,769	$26,401	$828,424	$8,270,535	2.37%	97.96%
2001	29,159	$356,600,000	$8,051,216	$329,155	$29,800	$728,203	$9,138,374	2.56%	97.74%
2002	30,854	$368,200,000	$9,214,874	$342,711	$34,063	$730,310	$10,321,958	2.80%	97.50%
2003	32,797	$359,400,000	$10,398,015	$366,829	$42,304	$773,691	$11,580,839	3.22%	97.11%
2004	35,669	$372,500,000	$11,193,899	$349,322	$84,841	$807,991	$12,436,053	3.34%	96.99%
2005	36,342	$373,500,000	$12,067,284	$407,946	$64,014	$923,846	$13,463,090	3.60%	96.77%
2006	40,359	$385,600,000	$14,308,871	$486,876	$143,589	$1,058,447	$15,997,783	4.15%	96.29%
2007	44,575	$391,700,000	$18,649,649	$547,761	$123,138	$1,198,141	$20,518,689	5.24%	95.24%
2008	50,034	$390,200,000	$21,957,675	$719,774	$192,864	$1,490,522	$24,360,835	6.24%	94.37%
2009	58,673	$396,500,000	$31,437,174	$855,827	$298,976	$1,769,921	$34,361,898	8.67%	92.07%
2010	75,465	$405,800,000	$46,454,672	$934,564	$410,993	$2,200,100	$50,000,329	12.32%	88.55%
2011	88,714	$509,100,000	$70,042,650	$718,714	$217,189	$2,048,915	$73,027,468	14.34%	86.24%
2012	90,942	$508,600,000	$74,663,109	$627,969	$65,574	$1,720,525	$77,077,178	15.15%	85.32%
TOTALS		**$6,185,400,000**	**$353,644,570**	**$8,030,835**	**$1,815,812**	**$18,227,317**	**$381,718,535**	**6.17%**	**94.28%**

A. Foreclosure and Auction

The most direct means for getting tax delinquent properties into the hands of new owners entails going directly from delinquency to a foreclosure auction. Under this method, after a statutory period of delinquency expires, the municipality notifies the owner of the commencement of foreclosure proceedings. After a statutory redemption period expires, the municipality clears title on the property takes it to a foreclosure auction. The proceeds accrue directly to the municipality.

On the positive side of the ledger, this approach represents the most direct form of title transfer after purchase at auction and returns the property to the private market. The municipality also retains direct control of properties up until the sale. On the downside, the municipality incurs all the legal costs throughout the foreclosure process. Because it is a time-consuming and expensive process almost entirely dependent upon government resources until the ultimate step, and because there are no built-in profit motives to change the structure of incentives for delinquent owners, it is difficult to move large numbers of properties off the delinquent property register at any one time. Of our target cities, Detroit has utilized this method, and its rates of collection are among the lowest in the country.

B. Third-Party Tax Lien Servicing

This method of collecting delinquent taxes is sometimes known as "tax farming." In this approach, a governmental tax collecting body will contract with a private firm, which will then be responsible for collecting delinquent taxes from the public. Usually these firms are paid on a commission basis, receiving a fixed percentage of the liens they recover. Some municipalities utilize third-party servicing to supplement in-house collection efforts, while others delegate all collections to a third party.[4] The leading firms in the industry analyze liens in much the same way as sophisticated investors, and tailor their collection strategies accordingly. Unlike the other methods discussed below, such as tax lien sales or tax deed sales, the city remains the sole owner of the liens in question.

On the plus side, the municipality retains full jurisdiction over the liens, there is relatively low cost and risk involved in entering into a servicing contract, and the contract can contain provisions prohibiting certain types of collection practices. Privatizing collections and pegging compensation to performance creates a new structure of incentives and a new relationship between the tax collector and delinquent property owners; in theory, market efficiencies should yield better results in terms of collections than in-house efforts. Privatization is also attractive to a municipality that is trying to avoid growing its permanent workforce. On the negative side, privatization means foregoing some of the revenues collected. As in other market-based approaches, there is an inherent misalignment of incentives between the tax collector, driven by profit, and the municipality, driven by a combination of need for revenue and desire to avoid the social costs of foreclosure, property abandonment, and homelessness.

C. Individual Tax Lien Sales

In this approach to tax delinquency enforcement, a municipality places a lien on a property – or, in some jurisdictions, on multiple properties owned by the same person – and then after the statutory notification, auctions liens publicly. By assuming the debt on a property and obtaining the right to foreclose on it if the debt is not redeemed within the statutory time frame, the purchasing entity gains strong financial incentive to pursue payment by the property owner. With the threat of foreclosure now driven by the

[4] Some municipalities, Philadelphia among them, employ a mixed system of public and private collections, which can complicate foreclosure proceedings and cause general confusion among the public. Each servicing agent in Philadelphia – the Revenue Department, and its two contracted law firms - follow somewhat different procedures, according to conversations with attorneys in the housing division of Community Legal Services.

purchaser's financial incentives, the property owner's incentive to settle the tax debt is heightened. The bidding system varies by municipality, but usually consists of online or live auctions where anyone who is not him or herself a tax delinquent property owner can bid on liens. Auctions are generally structured in one of two ways. First is the interest rate "bid-down," in which the municipality sets a top interest rate for collection on any given lien, and the winner of the auction is the purchaser who comes in at the lowest rate. Second is the "overbid" auction, in which bidders vie to pay the highest face price for any particular lien. In either case, the investor's rate of return derives from the arbitrage between the cost of the money used to purchase the lien and the interest and penalties charged in the redemption process. At present, with bank interest rates at historic lows, liens can be a very profitable investment.

There are some advantages to this method. Because it is almost purely market-driven, it is likely that the most desirable properties will re-enter private market. It also provides opportunities for small-time investors. The municipality has freedom of choice as to which liens it will auction at any given time, so it retains some control over the disposition of delinquent properties. From an investor's point of view, a lien purchase is generally a relatively low-risk proposition, since most states allow investors to collect a substantial transaction fee or penalty even upon rapid redemption. Proponents of lien sales also argue that the interest-rate competition among bidders helps delinquent properties owners, because they pay lower rates to redeem their liens than they would at the statutory maximum rate set by the taxing authority, often 18 percent. In more desirable areas and for more desirable properties, interest rates can be bid down as low as 0.25 percent.

However, this approach comes with some pretty significant disadvantages. There are generally several steps between the failure of a property owner to redeem the lien and the actual change of ownership of the property, which is a disadvantage to the investor, who either wants a return on investment via collections or the ability to re-sell a property purchased at a deep discount. It is also a disadvantage to the municipality, which similarly benefits most from the property changing hands; there is some evidence that lien sales in general lead to an increase in the number of "limbo" properties, stuck between redemption and foreclosure.[5] Because it is nearly impossible to vet potential bidders, there is no way for a municipality to screen out investors who merely want to "get rich quick" as the infomercials promise, by making a substantial rate of return on the arbitrage between the cost of the lien and the interest and penalties that accrue to the property owner and then either abandoning the property or flipping it to the next short-term investor. Thus, the municipality loses much control over these properties. There have been many recent news reports as well of collusion among bidders and other illegal and fraudulent activities.[6] It is also a reasonably slow method for disposing of delinquent properties, with a relatively high administrative cost per parcel. Finally, since it is a free-market auction, it is difficult to predict the actual revenue stream from any particular auction.

Nevertheless, Atlanta, Baltimore, and Chicago utilize this method, as do most municipalities in Florida and New Jersey, and all have substantially higher collection rates than Philadelphia.

D. Bulk Tax Lien Sales

Municipalities looking to quickly clear large numbers of liens of varying quality from delinquent property registers often look to the negotiated bulk lien sale. The first and critical step entails the creation of a suitable pool of liens to be sold. For success, the pool must balance the needs of the municipality both for revenue and some control over community development with the needs of investors for a reasonable return on investment. With an initial pool identified, a municipality typically issues Request For

[5] Kim Graziani, "Analysis of Bulk Tax Lien Sale, City of Rochester," Center for Community Progress (available at www.communityprogress.net).

[6] For two recent cases in MD and NJ, see "Baltimore lawyer admits to rigging tax sales," Baltimore Sun, March 4, 2011 (http://articles.baltimoresun.com/2011-03-04/news/bs-md-tax-lien-auctions-20110228_1_tax-liens-property-tax-debts-tax-sales); "Rigged New Jersey tax-lien auctions 'harmed thousands' of homeowners," Newsworks, January 12, 2013 (http://www.newsworks.org/index.php/local//new-jersey/49480-rigged-new-jersey-tax-lien-auctions-harmed-thousands-of-homeowners).

Proposals to attract one or more large-scale investors willing and able to make the bulk purchase. Negotiations will determine the purchase price and other details of the sale, which, ultimately, will depend upon the perceived quality of liens and the likelihood that a sufficient number of them will be redeemed to earn the investors a suitable profit. The municipality will want as close to face value for the liens as possible, along with an agreement to some share of the proceeds beyond full redemption value, and some right to regain control over some liens that don't sell within a specified period. Once the terms are settled, the purchaser or purchasers provide an upfront payment for the lien pool. After the sale, the right to collect on all liens is transferred to the purchaser along with any financial liabilities.

Like an individual lien sale, with a bulk lien sale the structure of incentives changes: the purchaser has an investor-driven incentive to collect past-due taxes or acquire the property through foreclosure, while the property owner has increased motivation to pay in order to avoid loss of property. In every state there is a statutory redemption period within which the property owner must satisfy the lien or risk foreclosure and loss of property to the investor. Unlike an individual lien sale, because the risk pool is diversified and investors will make their returns on the entire pool rather than on an individual property, the investment managers can make more nuanced decisions about which properties to aggressively pursue and which to steer toward foreclosure.

On the plus side of the ledger, the bulk lien sale affords a municipality the opportunity to write off substantial amounts of delinquent tax dollars in a relatively short period of time. By consolidating administrative costs into a single transaction, it is much more cost effective than many other methods reviewed herein. Needless to say, it also provides a quick infusion of revenue for the municipality, with little downside financial risk.

On the other hand, in exchange for these considerable benefits, the municipality loses much if not all control over all the properties sold. It is also rare for a city to receive full face value for the liens from a bulk purchaser. Additionally, even in the most well-structured lien pool, it is likely that some proportion of liens will fail to redeem, particularly those with higher LTVRs, and they risk becoming what some analysts have called "limbo" properties, caught between redemption and foreclosure. A municipality considering a bulk lien sale must carefully analyze and structure its lien pool, perhaps creating several "buckets" or tranches of liens to be sold under different terms. This is because in the final analysis, there is a fundamental misalignment of interests between investors and the municipality: investors care solely for their returns, which may give them incentive to string out redemption and earn profit from the arbitrage; the municipality is interested in both financial returns and in the public policy goal of ensuring that the property is turned over to better, more responsible ownership. While no cities in the study group utilize this method, an analysis of the City of Rochester's bulk lien sale was instrumental in determining the advantages and disadvantages of this method.[7]

E. Tax Deed Sales

Unlike a tax lien sale, where what is sold is the lien and the right to collect with threat of foreclosure, a tax deed sale is the sale of an actual deed to a property due to unpaid taxes. If the sale is in an auction format, the opening bid is generally the amount of taxes due, plus fees or penalties that are owed. Under most states' statutes, the property owner is notified twice of the pending sale: once before it happens, and then once right after the property is sold. After the latter notification, in most states the property owner has a statutory period in which to redeem the property, that is, pay off the debt and avoid eviction, but there is generally a high premium involved to compensate the tax deed purchaser for his or her investment.

Like the tax lien sale, the advantages in this method are inherent in its free-market nature. The most desirable properties are likely to sell and re-enter the private market. It is also a reasonably

[7] Graziani, op cit.

straightforward process for the deed purchaser, since there are fewer steps to taking possession of the property. On the negative side of the ledger, like lien sales, it is nearly impossible to vet potential bidders and thus the municipality runs the risk that purchasers may be interested solely in short-term gain rather than improvement of property. Also, because the right to foreclose must be determined prior to the auction and executed afterwards, it is a relatively cumbersome method and costly on a per-parcel basis. Nevertheless, among our target cities, Los Angeles and Houston both utilize this method with reasonable success.

F. Tax Lien Securitization

In many ways similar to a bulk tax lien sale, in a tax lien securitization, a pool of liens is selected and rated by a rating agency and sold as an asset-backed security to private or public investors. The rating, which will determine the interest rate that investors will earn, is based on a sophisticated analysis of the likelihood of returns due to a combination of redemption and foreclosure in the underlying asset pool. Once the security is appropriately structured, the municipality transfers ownership of the pool to a special purpose investment vehicle called a lien trust. The trust in turn borrows private money from investors to pay the city for the liens at an amount determined in advance and the municipality issues municipal bonds to back the investments. The trust then hires a servicer to collect the delinquent taxes to be used in the repayment of investors. Under the typical securitization deal, after the lenders are compensated in full for their investment, any additional returns will be paid to the municipality.

Like a bulk tax lien sale, securitization affords a municipality the opportunity to clear substantial portions of a delinquent tax register in a relatively short period of time. Needless to say, it also provides a quick infusion of revenue for the municipality, with relatively low downside financial risk, provided that the trust is established in such a way as to shield the municipality from liability and that the underlying lien pool is structured to perform according to investors' expectations.

A well-structured securitization can also pay dividends beyond redemption, as cities like New York have seen. New York has been offering lien-backed securities since the late 1990s. Every year, the city bundles its liens with LTVRs less than 15 percent into a security. For example, in 2004 the city sold $54.7 million worth of liens for $50 million to a trust; the trust sold bonds worth $50 million and the bonds were repaid within 3 years. But even after the bond was repaid, the city continued to collect revenues; because the trust still held delinquent liens and as it collected from debtors, it paid the city a portion of these proceeds. In the end, from a lien pool worth $54.7 million, the city earned $56.5 million. At the same time, the city takes ownership of those liens with LTVRs greater than 15 percent, rehabs the properties, and transfers them to a responsible nonprofit owner, thereby fulfilling other policy goals like preventing abandonment. [8]

While a model in some respects, New York's experience with securitization also highlights many of the potential risks of securitization: it requires a high level of financial and legal sophistication and entails significant upfront costs for underwriting, bond attorneys, and so forth. As Philadelphia learned in its ill-fated securitization experiment of 1997, a municipality considering securitization must take great care in analyzing and structuring its lien pool and in creating the trust that will issue the bonds. Rating agencies will rate bonds based on the quality of the underlying lien pool, and will place liens into tranches or "buckets" based on quality metrics like LTVR, age of the lien, and the absolute value of the underlying property. The municipality must also take great care to establish a trust that shields it from financial liability, such as a Delaware Business Trust.[9]

[8] See Jerilyn Perine et al, "The Invisible Transformation: Turning Debt Into Revenue," Citizen Housing and Planning Council (available at www.chpcny.org).

[9] In 1997, Philadelphia chose to house the trust in a city-related entity, the Philadelphia Authority for Industrial Development. When many liens turned out to be non-performing, the investors sued the trust and ultimately the city was on the hook for $40 million. See "As Predicted, Philadelphia Agency Defaults on $46M of Insured Tax-Lien Debt," Bond Buyer, July 27, 2004; Office of the Controller, City of Philadelphia, "Conducting City Business Through Quasi-Public Agencies," April 2000.

Furthermore, like a bulk lien sale, but even more so in securitization, the municipality surrenders much control over the properties backing the liens. The process is driven by forces well beyond a municipality's control – ratings agencies, institutional investors, and the bond and securities markets – exacerbating the misalignment of interests between investors interested solely in pecuniary gain and a municipality interested in both revenue enhancement and community development. Unlike a negotiated bulk lien sale, this is a market relationship and not a contract between private parties. There is substantial risk in a high-poverty city like Philadelphia that liens will fail to perform and that in the end, many distressed properties will require full foreclosure proceedings to generate returns for investors. These "real estate owned" (REO) properties face a high risk of vacancy. In the worst case scenario, the liens will fail to perform, the trust will be unable to recoup its investment in foreclosure, the bonds will not pay adequate returns, and the municipality will be on the hook to the investors – which is precisely what happened in Philadelphia in the late 1990s.

Nevertheless, the explosion in the asset-backed securities market in general is starting to greatly increase the number of lien securitization initiatives around the country. There are about $15-20 billion in annual property tax delinquencies in the US, of which about $5 billion is sold to investors. The State of Florida alone sells close to $2 billion in liens a year. [10] Many of these are packaged into privately-held bonds sold to hedge funds, providing little in the way of accountability.[11]

G. Land Banking

Strictly speaking, land banking is not a stand-alone lien management strategy. However, land banking can be an important component of a municipality's overall delinquent property management strategy. A land bank is an entity charged with holding land for a municipality to be utilized at a later date. A land bank typically functions as a clearinghouse, so to speak, for properties that no one else wants – those with high LTVRs, low property values, or complex title issues, unlikely to sell at sheriff auction nor desirable to tax lien investors. The land bank's primary function is to clear title so that the property can re-enter the marketplace, often into the hands of an affordable housing developer, a community development corporation, or a local land trust. [12]

In combination with the tax lien management strategies outlined above, land banks can play the vital function of dealing with "limbo" properties that both fail to redeem liens and fail to sell after foreclosure. In some cases, the city will authorize the land bank to sell or lease a property to a community organization, which will in turn convert that piece of otherwise vacant or unused land into something beneficial for the city. In other cases where the market demand for a property is high, the land bank will sell a parcel to an investor or developer and use the subsequent capital to fund other endeavors.

In municipalities with high rates of poverty and delinquency, a land bank provides control over the fate of foreclosed properties and can mitigate the social cost of vacant or abandoned properties. Like other strategies, there are downsides. Once a property is land-banked and title cleared, the municipality generally foregoes the tax revenue that could have been collected. Additionally, running the land bank itself requires a revenue stream both to perform the legal functions as well as to administer property rehabilitation and upkeep. However, the sale or lease of any land bank owned property to a third party would provide additional funds for the city. As the experiences of Boston and Baltimore and many other cities demonstrate, land banks are an important "safety net," in the overall tax delinquency management strategy.

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[10] Dechert LLP, "Tax Lien Securitization: Opportunities and Risks," DechertOnPoint, December 2010, Issue 38.
[11] "Wall Street Sees New Profits in Homeowner Distress," Huffington Post, December 9, 2010.
[12] Act 153, signed by Governor Tom Corbett on October 24, 2012, amended Title 68 of the Pennsylvania Code to allow for the creation of land banks in Pennsylvania. Legislation to create a Philadelphia Land Bank is currently under consideration in the Philadelphia City Council, Bill 130156.

A. Assessing Lien Quality

Many municipal governments sell tax liens to private entities, in either an individual auction or a negotiated bulk sale. In a growing number of instances, municipalities have created asset-backed securities. From an investor's point of view, measures of lien quality boil down to this: How likely is it that a particular lien or set of liens will be redeemed, that is, will pay off the delinquent tax burden plus interest and penalties, without going through the expensive and time-consuming foreclosure process. In the past two decades since the maturation of the asset-backed securities market, investors, rating agencies, and issuers have become more sophisticated in evaluating lien quality, and have developed a variety of metrics for doing so. We employed several common metrics below based on 2012 data.

Lien-to-Value Ratio[13]

The success of any tax lien sale, from both a financial and a public policy standpoint, requires a nuanced understanding of the nature of the potential assets, most commonly measured as the ratio of the outstanding tax debt (the lien) to the assessed value of the subject property, or LTVR. Investors recoup their investment in the liens they purchase via the arbitrage between the price they pay and the interest and penalties they are able to collect from the owners of the delinquent properties. All else being equal, the lower the LTVR, the more likely the property owner – or their mortgage company – will pay to avoid foreclosure. Table A.1 below tabulates Philadelphia's residential and multifamily liens by LTVR, while Table A.2 does the same for commercial liens, which are evaluated by a somewhat different set of criteria.[14]

By the simple measure of LTVR there are over 49,000 residential liens with LTVRs below 20 percent, representing about $4 billion in Market Value (MV) and about $133 million in delinquent taxes. There are about 5,000 multifamily liens at below 20 percent LTVR representing $840 million in Market Value and about $24 million in delinquent taxes. There are roughly 1,500 commercial liens with an LTVR below 15 percent representing a Market Value of $1.5 billion and $19.1 million in delinquent taxes. These three sets of liens represent about $271 million in delinquent taxes. Mixed-Use, Industrial, and Land liens not currently in payment plans with LTVRs lower than 15 percent constitute an additional $29.3 million, for a total potentially marketable pool of about $205 million.

Table A.1: Lien-To-Value Ratios, Residential and Multi-family Properties†

(Dollar amounts in millions)

LTVR	Residential	Total MV14	Delinquent Tax	Multifamily	Total MV14	Delinquent Tax
<=10%	42,895	$3,669.9	$86.1	3,852	$667.6	$14.7
10-20%	6,326	$330.9	$46.6	403	$36.0	$5.0
20-35%	4,066	$182.9	$48.2	210	$13.5	$3.6
35-50%	1,776	$63.7	$26.2	87	$5.6	$2.3
50-65%	914	$25.8	$14.5	41	$2.0	$1.1
>65%	870	$19.5	$16.6	57	$2.3	$2.4
TOTALS	56,847	$4,292.7	$238.2	4,650	$727.0	$29.1

†Excludes properties with payment plans.

[13] Calculating LTVRs in Philadelphia at present is tricky, since the city has recently undergone a major, market-wide reassessment called the Actual Value Initiative (AVI) that has seen the aggregate value of taxable property increase by nearly 150% between the 2013 certified assessments and those for 2014. The assessed values for the vast majority of the delinquent properties have gone up due to the reassessment; for example, of 66,107 delinquent residential properties, assessments have risen for 65,746 (99.5%); 56,588 properties have seen rises of 50% or more in assessed value. For the purposes of this study, we utilize the LTVRs based on the 2014 AVI assessments.

[14] We have also filtered out all delinquent properties for which there is a payment arrangement since, presumably, these would not be included in a lien offering.

Table A.2: Lien-To-Value Ratios, Non-Residential Properties†

(Dollar amounts in millions)

LTVR	Mixed-Use	Delinquent Tax	Commercial	Delinquent Tax	Industrial	DQ Tax	Land	Delinquent Tax
<=5%	2,194	$6.0	1,205	$11.4	466	$4.0	3,174	$2.5
5-15%	595	$5.8	294	$7.7	211	$4.1	2,636	$6.9
15-25%	161	$2.5	60	$3.5	72	$4.3	1,741	$18.4
25-50%	127	$3.0	57	$16.0	56	$2.8	3,345	$13.7
50-65%	13	$0.3	13	$3.9	16	$1.1	1,214	$8.0
>65%	18	$0.5	23	$4.7	47	$6.1	8,072	$73.0
TOTALS	3,108	$18.1	1,652	$47.2	868	$22.4	20,182	$122.5

†Excludes properties with payment plans.

Delinquency Vintage

Another factor in assessing lien quality is the age or "vintage" of the liens, in other words, how long has a particular property been tax delinquent. Of the 66,000 delinquent residential properties currently on the books, about 31,000 (47 percent) are 3 years delinquent or less, and nearly 39,000 (59 percent) are less than 5 years delinquent. Table A.3 below tabulates the age of delinquency for four classes of property liens. It demonstrates quite dramatically the long-term nature of Philadelphia's delinquency problem.

Table A.3: Liens by Age†

(Dollar amounts in millions)

Lien Age	Residential	Delinquent Tax	Multifamily	DQ Tax	Commercial	Delinquent Tax	Land	Delinquent Tax
<=3 years	31,173	$41.4	2,843	$8.4	1,114	$9.7	3,944	$4.4
3-5 years	7,639	$27.5	668	$4.2	215	$4.8	1,346	$3.2
5-8 years	5,681	$30.8	429	$3.8	133	$2.7	1,648	$14.8
>8 years	12,354	$138.6	710	$12.7	191	$30.0	13,239	$100.1
TOTALS	56,847	$238.3	4,650	$29.1	1,653	$47.2	20,177	$122.5

†Excludes properties with payment plans.

Assessing Lien Quality Using Rating Agency Criteria

In December 2009, the major rating agency Standard and Poor's (S&P) revised its criteria for rating liens that would form a lien pool for the purposes of securitization. S&P established 6 "buckets" for analyzing any particular lien pool. The S&P standards combine lien age with LTVR. We have applied their method to Philadelphia's actual lien pool in the tables A.4 through A.8 below. Since a security issue must withstand the scrutiny of the Securities and Exchange Commission as well as rating agencies and the institutional investors that are the primary purchasers of asset-backed securities, these tables represent the most rigorous assessment of Philadelphia's current residential lien pool. In sum, buckets 1 and 2 represent about $54.5 million in delinquent tax receivables in the Residential property category that would likely pass muster in a tax lien securitization, along with $11.3 million in Multi-Family, $11.7 million in Commercial, $5.9 million in Mixed-Use, and $2.5 million in Land, for a total of about $139 million.

Table A.4: Tax Lien "Buckets" for Single-Family Residential Properties†

(Dollar amounts in millions except for lien balance)

Bucket	Age of Lien	LTVR	Lien Balance	# Liens	Total MV14	Delinquent Tax
1	<=36 months	<=10%	>$1,500	9,391	$1,090.2	$28.5
2	36-60 months	<=20%	>$1,500	6,259	$465.4	$26.0
3	60-96 months	<=35%	>$750	5,584	$342.6	$30.5
4	>96 months	>35%	N/A	3,526	$108.5	$57.0
5	N/A	>50%	N/A	1,784	$45.3	$31.1
6	N/A	>65%	N/A	870	$19.5	$16.6

†Excludes properties with payment plans.

Table A.5: Tax Lien "Buckets" for Multi-Family Properties†

(Dollar amounts in millions except for lien balance)

Bucket	Age of Lien	LTVR	Lien Balance	# Liens	Total MV14	Delinquent Tax
1	<=36 months	<=10%	>$1,500	1,334	$308.4	$7.3
2	36-60 months	<=20%	>$1,500	596	$79.4	$4.0
3	60-96 months	<=35%	>$750	421	$49.2	$3.8
4	>96 months	>35%	N/A	170	$9.4	$5.4
5	N/A	>50%	N/A	96	$4.3	$3.5
6	N/A	>65%	N/A	56	$2.3	$2.4

†Excludes properties with payment plans.

Table A.6: Tax Lien "Buckets" for Commercial Properties†

(Dollar amounts in millions except for lien balance)

Bucket	Age of Lien	LTVR	Lien Balance	# Liens	Total MV14	Delinquent Tax
1	<=36 months	<=5%	>$1,500	570	$689.8	$7.4
2	36-60 months	<=15%	>$1,500	185	$97.2	$4.3
3	60-96 months	<=25%	>$750	120	$41.1	$2.2
4	>96 months	>25%	N/A	76	$58.5	$24.0
5	N/A	>50%	N/A	36	$10.9	$8.6
6	N/A	>65%	N/A	23	$4.0	$4.7

†Excludes properties with payment plans.

Table A.7: Tax Lien "Buckets" for Mixed-Use Properties†

(Dollar amounts in millions except for lien balance)

Bucket	Age of Lien	LTVR	Lien Balance	# Liens	Total MV14	Delinquent Tax
1	<=36 months	<=5%	>$1,500	775	$170.3	$3.1
2	36-60 months	<=15%	>$1,500	442	$64.8	$2.8
3	60-96 months	<=25%	>$750	301	$40.4	$2.4
4	>96 months	>25%	N/A	137	$9.2	$3.4
5	N/A	>50%	N/A	29	$1.1	$0.7
6	N/A	>65%	N/A	17	$0.5	$0.4

†Excludes properties with payment plans.

Table A.8: Tax Lien "Buckets" for Land†

(Dollar amounts in millions except for lien balance)

Bucket	Age of Lien	LTVR	Lien Balance	# Liens	Total MV14	Delinquent Tax
1	<=36 months	<=5%	>$1,500	102	$93.9	$1.2
2	36-60 months	<=15%	>$1,500	174	$23.1	$1.3
3	60-96 months	<=25%	>$750	640	$62.2	$12.6
4	>96 months	>25%	N/A	11,298	$87.3	$86.6
5	N/A	>50%	N/A	9,281	$57.5	$81.0
6	N/A	>65%	N/A	8,072	$43.3	$73.0

†Excludes properties with payment plans.

B. Investor-Owned Properties

Critics of tax lien sales argue that there are significant public policy downsides to privatizing property tax collection by selling tax liens. Among the most politically salient of these arguments is that vulnerable homeowners will lose the protection of the government against the loss of their single most important asset, their home, and that higher rates of foreclosure and abandonment are the natural result of the process of toughening enforcement, particularly in a poor city like Philadelphia. Though many studies have shown that foreclosure rates don't increase dramatically with the privatization of collections, many serious scholars have shown that higher rates of abandonment do, in fact, occur in the wake of tax lien sales. They warn municipalities, particularly those like Philadelphia with both high rates of homeownership and poverty, to proceed with extreme caution.[15]

From both a political and policy standpoint, it might make sense to narrow the universe of targeted delinquent properties to those that are investor-owned. According to an estimate by City Council's Technical Staff, about 35,000 properties on the delinquent tax roll are owned by investors, which they define as owners with multiple holdings and off-site mailing addresses. As depicted in Table B.1, the vast bulk of these are residential properties.

Applying the same analyses to this subset as we have to the larger pool, we find that the investor-owned delinquencies represent about $159 million in delinquent taxes; while there are about 19,000 residential liens that are 5 years or younger, representing $35.2 million in arrears, more than half of the liens are older than 8 years, as shown in Table B.1 below. About 16,000 investor-owned liens, representing $27.4 million in delinquent taxes, have LTVRs of 20 percent or lower, as shown in Table B.2. About 462 investors owe $50.4 million, representing one-third of the total.

[15] For an example of scholarship that generally favors tax lien sales, see Georgette Poindexter et al, "Selling Municipal Property Tax Receivables: Economics, Privatization, and Public Policy in an Era of Urban Distress," *30 Conn L. Rev 157 1997-1998*. For scholarship that is critical of tax lien sales, see Frank Alexander, "Tax Liens, Tax Sales and Due Process," *Indiana Law Journal Vol 75:747 2000;* Michelle Marchiony, "Making Debt Pay: Examining the use of Property Tax Delinquency as a Revenue Source," *Emory Law Journal 62: 217 2012*.

Table B.1: Investor-Owned Properties by Lien Age†

(Dollar amounts in millions)

Lien Age	Residential	Delinquent Tax	Commercial	Delinquent Tax
<=3 years	15,607	$22.10	2,050	$12.1
3-5 years	3,719	$13.10	459	$4.6
5-8 years	2,501	$12.50	277	$3.7
>8 years	9,463	$76.50	623	$13.8
TOTALS	31,290	$124.20	3,409	$34.2

†Excludes properties with payment plans.

Table B.2: Investor-Owned Properties by LTVR†

(Dollar amounts in millions)

LTVR	Residential	Total MV14	Delinquent Tax	LTVR	Commercial	Total MV14	Delinquent Tax
<=10%	11,611	$342.5	$13.6	<=5%	957	$151.0	$3.4
10-20%	4,450	$94.6	$13.8	5-15%	893	$84.0	$7.4
20-35%	4,201	$42.7	$11.2	15-25%	326	$22.7	$4.3
35-50%	1,448	$19.8	$8.3	25-50%	324	$13.1	$4.4
50-65%	1,240	$13.5	$7.8	50-65%	107	$2.6	$1.5
>65%	7,001	$42.9	$57.9	>65%	408	$8.0	$10.2
TOTALS	29,951	$556.0	$112.6	TOTALS	3015	$281.4	$31.2

†Excludes properties with payment plans.

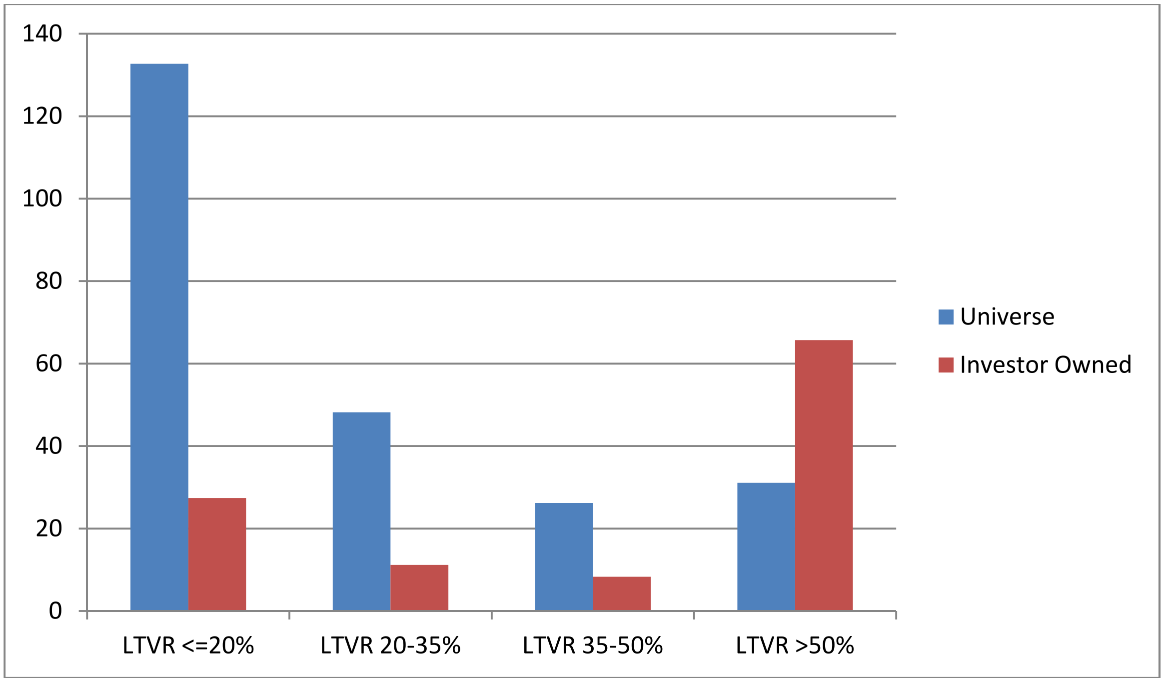
Table B.3. Investor-Owned Residential Liens Rated by S&P Criteria†

(Dollar amounts in millions)

Bucket	Age of Lien	LTVR	Lien Balance	# Liens	Total MV14	Delinquent Tax
1	<=36 months	<=10%	>$1,500	2,747	$142.40	$8.50
2	36-60 months	<=20%	>$1,500	1,804	$49.00	$7.50
3	60-96 months	<=35%	>$750	1,468	$31.50	$8.00
4	>96 months	>35%	N/A	7,825	$63.00	$60.00
5	N/A	>50%	N/A	7,032	$50.00	$54.30
6	N/A	>65%	N/A	5,880	$37.10	$46.90

†Excludes properties with payment plans.

Figure B.4: Lien-To-Value Ratios, Individual vs Investor-Owned Residential Liens (Dollar values in millions)



As the tables and charts above demonstrate, Philadelphia's lien pool is highly variable by all measures of quality. While there are significant numbers of liens with low LTVR, the vast bulk of these are liens against residential property as shown in Table C.1 below.

Table C.1: "Top Tier" Liens by Property Type
(Amounts in millions)

Property Type	LTVR	DQ Tax	%Total
Residential	<=20%	$132.7	45.90%
Commercial	<=15%	$19.1	29.50%
Multi-Family	<=20%	$23.6	67.80%
Mixed Use	<=15%	$11.9	56.40%
Industrial	<=15%	$8.1	32.80%
Land	<=15%	$9.40	7.50%
TOTAL		**$204.8**	**36.60%**

The vast bulk of Philadelphia's residential liens are held against individual property owners, presenting a difficult political choice: go after the "safe" $27.4 million in liens against investor-owned residential properties and take $105 million off the table, or risk major social cost and political blowback by tackling the entire pool. In any case, because there are also many liens of reasonable quality in the non-residential property categories, there seems to be significant potential for both short-term revenue enhancement as well as a transformative policy change that could shift the culture of property tax non-payment into one of compliance.

That said, the variability of the lien pool as well as Philadelphia's distinction as a city with a massive vacant and abandoned property problem also suggests that policymakers ought to avoid both individual tax lien auctions and tax lien securitization. In both cases, there can be a serious misalignment between the profit motivations of individual or institutional investors and the public policy goals of the city, with real danger of exacerbating an already dire abandoned and blighted-property problem. The city's lien pool is highly variable by all measures of quality.[16]

While there are significant numbers of liens with low LTVRs, the vast bulk of these are liens against residential property. If Philadelphia decided to pursue some type of lien auction or sale and include all "top-tier" liens in all property categories, the upper bound of what it might expect to raise is $205 million – not an inconsiderable sum, but less than 40 percent of total property tax arrears. If it were to pursue securitization, the upper bound would probably be $139 million or so, exclusive of start-up costs.

[16] Lien quality is also highly variable geographically. We would expect that areas with a lien quality score below 0.4 would be the most desirable from the point of view of lien investors, those between 0.4 and 1.5 would be moderately desirable, and those above 1.5 less desirable. Of Philadelphia's 47 zip codes, 21 have lien quality scores below 0.4 and 14 are between 0.4 and 1.5.

CONTROLLER'S OFFICE CONTACT AND STAFF ACKNOWLEDGEMENTS

City Controller's Office Contact	Harvey Rice, First Deputy City Controller, (215) 686-6696, harvey.rice@phila.gov
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