

LENDER RETAINS FULL PRINCIPAL RESIDENCE EXEMPTION ON FORECLOSED PROPERTIES

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Senate Bill 81 (reported from House Committee as S-1)

Sponsor: Sen. Jack Brandenburg

House Committee: Tax Policy

Senate Committee: Finance

Analysis available at
<http://www.legislature.mi.gov>

Complete to 7-28-15

BRIEF SUMMARY: Under Senate Bill 81, a lending institution that owns foreclosed properties would no longer have to pay the equivalent of the local school operating millage in order to retain the existing principal residence exemption (PRE) on the properties. The bill would take effect 90 days after being enacted.

Currently under Section 7cc of the General Property Tax, a lending institution can maintain the principal residence exemption (PRE) on a home it owns through foreclosure but, even so, it must pay the equivalent of the local school operating millage (typically 18 mills) into the state's School Aid Fund. This means that although the exemption remains attached to the property to pass along seamlessly to an eligible purchaser, the lending institution must pay school taxes as if the exemption were not in place. Under the bill, the lending institution could retain the PRE and pay at the PRE-based tax rate.

FISCAL IMPACT: As written, the bill could reduce School Aid Fund (SAF) revenue by \$15-25 million annually. This estimate is based on statewide averages; the exact amount of the reduction will depend on the specific characteristics of the foreclosed properties, which cannot be known in advance.

Although local tax collecting units collect the school operating millage equivalent at the same time and in the same manner as regular property taxes, the language under PA 114 of 2012 directs these revenues to the Department of Treasury for deposit in the SAF. This is why the primary fiscal impact of this bill falls on the SAF, rather than on local units.

Losses to local units would primarily come from a reduction in the administrative fee they were previously allowed to collect and retain on these equivalent payments. This would amount to slightly less than 1% of the total impact of the bill, likely between \$100,000 and \$200,000 total for all local units. Local units could also see their school funding decrease if the losses to the SAF resulted in changes to the per-pupil funding guarantee.

THE APPARENT PROBLEM:

The principal residence exemption, or PRE, gives owner-occupied properties an exemption against the 18-mill local school operating millage. The owner must file for this exemption, must live in that residence, and the exempt parcel must not be used for commercial

purposes. If a home ceases to meet the requirements, the PRE is rescinded and the property becomes subject to local school operating taxes.

In response to the increase in foreclosures due to the Great Recession, the Legislature enacted Public Act 114 of 2012. The intent of the legislation was to allow a foreclosing entity, such as a bank or credit union, to retain the PRE on foreclosed residences that had previously qualified for the exemption, while allowing the schools to receive from financial institutions the same amount of property tax that would be due if the property did not have a PRE. The idea was that allowing the PRE attached to a foreclosed-upon home would streamline the process of selling the property to a new qualifying homeowner, thus potentially reducing the number of vacant homes.

However, since there is no financial incentive, some foreclosing entities have opted not to retain the PRE, citing administrative burdens, and instead have been allowing the exemption to lapse. This, according to financial institutions and realtors, has made it more difficult to find qualified borrowers, as the anticipated taxes on loan documents reflect the non-homestead tax rate, rather than the rate with a PRE. Under Senate Bill 81, foreclosing entities would no longer have to pay the higher tax rate; instead, they could keep the PRE and also to pay taxes at the PRE rate. The aim is to remove the current disincentives that prevent a simple, seamless passing-on of a PRE to a new qualified homeowner.

THE CONTENT OF THE BILL:

Under Senate Bill 81, a lending institution that owns foreclosed properties would no longer have to pay the equivalent of the local school operating millage in order to retain the existing principal residence exemption (PRE) on the properties. The bill would take effect 90 days after being enacted.

The current language was added to Section 7cc by Public Act 114 of 2012. Under the language added by that act, in addition to paying the equivalent of the school operating millage, the lending/ foreclosing entity must also abide by all of the following conditions in order to retain the principal residence exemption:

- (1) The property is not occupied, other than by the person who claimed the exemption prior to the foreclosure or forfeiture.
- (2) The property is for sale.
- (3) The property is not leased to anyone other than the person who claimed the exemption prior to the foreclosure or forfeiture.
- (4) The property is not used for any business or commercial purpose.

Senate Bill 81 would retain these four conditions as the only requirements the lending/foreclosing entity must meet in order to retain the principal residence exemption. The foreclosing entity must file a "conditional rescission form" to retain the principal residence exemption and must annually verify that the four conditions still apply.

Under Section 44 of the General Property Tax Act, local units can assess and retain a maximum of 1% of the total property tax bill as an administrative fee. This fee will be reduced when the 18-mill equivalent is no longer part of the lending/foreclosing entity's tax bill. Finally, this bill would reduce the amount of time the lending/foreclosing entity can retain the PRE from three years under current law, down to two years.

HOUSE COMMITTEE ACTION:

Senate Bill 81, Substitute S-1, was reported from the House Tax Policy Committee without amendment.

ARGUMENTS:

For:

The state should be doing whatever it can to encourage the sale of foreclosed-upon homes. Getting such homes back into the hands of homeowners is good for neighborhoods and communities, as well as for the lending institutions who have become their owners. The small amount of revenue that is theoretically being foregone under the bill would never have been collected in the first place without the tragedy of foreclosure. Additionally, say financial institutions and real estate professionals, the inflated amount of taxes being paid on the home under current law reduces the size of the pool of eligible purchasers, since apparently purchasers must be able to afford the current level of taxes to qualify for a mortgage. Also, some potential purchasers could be discouraged if they do not understand that taxes will be lower once they have purchased the home and begun paying at the proper PRE rate. Foreclosing entities, according to testimony, are choosing not to go through the administrative hassle of keeping the PRE; allowing them to pay property taxes at the lower PRE-based rate would provide additional incentive. Lending institutions want to be rid of these residential properties; then they would have no associated property tax burden at all, and would be free of the other burdens associated with maintaining such properties. To keep the PRE, banks and credit unions must meet strict criteria, some of which prevent them from earning income on the properties; thus the PRE-based property tax rate is appropriate. Further, the bill reduces from three years to two years the length of time a financial institution can maintain a PRE on a foreclosed-upon home, which minimizes the revenue loss to the schools.

Against:

This bill essentially gives a tax break to financial institutions; eliminates funding that should properly go to schools; and is contrary to the whole idea of a principal residence exemption, which is intended to provide tax advantages to those living in owner-occupied homes, and not to properties owned by commercial entities. The aim of the current law was to help with the process of getting foreclosed-upon homes back into the hands of homeowners by allowing the PRE to pass automatically to qualifying new owners without further administrative fuss (filing a new PRE affidavit). It does not seem overly burdensome for relatively sophisticated foreclosing entities to meet the requirements of current law

POSITIONS:

A representative of the Michigan Realtors testified in support of SB 81. (3-18-15)

Representatives of the Michigan Credit Union League testified in support of the bill.
(3-18-15)

The Michigan Bankers Association indicated support. (3-18-15)

Michigan Department of Treasury testified in opposition to SB 81. (3-18-15)

A representative of the American Federation of Teachers Michigan testified in opposition.
(3-18-15)

Others indicating opposition were: the Michigan Association of School Boards, the Middle Cities Education Association, the Michigan Association of School Principals, and the Wayne Regional Educational Service Agency. (3-18-15)

Legislative/ Fiscal Analyst: Adam Desrosiers

■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.