PROPERTY TAX DEFERRAL: Why New Jersey should succeed where other states have faltered

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1. EXECUTIVE SUMMARY

NEW JERSEY SHOULD LEARN FROM THE MISTAKES of other states in setting up a property tax deferral program. If New Jersey implements the program a little differently, it would be a great boon to homeowners, at *zero cost* to the state, municipalities, and taxpayers.

The subtle but crucial differences are:

- New Jersey's program should be *self-supporting*, not subsidized.
- New Jersey should act as *bundler*, not borrower.

Surprisingly, these two features also reduce the tax deferral costs to homeowners.

A SUCCESSFUL PROPERTY TAX DEFERRAL PROGRAM has many benefits, including:

- making property tax more *progressive*, rather than regressive;
- giving homeowners some of their cash now, rather than making them wait until they sell their home;
- letting property taxpayers know that the state is doing something to help them.

2. INTRODUCTION: WHY DEFER PROPERTY TAX?

WHY IS PROPERTY TAX SUCH AN IMPORTANT ISSUE IN NEW JERSEY?

Some New Jersey homeowners can't keep up with property tax increases. A complaint is that property taxes are *regressive*: not tied to the ability to pay. This problem especially hurts fixed-income senior homeowners.

WHAT IS PROPERTY TAX DEFERRAL?

For years, New Jersey legislators have been discussing the concept of property tax deferral as a partial solution. Under a deferral program, eligible homeowners are allowed to delay paying part of their property tax each year until they sell their house, at which time the deferred taxes are repaid from the sale proceeds.

Twenty-five states, including Connecticut, Maryland, and Pennsylvania, have property tax deferral programs. Typically they let seniors defer paying their annual property tax increase, treating it as a secured, low-interest loan. Usually the state makes up the deferred revenue to municipalities, via a revolving fund.

WHAT ARE THE BENEFITS OF TAX DEFERRAL?

Property tax deferral helps senior homeowners by freeing up some of their cash now, rather than making them wait until they sell their home.

Deferral reduces the *regressiveness* of property taxation: it draws payment directly and proportionally from property wealth, rather than from income. Although deferral itself doesn't reduce tax, a state can combine it with tax reduction programs, like New Jersey's Senior Tax Freeze.

WHAT ARE THE COSTS OF TAX DEFERRAL?

Existing property tax deferral programs have been *subsidized*. That is, they carry costs which the state pays from other tax revenue. The costs to the state include the gap (if any) between interest received from homeowners and interest paid to state bondholders, and administration of the deferral program.

Most states with a tax deferral program reimburse municipalities for any deferred tax revenue. In a few states, the cost of deferral is borne by the municipalities rather than the state.

3. WHAT PROBLEMS HAVE TAX DEFERRAL PROGRAMS HAD?

SUBSIDIZED PROPERTY TAX DEFERRAL PROGRAMS have had mixed popularity in some states. Participation is low for several reasons:

- *Actual cost.* Subsidized programs for property tax deferral actually do cost the taxpayers money – and become a target for budget cuts after initial fervor fades.
- *Restricted eligibility.* Because subsidized programs for property tax deferral cost money, legislators restrict eligibility, to keep the programs from getting too big. In some states, the maximum income limit is so low that only a few dozen people each year qualify for the program.
- *Unfavorable risk pool.* By restricting eligibility to low-income residents, such programs become viewed in the bond market as carrying higher risk. This in turn affects the bond credit rating for the programs and effectively increases the costs to the state and to the tax-deferring homeowners.
- *Perception of personal finance risk.* Some homeowners are averse to leveraging their home equity and perceive deferral as risky.
- *Public awareness.* Subsidized property tax deferral programs are usually small and sometimes inadequately publicized. They fail to gain public awareness, confidence, and popularity.
- *Tax avoidance.* Some homeowners seek tax reduction, rather than deferral. They want to maximize the residential property wealth to their heirs, rather than pay property tax.

Concerns about these same issues have hindered approval of a property tax deferral program in New Jersey.

4. WHAT CAN NEW JERSEY DO DIFFERENTLY?

THERE ARE SURPRISING BENEFITS to making a property tax deferral program **un**subsidized, or *self-supporting*. In a self-supporting program, the costs are borne *not* by the state, but by the homeowners who defer tax, via deferred interest. This would solve problems experienced by some other states' programs:

- Because a self-supporting program costs the state and municipalities nothing, it would not be an annual target for budget cuts. The program is thus stable and reliable.
- When there is no drain on the state budget, legislators have no reason to restrict eligibility. More homeowners can choose to participate, and the program can benefit from economies of scale.

- More participation means that deferrals from higher-income homeowners can be bundled with those from lower-income homeowners. This reduces overall risk to bondholders, who in turn reduce the program's interest rates. These **lower costs** pass to the tax-deferring homeowners, making the program more attractive to them.
- Finally, greater usage increases public awareness and improves public perception of the program.

New Jersey should offer a *self-supporting* property tax deferral program. In other words, New Jersey's program should not be subsidized by a budget appropriation from taxes.

NEW JERSEY SHOULD ACT AS BUNDLER, not borrower. That is, the state should package ("securitize") the deferrals of all homeowners together as a unit. Shares in the unit are sold to the bond market. The transactions are formally between the homeowners and the bond purchasers, *without* making the state an owning intermediary.

For its administrative service as bundling agent, the state would add a small fee into the package, to be repaid as part of the bond, from the proceeds of sale when each homeowner eventually sells the home.

In this manner, the state would not have to borrow money to cover the deferrals. The property tax deferral program would have no impact on the state's own bond credit rating.

(The concept of bundling or packaging real-estate-backed securities has already been used by some municipal governments in New Jersey, for a different purpose – to clear their backlog of tax delinquencies.)

5. SELF-SUPPORTING TAX DEFERRAL HELPS HOMEOWNERS

Property-tax deferral in a self-supporting program is fundamentally a **loan** to the homeowner, secured in the amount of the deferral plus interest. New Jersey should offer it, rather than letting homeowners rely on similar instruments like **reverse mortgages**, for several reasons:

- *Uniform, simple, and convenient.* Terms are prescribed uniformly in law, rather than by lengthy contract. Application is one page, arriving with annual property tax bill.
- *Wide eligibility.* No minimum or maximum income. No minimum deferral amount. Homeowner may prepay at any time to reduce the lien.
- *Favorable terms.* Costs are low because of simplicity and uniformity of terms. Interest rate is low because risk is pooled across all deferral accounts. Expanding the eligibility lets participants take advantage of the credit power of a larger, less risky pool.
- *Trust.* The deferral is backed by the state. No need to worry about unscrupulous terms. No extra fees.
- *No surprises.* The interest rate on each year's deferral cannot change during the deferral lifetime. The deferral lien cannot be called early.
- *Risk-free.* If the homeowner defaults on any liens and loses the home, the property tax deferral lien does not increase the debt beyond the home itself.
- *Ready help.* Homeowners can feel reassured that this extra source of help is available when needed, even if they don't use it right away.
- *Positive community.* Property taxpayers can know that the state is doing something to help them.
- *End regressivity.* Deferral makes property taxation more progressive, because it lets homeowners afford the tax in proportion to their home wealth.

A self-supporting property tax deferral program will help New Jersey seniors choose to stay in their homes, at no cost to the State, its taxpayers, or municipalities.

6. POTENTIAL PITFALL OF PROPERTY TAX DEFERRAL

THE GREATEST DANGER of a self-supporting property tax deferral program is that it might work too well. Some seniors might feel encouraged to stay in a home that they can no longer genuinely afford. Instead of downsizing to a smaller home, they might keep their property but then end up with less cash when they do sell.

To avoid this problem, New Jersey should provide several types of help, including:

- financial counseling, including a worksheet to help each homeowner assess his/her own situation and to guide decision making;
- promotions or incentives for downsizing, to encourage homeowners to stay within their community while moving to a home that is better-matched to their needs;
- keeping eligibility for tax deferral on the homeowner's new, downsized home, not just on the former home.

7. CONCLUSIONS: NO DOWNSIDE

A self-supporting property tax deferral program has the power to overturn conventional thinking on New Jersey's system of taxation. It aligns tax affordability with property wealth, rather than income wealth.

Deferral helps solve the liquidity problem for cash-poor senior homeowners, by letting them apply part of their property wealth directly to property tax, at a favorable interest rate.

Nothing about tax deferral prevents it from being combined with tax reduction; they are two independent concepts. For that reason, there is no harm – only benefit – to taxpayers and to the state, from implementing a tax deferral program.

A self-supporting property tax deferral program is a way for New Jersey to help many of its residents. It lets homeowners deploy their property wealth to reduce their cash outflow – at zero cost to the state, municipalities, and taxpayers.

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I'm deeply grateful for the time, interest, and honest criticism from those who read the drafts. Their input led to a vastly improved document. Responsibility for the content, and especially for errors, is mine alone.

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- We value and appreciate the positive aspects of New Jersey.
- We appreciate good value in NJ state and municipal government.
- We support positive values of integrity, success, and improvement in our schools, towns, and state.

APPENDIX A: Implementation details for self-supporting program

HOW WOULD NEW JERSEY START a self-supporting property tax deferral program? No initial endowment is necessary. The state sets up a self-sustaining account. Deposits into the account are made by lenders who purchase bonds secured by batches of the deferral liens.

The lenders assume the risk via the bond market, and annually set the next year's interest rate for property owners on additional tax deferrals during the year.

Withdrawals are made by municipalities to cover their deferred revenues. Sellers deposit the tax repayment when a property is sold, plus interest at the agreed rates, and the bondholders are repaid.

THE STATE ESTABLISHES ELIGIBILITY CRITERIA for property tax deferral. Most states make seniors and people with disabilities eligible. Some states allow residents of any age to defer tax. Since the program costs the state nothing, there is no strong reason to restrict eligibility; optionally the program can be a benefit for all taxpayers.

THE STATE ALSO ESTABLISHES IN LAW the details of the program. Appendix B lists how other states do it. New Jersey has an opportunity to assemble an even better program by choosing options (Appendix C) to make the program as useful and helpful as possible. The implementation statute should specify standard features:

- lien on property for deferred amount;
- automatic transfer to surviving spouse;
- mortgages in New Jersey may not prohibit tax deferral;
- payable on death, sale, or move (except medical or nursing care facility);
- property must be owner's principal residence;
- homeowner must have at least 20% equity, based on assessed value;
- must keep replacement coverage insurance; must not be delinquent on property taxes.

The taxpayer's deferral form (Appendix D) is simple because it references the law, eliminating long contracts.

The statute should also specify the bond financing mechanism. The interest rate is based on the public bond market, using terms that parallel the deferral features. The program office purchases options to lock-in bond terms during the signup period:

- fixed interest rate; prepayment allowed;
- bond can be extended for homeowner's lifetime;
- secured by a bundle of deferral loans;
- subject to standard tax-default collection procedures but not beyond the property sale price;
- bondholder cannot call lien note early;
- each deferral lien is subordinate to prior liens.

The program exercises the options to sell bonds, totaling the amount of the deferrals. The program office adds the cost of the options, plus the office's own operating expenses, into the deferral interest rate.

THE STATE ESTABLISHES AN OFFICE to handle the administrative details. To pass the administrative costs to the property owners, the state can add a small fractional percentage (0.1–0.2%) to the deferral interest rate.

THE STATE ESTABLISHES ONGOING PUBLICITY CHANNELS for the program. A reminder printed on annual property tax bills would hit the right people at the right time.

APPENDIX B. Existing property tax deferral programs

PROPERTY TAX DEFERRAL – FEATURES COMMON TO MOST OR ALL STATES: State may bond or pay from revolving general fund. Annual statement. Permanent or annual renewal. Lien on property for deferred amount. Mortgage may not prohibit tax deferral. Owner must occupy property as principal residence. Payable on death, sale, move of principal residence (except medical or nursing care facility), move property out of state. Continue by surviving spouse. Require insurance. Maximum eligible value or acreage. No delinquent property taxes. Can prepay into account. Lien recording fee can be deferred.

state	max $ income	interest rate	eligibility / age	residency	governed by	equity $ required	max $ deferral	lien priority
AZ	10,000		70. Property value must <$150,000.	6 years, or in state 10 years	state	10%		
CA	24,000	4%	62 or disabled. May reborrow/transfer on move within state.	1 year	state	20%	All property tax on homestead.	Subordinate
CO	0 earned		65 Municipality may permit taxpayer to work off liability.			0%	All property tax on homestead.	Superior. Other lien holders must agree.
CT	36,000		65 or disabled. Property value must <$715,000. Must apply for state-reimbursed prop tax relief prog.	1 year	municipality		50% of property tax up to $2,500	
DC	50,000	8%	Any - may defer property tax >110% of prev year. 65 - may defer all property tax.	1 year			25% of assessed value	
FL			Any - may defer property tax exceeding 5% of income. Senior - may defer property tax exceeding 3% of income.					
GA	15,000		62			15%	Tax on first $50,000 of prop value, or tax >4% of income	
ID	28,000	6%	Any resident is eligible. 65 or widow(er) or blind or fatherless/motherless minor or disabled or former POW/hostage or vet with 10% service-related disability or receiving VA pension.				$1,320	
IL	50,000		65	3 years		20%	All property tax on homestead.	
MA	20-40,000 set by municipality	Max 8%. After death or sale, 16%.	65	10 years in state	municipality		50% of property value	
MD	60,000-120,000	0% typical	any	5 years	county		Increase in tax over previous year (except resulting from substantial improvement). Max 50% of property value.	Superior. County notifies mortgage holder.
ME	32,000	6%	65		state			Superior.
MI	10,000		62				Special assessments exceeding $300	
MN	60,000	5%	65 Tax refunds/rebates are applied to deferral loan.	15 years	state	25%	Property tax exceeding 3% of income.	
ND	14,000		65				Special assessments	
NH		5%	65	Senior - 5 years. Disabled - 1 year.	municipality	15%		Subordinate. Mortgagor must approve deferral.
OR	35,000	6%	62 or disabled		state. State pays county.		Property tax and special assessments.	Subordinate. Lien for estimated future deferral based on life expectancy tables.
PA	15,000		any		municipality	15%. Mortgage < 70%		

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SD	20,000		70	3 years. State resident 5 years.			All property tax.	
TN	12,000	10%	65 or disabled		municipality		Property tax on first $60,000 property value	
TX	none	8%	65 or disabled – all property tax. Others – excess over 105% increase + new improvements.					
UT	26,000	fed funds rate, max 6%	65 or disabled. Max property value $75,000		county		100% of property tax	
VA	50,000		65		municipality, revenue deferred until repayment.		Based on income and net worth limits.	
WA	40,000	8%	60 or disabled		state	20%	Exemption for under $35,000 income.	
WI	20,000	5.75%	65	6 month		50% including deferrals, 50% not including.	100% of property tax, up to $2,500/year.	
WY		4% or floating	62 or disabled or purchased home before 1988 or income < 150% of family-of-4 poverty level				50% of property tax up to 50% of property value	

APPENDIX C: Legislative options worksheet

Interest rate	☐ **Fixed.** Benefits seniors when market interest rates are higher. But costs the State money to subsidize the fixed rate. Makes the property tax deferral program less popular when interest rates are low.
	☐ **Market rate determined annually for new deferrals.** Self-supporting (no cost to state). Full cost passes to the deferring homeowner.
Eligibility	☐ **Seniors and people with disabilities.** Offer the deferral benefit to those who need it most.
	☐ **All property taxpayers.** Offer the deferral benefit to more residents, but still at no cost to the state. Five states offer deferral to all taxpayers.
Entity in charge	☐ **State.** Bigger risk pool means lower rates. Central administration and uniform program means lower costs. Deferral available to homeowners in all municipalities.
	☐ **Municipality or county, at local option by ordinance.** Program implemented in some localities where demanded.
	☐ **Private lenders.** State certifies lenders and provides uniform standards, procedures, and guarantee. Lenders might not participate without state subsidy or full power to set rates and fees.
Lien priority	☐ **Superior.** Homeowner must seek permission from mortgagor to allow deferral lien to have higher priority. Or if law gives higher priority to deferral lien, lenders may raise rates for all borrowers in NJ.
	☐ **Subordinate.** No need to seek permission from mortgagor. Assign equal priority with other tax liens.
Max income	☐ **Low ($30-40,000).** Keeps the deferral program small. Would not benefit many residents who feel they need property tax deferral.
	☐ **High ($120,000 or no limit)**. More participants in deferral program. Higher income means lower risk to bond holders; lower interest rates.

APPENDIX D. Comparison

What are the benefits of **property tax deferral**, compared to a **reverse mortgage**?

- **Simple and convenient.** The deferral terms can be prescribed uniformly in law, rather than a complex contract. The application can be a single page.
- **Trust.** The deferral is backed by the state. No need to worry about unscrupulous terms.
- **Favorable terms.** Interest rate can be lower because risk is pooled across all deferral accounts. Costs can be lower because of simplicity and uniformity of terms.
- **Small dollar amounts**. The deferred amounts are relatively small. Because there are no fees, there is no disadvantage to the small dollar amounts.
- **Universal availability.** Because the requirements are simple, it might be easier for some people to qualify for property tax deferral than for a reverse mortgage.
- **No surprises.** The interest rates are fixed upon deferral and don't change in later years for the previously deferred amounts.
- **Ready help.** Seniors can feel that this extra source of help is available when needed, even if they don't use it right away.
- **Positive community.** Most importantly, seniors will know that we are doing something to help them.

Average interest rate on prior deferrals. Fixed rate until deferral ends.

Allowed to repay early with no penalty

Last year
This year
Next year

Interest rate on new deferral. Fixed rate until deferral ends.

Existing mortgage(s).

Must own at least 20% equity.

Roll back your property tax to the year in which you turned 65.

Sample Township 2010 Annual Property Tax Bill

SAMPLE ONE-PAGE APPLICATION

Owner(s): Beatrice Langford Russo and Joseph Anthony Russo
Owner Mailing Address: 181 Progress Way, Sample Township, NJ 07777
Property Address: 181 Progress Way, Sample Township, NJ 07777
Property Identifier: Eventax County, Sample Township, Lot 56 Block 107A.

Property Assessed Value: land $153,018 + building $228,392 .... $381,410

	Tax rate	Tax
Eventax County:	$0.001832	$ 698.74
Eventax County open space	$0.000427	$ 162.86
Sample Township municipal	$0.006018	$2,295.33
Sample Township school district	$0.012709	$4,847.34
TOTAL PROPERTY TAX	**$0.020986**	**$8,004.27**

Qualifying start year for deferral: 2003 (turned 65 or purchased home)
Tax on property in qualifying start year: $5,275.29

2009 Deferral Account Statement

Deferral account balance as of 2008:	$2,614.07
Average 5.35% interest during 2009 on 2009 balance:	$ 139.85
Deferral amount repaid during 2009:	$ .00-
Deferral account balance as of 2009:	$2,753.92

2010 Deferral Account Plan

Average 5.35% interest during 2010 on 2009 balance:	$ 139.85
Maximum tax eligible for deferral in 2010:	$2,728.98
5.63% interest on 2010 balance:	$ 153.64
Deferral account balance as of 2010:	$5,776.39

Lien holders:
Cherrystone Littleneck Bank, 1600 Route 517, Littleneck, NJ 08380. $18,203

Owners' equity in property: $356,604 (93.5%)

I/we hereby defer this amount of 2010 property tax (maximum $2,728.98): $ 2,728.98 .
I/we understand that this is a secured loan which I/we will repay, plus interest, when the property is sold or is no longer my/our primary residence. I/we understand that this is a legally binding document, governed by New Jersey law title 118 section 29 and other titles.

Owner 1: Beatrice Langford Russo (birthdate 1940-08-29) disabled (☐) Beatrice L. Russo

Owner 2: Joseph Anthony Russo (birthdate 1934-03-12) disabled (☐) Joseph A. Russo

Attachments: ☑ Insurance page. ☑ Mortgage balance statement(s)