

TRANSFERS OF TAX LIENS TO TAX LENDERS

What you don't know can hurt you!

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Many lenders who do not escrow for real property taxes take a rather passive attitude toward their customers' payment of tax bills. However, a lender could lose its collateral if it fails to actively monitor loans that do not require escrow accounts for real property taxes.

Texas has long had a law which allows a third party – at the specific request of a property owner – to pay real property taxes for the owner. That third party tax lien lender was able to obtain a certificate of transfer for real property tax liens which primes all existing mortgage liens, regardless of the date filed. **Foreclosure of a real property tax lien extinguishes all existing mortgage liens on the property, subject to a two-year redemption period, with penalty.** Lenders were protected under this system because tax lien lenders had to foreclose the transferred tax liens judicially – just like a tax authority.

A judicial tax lien foreclosure is a lengthy and expensive process which offers the existing lender a high level of protection. In a judicial foreclosure, the tax authority or tax lender has to comply with the basic requirements of Constitutional due process, such as providing legal notice by citation, service of process on the taxpayer and the lender, and an opportunity to be represented by legal counsel at trial. Thus, existing lenders receive formal, legal notice of the lawsuit and have adequate opportunity to respond, work a repayment agreement with the borrower, and avoid the loss of the property to a tax sale.

The Texas Tax Code has changed the landscape for lenders. Texas now allows tax lien lenders to foreclose either by judicial foreclosure or by nonjudicial foreclosure, through the power of sale provision in the deed of trust. A nonjudicial foreclosure takes as little as 21 days to accomplish, does not involve a judge or other public authority, costs much less to complete and has few due process protections for a lender. **Given the time and expense involved in a judicial foreclosure, the nonjudicial foreclosure sale is the sale of choice for tax lien lenders.**

A tax lien lender accomplishes a nonjudicial foreclosure sale by posting a notice at the courthouse where the property is located and mailing a notice 21 days prior to the sale to the owner and to the holder of any recorded mortgage lien. While the lender may receive the notice, it will often arrive shortly before the sale, leaving little time to react to protect the lender's lien position. **If the property is sold at a tax lien nonjudicial foreclosure without intervention by the lender, the lender must pay a statutorily mandated redemption penalty in order to recover the property after the sale.**

Further increasing the risk of losing the collateral is section 32.065(g) of the Texas Tax Code, which appears to allow tax lien lenders for liens established prior to September 1, 2005, to foreclose without any notice to existing lienholders.

Tax lien loans are close to a “sure thing,” because tax lien lenders can charge up to 18% interest; obtain free and clear title in a quick, inexpensive nonjudicial foreclosure, and receive a 25% penalty payment if the first lienholder decides to redeem the property after the sale. Tax lenders may aggressively market borrowers who fall as little as one day behind on their taxes. Many tax authorities make their delinquent account list available to third parties, so the odds are high that delinquent taxpayers will be solicited by tax lenders.

A mortgage lender can take several steps to help protect its position:

1. Aggressively collect and advance taxes. Don't wait too long before deciding to advance delinquent real property taxes. While many lenders do not like to advance delinquent taxes, the best defense against losing real property to a tax sale is the offense of advancing the taxes and recovering them via an escrow account with the borrower.
2. Educate borrowers. Let them know that financing real property taxes, which is frequently a technical violation of the deed of trust, is not an option.
3. Consider litigation options. The nonjudicial foreclosure process in the context of a tax lien foreclosure may violate due process because it involves state action (the transfer of the tax lien) which can deprive one of property without adequate legal safeguards. In a recent U.S. Supreme Court case styled *Gary Kent Jones v. Linda K. Flowers, et al.*, Case No. 04-1477, the Court held that “notice” by certified mail (which is now permitted by the Texas Tax Code) is a violation of due process if the tax lien foreclosure is conducted by the state. Whether the same law will apply to actions taken by a non-state entity remains an unanswered question.

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