How the Mortgage Crisis Has Affected the Tax Lien Market

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Abstract

In 2007 the authors published a paper concerning tax liens as an investment. Since then, the real estate market has experienced a dramatic upheaval with prices declining in some markets as much as twenty-five to thirty percent. Furthermore, with interest yields in the credit markets declining dramatically, and stock markets having mediocre returns at best, investors are very much attracted to double-digit returns that tax lien investments may provide. This paper will review the basics of the tax-lien market, update the environment for individual investors as well hedge funds and also review the dramatic decrease in property values and how this may affect the tax lien market.

KEY WORDS: Tax-Liens, Mortgage Crisis, Hedge Funds
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I. Introduction

Historically property taxes have been a primary source of income for local governments, including school districts and counties. When property taxes are not paid by the owners, a lien is created against the property. Specifically a tax-lien is a legal restriction on property rights used by a governmental entity to secure repayment of a debt owed to the entity. Governmental entities will after a short period of time attempt to sell the liens in order to generate the necessary current operating cash flow. It is the sale of these tax-liens that creates the opportunity for investors to receive above-market rates of return, in many cases 10-15%. Given, the paltry fixed security returns of .25-3% in U.S. Treasury bills and 10-year notes, it is no wonder many investors are investigating a possible investment in tax liens.

This paper will explore how the tax lien market has been affected by the real estate mortgage crisis.¹ A brief review of the tax lien basics, including the different processes in selling the liens will be discussed, but the majority of the paper examines how institutional investors along with hedge funds that have become a driving force over the last few years. This paper will also discuss the impact of significantly declining real estate values on the tax lien market, along with the increase in foreclosures and its relationship with tax liens.

II. Understanding the Basics of the Tax-lien Market

¹ One of the interesting side-effects of the mortgage crisis has been the significant drop in marriages. “Household formation (marriages) is also shrinking now, down to an annual rate of about 600,000, compared to net household formation in excess of a million annually during the bubble years.” Zuckerman (2010).
For local governments, revenue from real property taxes comprises a significant, if not primary, source of income. At the beginning of the twentieth century, property taxes provided approximately 80% of all revenues received by state and local governments. By 1948, the percentage had dropped to 35%; by 1978 the number had decreased to 21%. Since 1978, the percentage has remained constant at 18% (Alexander, 2000). Although most local governmental units rely more heavily on sales taxes as a source of revenue, nevertheless the prompt collection of real estate property taxes is a very important cash management operation given that local governments and special districts have received over 96% of all property tax revenues.

For over a century, tax liens have existed as statutorily-created assets. Tax liens have been classified as future receivables, performing receivables, long-term receivables, or non-performing assets, depending upon the specific case. To remove such non-performing assets from its books, municipalities have historically sold tax liens individually, in a fashion similar a private firm selling accounts receivable. However, in contrast with selling accounts receivable for a discount as with factoring, tax liens most commonly are sold at a premium, providing the investor with an above average yield, secured by an eventual senior right to foreclose upon the underlying property (de la Torre & Martinez, 2007). It is also important to recognize that a tax lien at its core is a collateralized revenue stream that relies on a specialized priority system that is discussed in the next section.

Investors must also realize that many rates of return on liens are typically derived from a base rate, usually a listed index plus a premium. For example, Colorado Revised Statute § 39-12-103(3) the interest rate set for the redemption of the tax sale certificate is 9% “above the discount rate, which discount rate shall be the rate of interest a commercial bank pays to the
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federal reserve bank of Kansas City using a government bond or other eligible paper as security, and shall be rounded to the nearest full percent.” Given that the current discount rate is .75%\(^2\) this would mean that the current return for tax liens in Colorado is currently 10%, better than most investments, and certainly more likely to increase in the near future.

A. **The Priority of Property Tax Liens**

   Most property liens are prioritized based upon when the lien was perfected.\(^3\) This means that the higher the priority, the more protection and likelihood of being repaid. However, since 1966 property tax-liens have enjoyed priority status even over purchase-money mortgages and federal tax-liens (Staricha, 1998).\(^4\) Historically this was not the case as the 1866 federal general tax lien law did not contain the requirement that a notice of the federal tax lien had to be filed or recorded in order for the lien to be enforceable. The 1966 Federal Tax Lien Act\(^5\) redefined the federal tax lien to a position more in line with other perfected liens. In part because the federal

\(^2\) [http://www.frbdiscounthome.org/index.cfm](http://www.frbdiscounthome.org/index.cfm)

\(^3\) A perfected lien refers to the fact that the lien has been recorded as required by state law (usually with the county clerk’s office), thereby giving notice to all third parties. This is very important when establishing priorities among competing liens. A perfected lien, \(i.e.\) one that has been recorded, is given more priority over a non-perfected lien, even if the non-perfected lien occurred first in time.

\(^4\) Typically a purchase-money mortgage is given preference over other mortgages for the fact that the money involved supports a purchase for value given. Second mortgages are prioritized yet because there is no conveyance the law provides a lower standard of creditor protection.

tax lien is a general lien that bears no special or specific relationship to the real property in question, whereas the property tax arises from the nature of the property itself, legal commentators along with the American Bar Association pushed for federal liens to occupy a subordinate priority position even if the federal tax lien had been perfected before the property lien had been created.

The current federal statute\(^6\) further clarifies the notice requirements necessary for perfection to occur, but it does not change the super-priority status of the property tax lien. Thus a private lender with a perfected security interest can be preempted by a later-arising property tax claim if that tax claim arises under the state’s real property tax lien law, but the private lender will not be preempted by a later-occurring federal tax lien. This helps explain why mortgagees, \textit{i.e.} the lender, will assume any tax liability created by the mortgagor, \textit{i.e.} the borrower. In the case of a property tax lien preempting a recorded mortgage the private creditor with a perfected security interest need only make sure that the real property taxes get paid, before the real property forfeits absolutely to the holder of the tax lien.

Consequently investors that buy tax liens need to understand that secured creditors including mortgagees will be inclined to redeem the tax liens.\(^7\) Because the lien is usually worth between three and seven percent of the value of the property, it is rare—in fact an urban myth, that a property owner will allow a foreclosure just to avoid paying the lien. The only property


\(^7\) In fact, if a mortgagor/borrower gets behind in their property taxes such that the lender is required to pay the tax on behalf of the mortgagor, most debt-service providers will from that point forward, require an escrow account so that the non-payment does not occur again.
that will face foreclosure is the type that no one would want to own (de la Torre & Martinez, 2007).

Even so, an investor should also realize that as a purchaser of a tax lien, one would not have to foreclose on the delinquent property if he does not want to do so. For example, if an investor bought the tax lien on a property and continued to pay the tax for two subsequent years, in Colorado as in many other states, the tax lien purchaser would be able to foreclose on the property. However, if for example the lien purchaser realizes that there are severe environmental problem associated with the property such that a former meth lab was discovered, the lien purchaser would not be obligated to foreclose on the property.

The worst case scenario would be that the tax lien holder would lose their investment and interest in the tax liens. On the other hand, from the default risk perspective, for the investor interested in having a “safe” investment, the super-priority of property taxes provides a great deal of security. Knowing that that all other creditors can have their claims preempted from receiving payment provides a great deal of assurance that repayment of the principal and interest should occur. In summary, the investor should realize that repayment of principal and interest for most tax liens is very probable, and yet on the other hand, the chance of acquiring a property in foreclosure is not very high, except for the most undesirable properties.

B. Current Methodologies used to Dispose of Tax Liens

Rather than pursue the collection remedies themselves, most governmental entities elect to dispose of their tax receivables or liens through the use of outside third parties—in essence privatizing the process. Politically it makes more sense for a private third party to foreclose on a constituent if necessary than for the governmental entity to do so. The three most commonly
used methods for disposing of tax liens include the 1 negotiated bulk sale, 2 securitization and 3 auction.

The negotiated bulk sale of tax liens involves selling a portfolio of liens to a private entity. The private entity assumes responsibility not only for collection of delinquent taxes, but also for foreclosing on the underlying property should collection of taxes not prove possible. In exchange for collection risks, the purchaser in a negotiated bulk sale will be able to purchase the liens for about a twenty-five percent discount on the face value of the liens which provides the economic incentive that investors need (Poindexter, Rogovoy, & Wachter, 1997).

Another means used to sell tax liens involves securitizing the liens using similar methods employed by mortgage-backed security industry. Securitization of tax liens has been gaining popularity since the first securitization occurred in the early 1990s. Many of the same public policy considerations come into play in a securitization transaction as in a negotiated bulk sale transaction; however, the underlying concept and financial structure of the deal are substantially different. Typically the tax liens are purchased by a trust used by a municipality to dispose of its tax liens. After the trust purchases the tax liens, it then issues bonds that are backed by the tax lien receivables. These bonds are purchased by investors, usually in the institutional market.

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8 In 1993, Jersey City, New Jersey completed the first transaction involving the securitization of approximately $44 million in tax lien receivables. In 1996, New York City followed with a $215 million bond issue backed by tax liens.

9 Quite often governmental units struggle with the decision to sell liens at a discount. Although the convenience of sell a large number of liens at once cannot be argued, the question is whether the discount or the cost of securitization outweighs the benefit.
Securitization provides a reasonable alternative for cities that want to dispose of their tax liens but find either the auction method or the negotiated bulk sale method inadequate.

The previous two methods are most suited for governmental entities that have a large number of properties with liens that may not be attractive to individual investors. By securitizing the process or by bundling a large number of the liens and then selling them at a discount, the purchaser understands that some of the liens may not perform. However the risk is acceptable if an applied discount is large enough. Clearly a governmental entity would like to capture the full value of the lien or even more so, but on the other hand, the ability to receive the delinquent real estate tax money without the time and effort to collect the liens, is worth the discount. Not surprisingly smaller governmental units have more incentive to pursue an auction when possible, given the fact that this method is the only means by which the government may be able to capture the full value of the lien—and even with a possible premium.

The auction is the only method that allows individual investors an opportunity to compete for the higher yields associated with tax liens. The format used at tax lien auctions varies dramatically across states and even within states. In Colorado, for example, several counties conduct auctions on-line, similar to an EBay auction, while other still allow for a live, in-person event. In either case, the auction process can also vary as to how the bids are calculated. For example one method that is used in Arizona’s Maricopa County, as well as Cook County, Illinois, awards liens to investors willing to accept the lowest interest rate. Starting at a rate as high as 18%, investors will bid down the rate on the lien. The benefit indirectly goes to the delinquent tax payer as investors share the burden of the high interest rate with the property owner.
While this method of premium bidding is very straightforward, and politically palatable to constituents, it does create a cap as to the amount of money the county can receive. The investor agrees to pay the delinquent taxes and the accrued interest to the county and to accept an interest rate determined at auction with the understanding that the winning bid will also have the opportunity to continue the lien for a second year, without having to pay any additional premium.

On the other hand, Colorado employs a pure premium bid that is essentially a non-refundable amount paid to the county (de la Torre & Martinez, 2007, pp 52-55). For example a $1200 tax lien is sold at a premium of $40, means that the investor bid a premium to the county for the privilege of collecting the interest on the lien. However, this premium is not collectable from the tax lien owner which makes this type of bidding relatively risky given the possibility of an early payoff. Thus the maximum return this investor could receive assuming a 10% statutory return would be:

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$1200 \times 0.10 = \frac{120 - 40}{1200} = 6.67\% \tag{1}
\]

As a point of comparison although certificates of deposits (CDs) are only paying between one and three percent, there is no realistic opportunity to have a negative return. Unfortunately with this type of premium bidding the property owner can pay off the lien at any time with no minimum guaranteed interest.\(^{10}\) Assuming the property owner pays the lien tomorrow, the return to the investor would be:

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\(^{10}\) In Weld County, Colorado, there is a minimum of 1-month interest regardless of when the lien is redeemed.
As equation (2) demonstrates the tax liens can produce negative returns if purchased at a premium. However, another important aspect of the premium bidding involves the roll-over of the lien to a second and third year. This is sometimes referred to as an “endorsement.” Not only is the holder of a lien is allowed to keep the claim for a second and third year, without paying any additional premium as long as the buyer of the lien pays the appropriate property taxes for the year, but an interest rate bottom is fixed at the time of the purchase. In the best case scenario, the premium paid is allocated over a three-year holding period, which produces a much more respectable rate of return. For the “serious” lien investor, this is the real benefit is premium bidding.\textsuperscript{11} The following section discusses the changes the mortgage crisis has brought to the hedge funds and auctions.

III. Foreclosures and Tax Lien Hedge Funds

A. The Impact of Foreclosures

In the aftermath of the 2008 financial crisis has been the dramatic increase in bankruptcies and home foreclosures. Many would believe that a dramatic increase in foreclosures automatically would result in an increase in the number tax liens. However this

\textsuperscript{11} Hedge funds that specialize in tax liens, realize that this feature can often turn mediocre returns based on premium bidding, into returns that can reach more respectable levels.
ignores the fact that most mortgages include escrow for property taxes. Although some lenders provide the option for the homeowner to pay the property tax directly, almost all lenders require the use of an escrow account once a borrower falls behind on the mortgage payments, or fails to make timely property tax payments. While there may be a temporary tax lien, the implication is that most mortgaged property will not have multi-year tax liens. On the other hand once a foreclosure is initiated the responsibility to pay the any resulting lien transfers to the lending institution.

Depending on the jurisdiction the foreclosure process can take anywhere from 6-18 months. In the interim property tax levies may go unpaid inadvertently primarily because of a judicial due process delay where the original buyer/homeowner is no longer interested in paying the lien, and the bank who does not completely control the asset. Once the foreclosure is finalized and banks decide to sell the foreclosed property, the lien must be paid. A recent Wall Street Journal article intimates that banks are sitting on a growing inventory of foreclosed homes that will be unloaded on to a soft real estate market (Timiraos, 2010a). Even more alarming is the number of homes owned by Fannie Mae and Freddie Mac. These two entities are also in the midst of disposing of hundreds of thousands of homes—especially in a very inhospitable environment that no longer includes first-time home buyers’ tax credits (Timiraos, 2010b).

In other words, the foreclosure process, due to the transactional frictions in transferring ownership, has created a number of short-term temporary liens. The net result will be that many tax liens created by the foreclosure process and currently sitting in hedge fund portfolios will be
redeemed, especially if the banks and other financial institutions want to convey the properties.\footnote{Liggett & McOsker (2010) state, “With the decline in the real estate market over the last few years, the supply of liens has increased dramatically (30\% in 2008, 20\% in 2009, according one survey) due to increased delinquencies by property owners.”} Given the problems associated with in the banking industry and their balance sheets, these foreclosed homes that are classified as non-performing assets will be sold in an expedited fashion. When this happens, the hedge funds or individual investor holding these liens will be flooded with redemptions, forcing the hedge funds to re-invest, or refund the money. Yet in either case, the investor may be forced to deal with an inhospitable reinvestment environment.

On the other hand investors, may find as the number of foreclosure actions increase, the direct effect would be that lenders would regain ownership or at least temporary control the property. If a tax lien has already been established, then these liens would quickly be transferred to the lender. Once in the hands of the lender, these liens would be paid. The only question is the timing of the payment. Will a bank find it cost effective to pay 10\% or more in interest on a lien, or borrow from its near costless reserve account to pay the lien? While it would seem that a bank would choose the latter, the banking industry contains an abnormal number of troubled banks and converting reserves to pay a tax-lien liability that may not show up on the bank’s balance sheet, may not be as clear-cut a decision. The result the individual investor may find that the inventory of tax liens may not be as extensive given the non-payment of mortgages would one tend to believe.
In either case the cautious investor must realize that while a potential return of 10-15% may seem highly attractive as compared to a .193%-3.723% treasury return, the redemption problem caused by the foreclosure and subsequent bank involvement may skewer these potential yields. Current conditions and subsequent redemptions may represent an absolute peak period for tax lien returns for the near future. Furthermore many hedge funds require that investors park their money for a minimum time period, often two-years or more. With a strong possibility of large tax lien redemptions, investors need to be clear about their options and whether large redemptions provide a predefined condition under which investors can withdraw their funds without penalty. As the next section will discuss, declining property values may also place a drag on returns.

B. Tax Liens Hedge Funds

For years county treasurers have been well aware of investment syndicates that pool money together for purposes of buying tax-liens throughout the country. Through the law of large numbers along with the geographic diversification, these syndicates have sought to minimize idiosyncratic risk and take advantage of the larger liens that most individual investors may feel uncomfortable in holding as an individual investment. With more investment capital

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13 *Wall Street Journal*, September 24, 2010, the 6-month Treasury bill was yielding .193%, while the 30-year Treasury note yielded 3.723%.

14 Just as mortgage lenders have to recognize the risk of concentrating lending operations in a single geographic location, syndicates of hedge funds also have to recognize the high correlation of returns within a region and the resulting risk.
the syndicate is able to purchase a much deeper and diversified portfolio of liens, including liens on commercial properties.

These syndicates soon morphed into the familiar hedge fund vehicle (Ip, 2005). As an unregulated pool of investment capital known for investing in “risky” investment alternatives, hedge funds historically invested in short-term derivatives including futures, options, swaps, interest rate spreads and other arbitrage strategies. Yet a hedge fund that exclusively invests in tax-liens suffers from a predefined cap on returns, and at the same time an undefined risk of default, as well as the cost of foreclosing and may also suffer from a lack of geographical diversification.

In addition, there is also the redemption risk in the form of pre-pays along with the regular payment of liens beyond the one-year holding period, which left unmanaged would tend to provide an uncertain reinvestment risk as well as a very uneven revenue stream.15 Even with these uncertainties, MD Sass, a New York-based private hedge fund family has one fund with has a primary focus on tax-liens and has made returns of 8-14% a year (Altucher, 2005).

In addition investors need to realize that many hedge funds carry significant fees such as the “2 and 20” which means that the annual asset management fee is 2%, along with 20% of the gain. These fees may not matter as much in the traditional hedge fund environment but given the fixed rates of return and the high possibility of redemption, this type of investment vehicle may not make sense for individual investors.

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15 Mortgage-backed securities have long managed the prepayment problem by forming different tranches that have different returns based on the priority of prepayments.
Because a generic hedge fund is not regulated by the Securities and Exchange Commission, periodic and public filings are not required, making the task of finding specific performance information difficult. Many of these hedge funds will not divulge any past return information unless that person is an accredited investor. However, there is much information that can be gleaned by recent announcements involving the state of Florida.

For example the Mooring Tax Lien Fund I was formed in 2008 from Florida tax liens, just about the time that the number of foreclosures accelerated rapidly. Similarly, the Jericho Group, a Florida-based commercial real estate specialist launched a 2010 Tax Lien Master fund that also invests in Florida municipal tax lien certificates across 67 counties. Given the number of foreclosures and the fact that the process requires a judicial order—a type of transactional friction, resulting in having the average foreclosure last over 550 days (Whelan, 2010), it is not surprising that a number of hedge funds have decided to concentrate on Florida.

Recently an investigative report appearing in the Huffington Post online, detailed the use multiple aliases by Bank of America and at least one large hedge fund, Fortress Investment Group, for purposes of buying Florida tax liens. While no comment was made by any of the banks or hedge funds, it appears that these entities are bidding up the prices on the liens while driving down the yields. Some banks are purchasing the liens directly while others are lending

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16 A fact sheet prepared by Mooring states, “With a well-timed portfolio of Florida tax liens in place, purchased in Summer of 2008, Mooring Tax Lien Fund I is expected to deliver net double-digit rates of return to investors.”

17 The list of banks also includes Wells Fargo, Deutsche Bank and BankAtlantic. Schulte & Protess (2010).
to subsidiaries and other related buyers. Why would Bank of America invest in tax liens? Without direct confirmation, it may well be that large banks are turning “lemons” into lemonade. Understanding that the tax liens are going to exist regardless of the banks’ involvement or not, these large institutions may be reaping the benefits of fee and interest income even though the homeowners are also mortgage customers. In their defense, banks are not taking sides against the homeowner but only receiving transaction income that would go somewhere else. Regardless, the mere participation of the banks in tax lien sales is a public relations nightmare.

What this means to the individual investor is that tax lien yields are going to be harder to garner. Professional investors understand that the U.S. real estate market may be years away from recovery. Not surprisingly banks who used to lend on the assumption of increasing real estate values, have eschewed this type of lending and instead have seized upon lending for a residual claim secured by real estate—the tax lien. With the help of the hedge fund vehicle, the mortgage-backed security or collateralized debt obligation has now given way to the tax lien hedge fund. More importantly, the investor who chooses a tax lien hedge fund should be very aware of the looming reinvestment risk given the almost certain redemption of the tax lien. It also behooves the investor to thoroughly understand the hedge fund’s minimum requirement time of investment given that 2011 may be the apex for foreclosures and for tax liens based on soon to be declining property values. This is discussed in the next section.

IV. Declining Property Values, and Future Trends

A. Declining Property Values

About 22.5% of all U.S. mortgages are underwater, meaning that the mortgage is worth more than the underlying property. In Florida, that number is closer to 50% (Miller, 2010).
Understanding that property tax revenue is *ad valorem* in nature, the precipitous drop in property values has caused governmental property tax revenues to significantly decline. The only means to counter such a loss in revenue is to raise the mill levy or tax rate. However, the worst may not be over. For example, in Colorado property values are re-assessed every two years. The last property tax which was collected in 2010, was based on assessed values as of June 30, 2008, which was just before real estate market declined precipitously. This means that in many parts of the country, the true impact of declining property values will be fully felt in the next few years. County assessors have known for a long time that eventually the declining property values would have to be incorporated as part of the assessment process and perhaps spawning a need for a tax rate increase. Recently a *Denver Post* article revealed that the last time property values decline was in the late 1980s. Residential property values are estimated to drop 10.4% (Bartels, 2010).

For taxes accrued in 2011 collected in 2012, the latest assessment date used will be June 30, 2010. This represents the first-year using the downward adjusted values to collect the 2011 taxes paid in arrears. With a lower property base, the property tax due will also decrease. For keeping the status quo tax rate, any tax lien resulting from the non-payment of the bill will also decrease.

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18 “Property taxes continued to grow through the recession and recovery, in part because local governments calculate the levy based on property assessments that are often years old. Property taxes grew 5.7% to $170 billion in the last three months of 2009 versus the same period in 2008. That won't last as tax assessments catch up with reality. In California, one of the first states into recession, Santa Barbara County saw its 2009 property taxes decline for the first time since 1978. Property taxes ‘have only just begun to slump, meaning that cities and other localities will be contending with increasing budget pressure for the next several years,’ writes the Brookings Institution, a left-leaning Washington think-tank, in a recent report on local government.” (Dougherty, 2010).
be lower. The variable that still exists is whether local taxing authorities will attempt to increase the mil levy as a way of stabilizing revenue.\textsuperscript{19} Given the fact that unemployment remains stubbornly high, politicians may not be eager to ask for a tax increase. On the other hand, government officials have and will continue to threaten much liked services as well as the possibility of governmental layoffs as a consequence of not increasing property taxes. The implication is of course that future tax liens may be on average smaller as compared to those in the past, even though there may be a lag before this decrease is realized.

What is also unclear from the aftermath of the mortgage crisis is how long this decline in property values will last. While no one can foresee the future, what is clear is that real estate values may take years to recover the lost principal. Much has been said about the fact that real estate will not come back until employment recedes to the 5-6\% range.\textsuperscript{20} But the construction industry must also recover for the overall employment to recover.\textsuperscript{21} It is the classic case of the “chicken or the egg” conundrum.

\textbf{B. Future Trends}

\textsuperscript{19} See Johnson (2010) for an example of a recently approved property tax hike.

\textsuperscript{20} See Pharisien (2009) for an article that indicates the market will rebound in 2013. On the other hand, see O’Connell (2010), for a more pessimistic viewpoint.

\textsuperscript{21} Zuckerman (2010) states, “That is why housing was such an important generator of normal economic recoveries. To give this context, residential construction was 6.3\% of GDP at it recent peak in 2005 and 2006 but has fallen to 2.4\% this year, according to economist A. Gary Shilling. This is significant if you recognize that a 3\% top-to-bottom decline in real GDP constitutes a serious recession.”
The tax lien market resembles the mortgage market of 20-years ago. Liquidity was an issue for mortgage lenders, and securitization was still in its infancy. Likewise with little to no secondary market for tax liens, an investor must accept limited liquidity or realize that the investment time horizon in tax liens may be much longer. To counteract this lack of liquidity, GFI Group, a New York-based wholesale brokerage, hired Thomas McOsker and Howard Liggett of Sycamore Capital Partners, to launch a tax receivables desk (Margulies, 2010). The launch of a new secondary market for tax liens will provide much needed liquidity. “Considering the tightening credit environment and increasing need for liquidity, many tax lien investors are searching for a trusted marketplace to be able to sell their liens.” he said. “In this heightened regulatory environment, we will bring necessary liquidity and transparency to this asset class.” (Margulies, 2010).

The other trend that needs to be mentioned is efficiency being created by county officials when selling tax liens. With of the tax liens being auctioned on-line similar to an EBay transaction, competition becomes nationalized with likely rates of return decreasing. This will continue as more counties realize that revenue dramatically increases once the tax lien auction is placed on-line. Furthermore many of the participants are larger institutions with deeper

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22 “As governmental units discover and understand that on-line bidding would produce a national investor pool, the higher probability of higher premiums for the tax liens will certainly increase the competition from the hedge fund participants. Consequently the rates of return should decline. For the small investor looking for above average rates of return, the ‘salad days’ of tax liens may be over.” (de la Torre & Martinez, 2007, p. 58)

23 In a recent conversation (November 2010) with Weld County Treasurer, John Lefbvre, indicated that the first year using an on-line auction increased tax receipts by approximately 15%.
pockets that can afford to overbid on some occasions. The net effect is that the small individual investors may see future returns decrease.

In many ways, the mortgage crisis has spawned far reaching effects, including a possible temporary increase in tax lien inventory. While double-digit returns on tax liens may represent an irresistible investment this article has illustrated the many problems that may exist with using either a hedge fund or competing against hedge funds for these tax liens. The current climate may represent a temporary high point in the number of tax liens given the current climate of foreclosures. But with these foreclosures comes the inevitable conveyance that requires a redemption of the tax lien. The dynamics are such that foreclosures along with a deteriorating real estate base may result in an indeterminate inventory, but also one with significant re-investment risk. Individual investors seeking double-digit returns should be cautious realizing that hedge funds have discovered this niche making the competition for returns that much harder.
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