STATE OF WASHINGTON
DEPARTMENT OF REVENUE
OFFICE OF THE DIRECTOR
P.O. Box 47454 • Olympia, Washington 98504-7454 • (360) 534-1600 • FAX (360) 534-1606

November 30, 2012

TO: The Honorable Ed Murray, Chair
Senate Ways and Means Committee

The Honorable Ross Hunter, Chair
House Ways and Means Committee

FROM: Brad Flaherty, Director BF

SUBJECT: Senior Citizens and Disabled Persons Property Tax Deferral Interest Rate Report

This report is submitted to the Legislature pursuant to Chapter 275, Laws of 2006 (SHB 2569, 2006 Regular Session). SHB 2569 decreased the interest rate for the senior citizens and disabled persons' property tax deferral program from 8 percent to 5 percent for deferred property taxes which were levied for collection in 2007 and beyond. The bill also asked the Department to review the adequacy and appropriateness of the interest rate in relation to the objectives of the deferral program.

After the interest rate was lowered to 5 percent, the number of senior citizens and disabled persons utilizing the deferral program and the amount of taxes and assessments deferred increased. Between when the deferral program started in 1976 and September of 2012, the median 30-year fixed rate mortgage interest rate was 8.21 percent. However, since June 2009, the 30-year fixed rate mortgage interest rate has been decreasing and in the first nine months of 2012, the median rate was 3.8 percent. Participation in the deferral program has remained strong in recent years, so the 5 percent deferral interest rate appears to be adequate and appropriate.

This report was prepared by staff in Research and Fiscal Analysis and the Property Tax Divisions. If you have questions about this report, please contact Kathy Oline at (360) 534-1534.

Attachment

cc: Tom Hoemann, Secretary, Washington State Senate
Barbara Baker, Chief Clerk, Washington State House of Representatives
Jennifer Ziegler, Director of Legislative Affairs, Office of the Governor
Stan Marshburn, Director, Office of Financial Management
Members, Senate Ways and Means Committee
Members, House Ways and Means Committee

STATE OF WASHINGTON
DEPARTMENT OF REVENUE

Research Report #2012-9

SENIOR CITIZENS AND DISABLED PERSONS
PROPERTY TAX DEFERRAL
INTEREST RATE
SHB 2569 - RCW 84.38.100

Department of Revenue
November 2012

Background

Senior citizens and disabled persons with a primary residence in Washington can defer property taxes and special assessments under any of the following conditions:

- If they are at least 60 years old by December 31st of the application year for the deferral,
- If they are unable to work because of a disability, or
- If they are at least 57 years old and the surviving spouse or domestic partner of a person who was receiving a deferral at the time of his/her death.

Under the deferral program, the Department pays the taxes or assessments and then the amount paid plus interest becomes a lien on the property in favor of the state until repaid.

In the 2006 session, the Legislature adopted SHB 2569 decreasing the interest rate for the senior citizens and disabled persons property tax deferral program from 8 percent to 5 percent for deferrals of property taxes levied for collection in 2007 and beyond. According to the bill,

> "The legislature finds that the intent of the property tax deferral program is to assist retired persons in maintaining their dignity and a reasonable standard of living by residing in their own homes, providing for their own needs, and managing their own affairs without requiring assistance from public welfare programs."

The Department was asked to review the adequacy and appropriateness of the interest rate in relation to the objectives of the deferral program and report its findings by December 1, 2012.

Research and Fiscal Analysis Division
P O Box 47467 ♦ Olympia, Washington 98504-7467 ♦ (360) 534-1550 ♦ Fax (360) 534-1526

Senior Citizens and Disabled Persons Property Tax Deferral

Since the "retired persons" deferral program started in 1976 (passed the legislature in 1975) the senior citizens and disabled persons' property tax deferral program has helped approximately 5,000 senior citizens and disabled persons. Currently, there are over 1,200 active deferrals.

When a senior citizen or a disabled person files a deferral application with the county assessor, the assessor reviews the application and approves or denies the deferral. Approved applications are then forwarded to the Department. The Department audits the application and approves it for payment or returns the application to the assessor for denial.

The first time the person applies, the Department also files a lien against the property. After a lien is filed, the Department pays the property taxes and special assessments which the taxpayer asked to defer.

In Fiscal Year 2007 the Department:
- Filed 86 liens for new applicants, and
- Made 632 payments totaling $590,057 in deferred taxes and assessments.

In Fiscal Year 2012 the Department:
- Filed 221 liens for new applicants, and
- Made 983 payments totaling $1,337,375 in deferred taxes and assessments.

In the last five fiscal years, there has been an increasing number of deferral applications, an increasing number of new applicant liens filed and an increasing amount of property taxes and special assessments being deferred. At the same time, the number of released/amended liens has been decreasing (see table below). Also, the total cost of the liens filed has increased but this is because the cost per lien increased from $42 to $72 for each lien filed.

Fiscal Year	Property Taxes Deferred	Total Repaid*	Number Applications	# New Applicant Liens Filed	# Liens Released or Amended	Number Payments Made	Cost of Liens Filed
2007	590,057	1,516,721	433	86	190	632	NA
2008	660,098	1,104,895	421	96	132	658	9,576
2009	995,705	859,786	504	174	107	841	11,802
2010	1,157,133	908,341	581	153	103	894	15,774
2011	1,436,983	852,122	577	179	82	994	16,368
2012	1,337,375	1,069,447	636	221	89	983	19,603

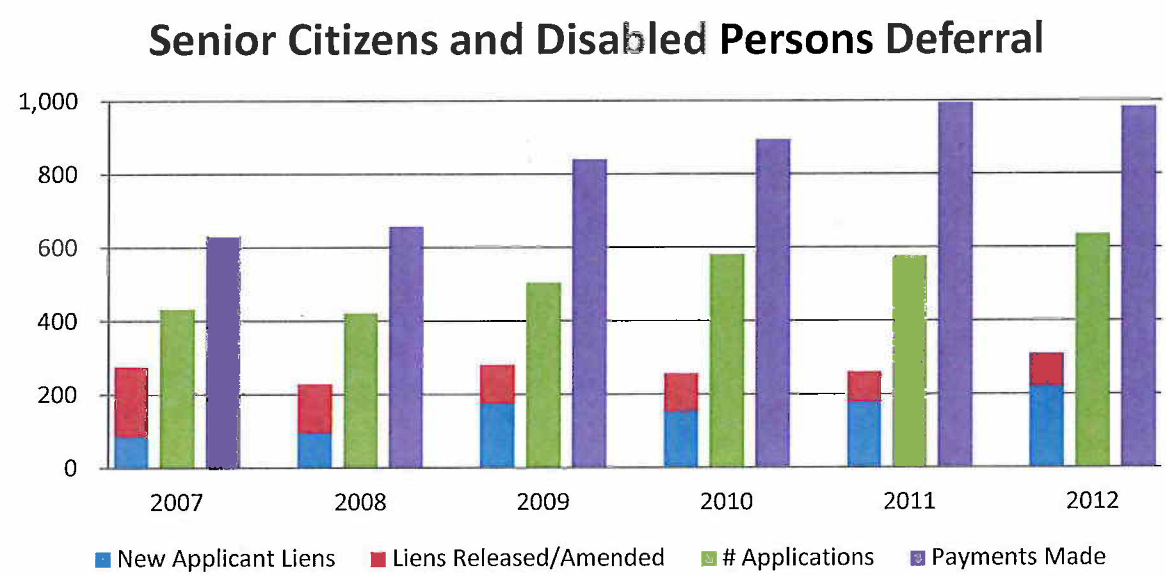
* Includes interest and refunds

NA = Not available

Also in the above table, you may notice that more payments are made than applications are received. This is because some applications require more than one payment. As an example, when both overdue property taxes and current year property taxes are deferred separate payments are made. Also, when special assessments have a different due date than property taxes they are made with a separate payment.

Each year, some deferrals are paid back by the property owner and some deferrals are paid back as part of the sale of the property by the senior citizen or disabled person's estate/heirs. In Fiscal Year 2012, $1.1 million of deferred property taxes and interest was repaid.

While a similar number of liens have been filed in each of the last five fiscal years, the number of new applicants is increasing as the number of released/amended liens is decreasing. Also, the number of applications received and the number of payments made by the Department are growing (see graph below).



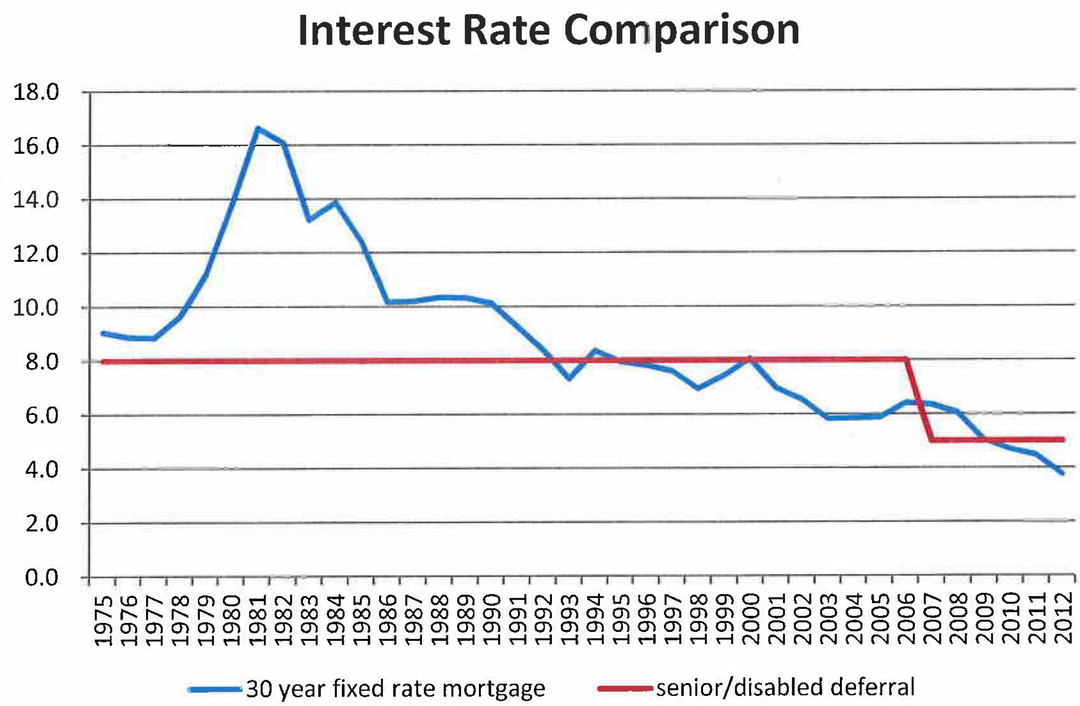
Interest Rates

The 2006 decrease in the interest rate was the first change to the interest rate since the deferral program was started in 1976. As part of the legislative testimony on SHB 2569, which lowered the interest rate, it was noted that "a variable interest rate was not used because it confuses senior citizens."

In 2006, when the interest rate was lowered to 5 percent, deferrals for property taxes and special assessments made prior to January 1, 2007 continued to accrue interest at 8 percent. Of the currently active deferrals:

- Over 250 only accrue interest at the 8 percent rate,
- Over 700 only accrue interest at the 5 percent rate, and
- Over 280 have taxes and assessments deferred at both rates.

Since the deferral program started in 1976, interest rates have varied greatly. Below is a comparison between 30-year fixed rate mortgage interest rates and the senior citizens and disabled persons deferral interest rates.



When the program started, the 30-year fixed rate mortgage interest rate was slightly higher than the interest rate set for the deferral program. Shortly thereafter, interest rates increased greatly and then fell sharply keeping the deferral interest rate significantly lower than the annual average interest rates for 30-year fixed rate mortgages for more than 15 years. Between 1992 and 2000, the two interest rates were similar with the deferral interest rate usually being at or higher than the 30-year fixed rate mortgage interest rate. However, the 30-year fixed rate mortgage interest rates started falling in 2001 and remained lower than the deferral program until the deferral interest rate was decreased in 2006.

After the deferral interest rate was lowered, the deferral interest rate stayed lower than the average annual interest rates for 30-year fixed rate mortgages for two years. Then at the end of the Great Recession (2009) the interest rates were the same, but as the interest rate for 30-year fixed rate mortgages has continued to decline, the deferral rate is now again higher than the 30-year fixed rate mortgage interest rate.

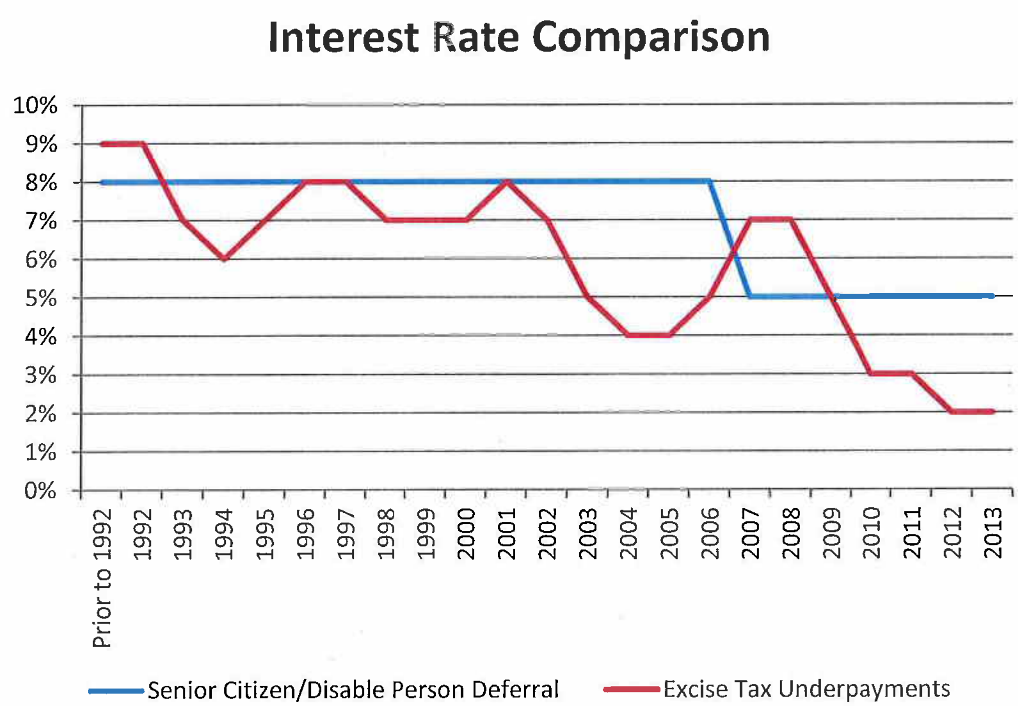
Interest rates have plummeted in recent years as the U.S. economy continues to struggle. However, Global Insight's September 2012 forecast indicates little change in interest rates until the second quarter of 2015, and then a slow rise in interest rates over the course of a couple years.

There are two other interest rates related to property taxes. One is the interest rate for the limited income deferral program. In 2007, the legislature passed an additional property tax deferral program for homeowners with limited income. Homeowners with limited income property tax deferrals use a variable interest rate which is based on an average of the federal short-term rate, plus 2 percent. This is also the interest rate used by the Department for the underpayment of excise taxes.

As can be seen in the graph below, between 1992 and 2002 the excise tax underpayment interest rate was:

- Higher than the senior citizens and disabled persons deferral interest once (1992),
- Three times they were the same, and
- Six times the excise tax underpayment interest rate was lower than the deferral interest rate.

Between 2002 and 2006, the excise tax underpayment interest rate remained lower than the deferral interest rate. After the deferral interest rate was lowered in 2006, the excise tax underpayment interest rate was higher than the deferral interest rate for a couple of years and then in 2009 they were again the same. However, since 2010 the excise tax underpayment interest rate, like the 30-year fixed rate mortgage interest rate, has been lower than the deferral interest rate. Again, this is a reflection of falling interest rates – including the federal short term rate.



The other property tax related interest rate applies to property taxes that are delinquent. Since 1981, the delinquent property tax interest rate has been 12 percent per year. The deferral interest rate has always been lower than the delinquent property tax interest rate.

In some ways, the senior citizens and disabled persons deferral acts like a reverse mortgage for the taxes which are deferred. Most reverse mortgage interest rates are based on an index plus a margin and thus calculated much like the excise tax underpayment interest rate. However, reverse mortgage interest rates usually are set at the time of the reverse mortgage loan and then have a maximum amount the interest rate can increase in a year and an overall maximum rate.

Cost of the Program

The interest rate applied to deferrals is assumed to be charged to cover the cost of filing and removing the liens associated with the deferral. Current fees to file and release a single lien are $144 ($72 x 2). Liens sometimes need to be amended. For example, if the parcel number or legal description of the parcel changes, then the lien has to be amended. So, on average, a deferral has 2.19 liens filed which at today's fees would result in average deferral lien fees of $158.

Using the average amount of taxes and assessments deferred, at 5 percent interest it takes on average 2.3 years of interest to recover the cost of the lien fees. On average a deferral lasts approximately 5.7 years, so the state currently recovers the total cost of lien fees on deferrals. However, if the interest rate was lowered to 2 percent (the current excise tax interest rate for 2013), it would take 5.9 years of interest to cover the average lien costs; making it likely that the state would not recover all of the costs of the lien fees.

Conclusion

Lowering the interest rate to 5 percent has allowed more senior citizens and disabled persons to utilize the deferral program. In the last five fiscal years, there has been an increasing number of deferral applications, an increasing number of new applicant liens filed and an increasing amount of property taxes and special assessments being deferred.

While the deferral interest rate of 5 percent currently appears high when compared to other interest rates, it does not appear to be discouraging senior citizens and disabled persons from utilizing the program. The interest rate appears to be adequate for covering the cost of lien filings related to the deferral programs and appears to be appropriate in relation to the key objectives of the program.