Improving the Property Tax by Expanding Options for Monthly Payments

Executive Summary

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For roughly half of U.S. homeowners, the property tax is unlike practically any other bill or tax because it is paid in just one or two large lump sums each year rather than in smaller (monthly) payments. This payment schedule appears to cause several problems for homeowners and local governments; it can create financial challenges for households, increase tax delinquency, foster political opposition to the property tax, and requires governments to deal with irregular revenue inflows.

Fortunately, there is a fairly simple solution to this problem: local governments can expand options to pay property taxes on a monthly basis. In the United States, there are two existing models for paying property taxes monthly: 1) prepayment programs that allow taxpayers to apply to pay monthly and have the funds accumulate in an escrow account to pay off their annual or biannual tax bill; and 2) a monthly installment plan in Milwaukee, Wisconsin, where every tax bill includes the option to either pay in full or in monthly installments.

This report describes these two approaches for allowing monthly property tax payments and outlines some best practices that can enhance the effectiveness of these programs. Some key findings from the report include:

Roughly half of U.S. homeowners pay their property taxes in just one or two large lump sums each year. In the U.S., there are two key features of the property tax system that affect the frequency with which homeowners pay their taxes.

- **Property tax escrow accounts managed by lenders:** Many homeowners have tax escrow accounts managed by their lender. The owner pays their property taxes as part of their monthly mortgage bill, the funds accumulate in their escrow account, and then the lender uses funds in the escrow account to pay the owner's property tax bill. However, only 44 percent of U.S. homeowners paid their property taxes along with their monthly mortgage payment in 2015. The remaining 56 percent either did not have a mortgage (36.6 percent), or they had a mortgage but did not escrow their property taxes (19.8 percent). Seniors are far less likely to pay their property taxes along with their monthly mortgage bill. Only 20 percent of homeowners 65 years or older had property tax escrow accounts, compared to 55 percent of homeowners under age 65. There are also large variations across states in the share of homeowners with escrow accounts, ranging from less than 40 percent in 13 states—including California, Pennsylvania, and Texas—to over 60 percent in Colorado and Maryland.

- **Installment payments:** In 36 states, state law provides for installment payments, which are used to break the annual property tax bill into smaller increments, usually two biannual payments but sometimes three or four payments per year.

Billing property taxes as large lump sums causes problems for both homeowners and local governments. While there has not yet been extensive study of these issues, evidence suggests that collecting property taxes as large lump sum payments causes several problems.

- **Creates financial challenges for homeowners who struggle to save for large expenses:** Very few homeowners can afford to pay an annual or biannual property tax bill out of their monthly cash flow; they need to save in advance. However, about half of American households are financially insecure, and have practically no savings to cover an unexpected expense. If these households have not saved in advance for their property taxes, an annual or biannual tax bill could easily force them to either: 1) borrow money and accrue debt, often credit card debt; 2) become delinquent in paying their property taxes; and/or 3) skip some other bill payments to pay their property taxes, such as becoming late on a mortgage payment.
- **Increases property tax delinquency:** Evidence suggests that as the number of tax installments decreases, the property tax delinquency rate increases. Homeowners who become delinquent face high interest rates on their delinquent taxes, typically face penalties and fees, and can eventually lose their homes through property tax foreclosure.
- **Fosters political opposition to the property tax and erodes municipal fiscal health:** Research shows that paying in large lump sums makes the property tax a very salient tax, which increases political opposition to the tax, and can in turn result in property tax limits and other policies to reduce property taxes. Many of these policies have serious unintended consequences and erode the fiscal health of local governments.
- **Irregular revenue inflows for local governments:** Collecting taxes in large lump sums means that governments receive property tax revenue just once or twice per year, and need to rely upon short-term borrowing and/or hold large amounts of idle cash in safe and liquid assets that earn little interest, in order to meet their regular spending requirements.

In the United States, there are two approaches used to allow monthly property tax payments.

- **Prepayment programs administered by local governments:** At least sixteen states have local option programs allowing tax collectors to establish prepayment programs for property taxes where taxpayers can apply to pay on a monthly basis. The monthly payments are held in an escrow account managed by the city or county treasurer, where the payments accumulate and are then used to pay off a taxpayer's annual or biannual property tax bill, and at that point the funds are distributed to taxing districts. States use a variety of names for these programs, including prepayment agreements, property tax escrow accounts, monthly installments, early payment plans, or simply monthly property taxes. While the number of localities that have established prepayment programs is still small, there are several large jurisdictions that do allow monthly prepayments, including Indianapolis, Travis County (Austin, TX), and the largest counties in Ohio (Cuyahoga, Franklin, and Hamilton).

- **Monthly installments:** In Milwaukee (WI), every tax bill includes the option to either pay in full or in monthly installments, and taxpayers are automatically enrolled in the monthly installment plan when they make their first monthly payment. Taxpayers do not need to submit an application to pay monthly, and there are no escrow accounts so the funds are distributed to local taxing districts every month and could be spent immediately. Taxpayers can set up automated monthly transfers from their checking or savings account, or mail a check each month.

Our research has identified some best practices that can enhance the effectiveness of monthly property tax payment plans.

- **Allow taxpayers to pay monthly without requiring an application:** Arguably the most important difference between the prepayment programs and Milwaukee's monthly installment plan is that only Milwaukee's plan allows taxpayers to enroll in the monthly payment plan without first submitting an application. This difference is likely the biggest reason why participation rates are 5-10x higher in Milwaukee than in jurisdictions with prepayment programs that require an application.
- **Create established processes that make it easy for taxpayers to pay monthly:** Some jurisdictions that allow prepayments use ad hoc processes to reach payment agreements with individual homeowners. Other localities have more established processes, where the treasurer's office provides application forms, estimates taxpayers' monthly payments, and provides all necessary information about the program on their website. These more formal programs make it easier for taxpayers to pay monthly and tend to have higher participation rates.
- **Encourage automated monthly payments, but provide other options:** Many local governments allow taxpayers to establish automated monthly payments with transfers from their checking or savings accounts, which eliminates the need for them to remember to make monthly payments.
- **Monthly payment plans should be authorized as a local option, but not required for all governments:** There are large differences across local governments in the upfront costs to start accepting monthly payments, depending on whether their existing software for tax collection allows them to track monthly payments. Some jurisdictions could start accepting monthly payments for practically no cost, while others would need to spend millions of dollars to implement a new property tax collections software module. While these upfront costs can be substantial, the ongoing administrative costs and staff time needed to

manage monthly payment programs are small once the necessary software is in place, according to interviews with tax collectors.

- **Consider shared service arrangements to reduce the cost of tax collections:** If new collections software is needed to start accepting monthly payments, governments can substantially reduce these cost by sharing collections software. For example, the Iowa County Treasurers eGovernment Alliance allows taxpayers in 56 of the state's 99 counties to set up monthly recurring property tax payments.
- **Minimize transaction costs for monthly payments:** To avoid penalizing taxpayers for making monthly payments, localities can cover transaction costs for payments made from checking or savings accounts. Local governments can use a request for proposals to minimize these transaction costs by soliciting bids from multiple companies that provide these payment services. For example, in Milwaukee, the cost for automated monthly transfers is just 1.5 cents per payment, with the city government covering this cost.
- **Use outreach and advertising to increase participation rates:** To make sure taxpayers know about the option to pay monthly, tax collectors could include a separate flyer with the tax bill publicizing the option to pay monthly, or put a highly visible notice on the tax bill itself or on the envelope used to mail out tax bills.