

MEMORANDUM

TO: Board of Selectmen
CC: Maureen Valente, Town Manager
FROM: Andrea Terkelsen, Finance Director/Treasurer/Collector
DATE: June 6, 2012
RE: Senior Tax Deferral Rate Request for FY13

On an annual basis, the Board of Selectmen votes to set the Senior Tax Deferral interest rate for the coming fiscal year in accordance with M.G.L. Chapter 59, Section 5 (41A) and as amended by Sudbury's Special Act of 2002. The chosen rate will be charged against any taxes deferred in FY13 (only) and will remain in effect until that year's deferral amount has been paid in full.

As in past years, I have attached my latest report on Sudbury's senior tax deferral program. I hope you will find the updated program statistics, historical information and commentary useful in your decision making process. I wish to draw your attention in particular to a newly added "frequently asked questions" section, reconfigure local options discussion and expanded comments on reserves and receivables.

Vote Request

That the Board of Selectmen vote to approve a senior tax deferral interest rate for fiscal year 2013 of **2.5%**.

For your consideration

The reasons for my interest rate recommendation of 2.5% have not changed from the prior year. By way of quick review, I wish mention following key areas when considering an appropriate interest rate for a program that affords a narrowly selected group of taxpayers the ability to borrow against their future home equity for an extended period of time:

- ✓ The rate remains at or below other financial instruments, especially those pertaining to longer-term borrowing, with similar duration of Sudbury's Senior Tax Deferrals.
- ✓ This rate continues to offer participants a very low cost alternative to any consumer, market-based borrowing options.
- ✓ This rate remains at or below the majority of other Massachusetts' communities with an active deferral program.
- ✓ This rate still reflects the tenor of the 2002 Town Meeting when taxpayers opted for the ability to lower the interest rate from the 8% State mandate to something more affordable for seniors but did not vote to abolish charging interest.
- ✓ This rate allows the Town to modestly recoup some administrative costs of program without placing an excessive financial burden on participants. [Example: Using the average annual deferral amount in FY12 of \$6,073 at 2.5% interest charge comes to \$150 per year per deferral or less than \$11,000 in total. Even without considering the costs associated with receiving, approving, and processing 70+ deferrals each

year, the interest charge at a minimum covers the filing fees required to maintain these special tax liens at the Registry of Deeds. While some participants actually pay more towards the annual program administration than others, this being commensurate with property asset value for future payment is considered reasonable and consistent with how all other non-qualifying taxpayers are charged interest.

- ✓ This rate provides some parity between the needs and special consideration afforded one group of taxpayers with the many other taxpayers who have no choice but to pay their taxes every year regardless of financial hardships or incur a statutory 14-16% interest charge, title and legal fees, as well as foreclosure proceedings.

REPORT – SUDBURY'S SENIOR TAX DEFERRAL PROGRAM DETAILS

PROGRAM INFORMATION AS OF JUNE 2012

FREQUENTLY ASKED QUESTIONS (FAQ'S) ABOUT SUDBURY'S DEFERRAL PROGRAM

How does a senior tax deferral differ from an exemption or abatement of taxes? Unlike an exemption or abatement of taxes, a senior tax deferral simply allows someone to *postpone* payment of taxes. A tax deferral agreement requires the deferred taxes along with interest to be paid in full *ONLY* (1) when the property is sold or transferred, (2) upon death, or (3) upon the death of a surviving spouse if he or she qualifies for a deferral and enters into a new tax deferral agreement.

What is the current balance for all tax deferrals in Sudbury? As of the date of this report the balance is \$2.42 Million.

What besides senior tax deferrals is recorded in Sudbury's tax deferral account and what is that balance? Included in this general ledger account grouping is any activity for *temporary hardship deferrals*. As of the date of this report the balance for temporary hardship deferrals is \$66,766.

Does Sudbury receive any sort of reimbursement from the State for tax deferrals? No. Unlike some other age or income tax relief options granted at the local level the State does not give municipalities any funding for tax deferrals either on a permanent or temporary basis. Massachusetts has not adopted legislation similar to Washington, Minnesota, Idaho and Oregon that require the State's Treasury to lend funds (equal to annual deferrals) to the local taxing authorities. When deferrals are paid the local government refunds the state treasury, including interest collected. A state reimbursement program of this kind would typically require the establishment of a special revolving fund that would allow for an accumulation of earnings for future self-funding and/or borrowing outside General fund appropriations. Therefore in order for Massachusetts to adopt something similar the legislature would have to identify a potential revenue source or devise a way to borrow funds to support a statewide program.

If Sudbury's Special Act for a Senior Citizen Exemption becomes law how will this impact the senior tax deferral program? This new tax exemption would not preclude seniors from also taking advantage of the Senior Deferral program. The value of any exemption is applied to a taxpayer's tax liability first thereby lowering the amount to be deferred.

Is charging interest on senior tax deferrals required by Massachusetts General Law? No, not since 2006 when State legislation was passed allowing communities based on Town Meeting vote to set an annual interest rate on senior tax deferrals anywhere from (the previous statutory rate of) 8% to as low as zero.

How does Sudbury determine the interest rate on deferrals? In 2003 a special act regarding senior deferrals went into effect. The Act calls for the Board of Selectmen to set the interest rate for each fiscal year. This process supersedes the changes subsequently made at the State level in 2006 that requires Town Meeting approval to determine a rate not to exceed 8% but that may be as low as zero.

How does the Board of Selectmen determine what the interest rate should be each year?

At or near the beginning of each fiscal year the Town Treasurer provides the Board of Selectmen with one or more recommendations for an interest rate for the coming year. The Treasurer provides a report that includes Program's current status and other information considered useful in their decision-making process.

TIMELINE FOR SENIOR TAX DEFERRAL PROGRAM

Governances – M.G.L. Chapter 59, Section 5 (Clause 41A) and all updates relative thereto from Legal Acts, general or special.

1993 Sudbury's *first long-term tax deferral* is granted. Program administered under regular State criteria; mandated interest rate of 8%.

1998 Sudbury's senior tax deferrals increase to *two*. Program administered under regular State criteria; mandated interest rate of 8%.

2002 Town successfully submitted special legislation to expand the existing eligibility parameters for senior tax deferrals. This allows the Board of Selectmen to set the deferral rate at their discretion annually, not to exceed statutory 8%. Sudbury has **5 senior tax deferrals**.

2003 Town lowers interest rate from 8% to 4%. Participation in program doubles again from **5 to 10 senior tax deferrals**.

2005 Town sets interest rate at 2.5% primarily based on 1-year Constant Maturity Treasury Bill rates. Participation in program continues to increase; **quadruples to 20** since passing special act 2002.

2006 State allows all communities to lower interest rate based on Town Meeting vote to anything between 8% and zero. This does not affect the Town's program under special act 2002. **49 senior tax deferrals**.

2008 State allows all communities to further increase qualifying gross receipts limitation by a fixed amount or as a percentage of circuit breaker level to increase annually. This does not affect the Town's program under special act 2002. **65 senior tax deferrals**.

2010 Town maintains 2.5% interest rate based on longer-term Constant Maturity Treasury rates. Longer horizon for rate setting chosen to bypass volatility of short-term economic markets and realize a reasonable rate of return for receivable payoff horizon of 10-20 years. **77 senior tax deferrals. Total of 92 parcels in deferral, total receivable increases to \$1.74M.**

2012 Town's Special Act of STM 2011 for Senior Tax Exemption is still being considered by Massachusetts' Legislature. Town maintains 2.5% interest rate based on longer-term Constant Maturity Treasury rates. **71 senior tax deferrals issued in FY12. Total of 90 parcels in the program, total receivable increases to \$2.35M.**

LOCAL OPTIONS RESULT IN LOCAL FINANCIAL CONSEQUENCES

As mentioned in previous reports, very little has been done over the years regarding senior tax relief legislation at the State-level except to allow local options unfortunately also place the burdens onto local municipalities. Recent Circuit-Breaker legislation is the notable one exception that benefits both seniors and local communities by offering a real estate credit that on State income taxes.

At the local level Sudbury continues to lead the way in developing meaningful tax relief for seniors. Most recently Sudbury passed at Special Act for senior tax relief in 2011. This groundbreaking legislation if passed into law later this year would establish a pilot exemption program in Sudbury that promises to deliver tax relief to a majority of seniors that also qualify for the State's tax circuit-breaker program. If enacted, the annual cost of providing benefits under this new program would be borne entirely at the local level.

How does senior tax relief impact finances at a local level? Senior tax relief programs either a) reduce the amount of taxes collected (exemptions), b) delay the collection of taxes (senior and temporary hardship deferrals) for years or even decades, or c) shift the burden of one segment of taxpayers onto the rest of the residential tax base (Sudbury's pending special legislation of 2011). Exemptions of taxes and property values are financed through the municipal budgeting and tax rate setting processes, respectively. Tax deferrals on the other represent revenues that are budgeted for each year but not collected for years or even decades. It is important to note that while tax deferrals do not throw our annual budget "out of balance" they do represent an impediment to building reserves.

A municipality is allowed to consistently spend more than it collects in revenues? Yes. Remember that spending is controlled by the appropriation process. While a municipality cannot spend more than what is appropriated at Town Meeting it may spend more in annual appropriations than what it collects in property tax revenues. The reason for this is that there is a basic assumption that because the town has a lien on the property it will eventually collect the taxes. This premise holds true for *all* property taxes including balances that become delinquent (not paid by June 30) or otherwise fall into the special category of tax deferral.

If a large portion of tax revenues are not collected then where does the money come from to pay for the appropriations every year? The Town may continue to spend up to its annual appropriations by using available funds in reserve. Unlike revenue deficits that are required to be raised on the next year's tax rate this type of "borrowing" from available cash flow can put a tremendous burden on a community's ability to maintain adequate cash reserves for the future. While we may have not reached that tipping point yet we need to remain cognizant of that possibility somewhere down the road depending on if the amount of annual deferrals were to increase significantly and/or receivables rise to a level that far exceeds our ability to generate sufficient Free Cash to support this program's continued growth or other extraordinary needs that require reserves.

RECENT USAGE OF SUDBURY SENIOR EXEMPTIONS AND DEFERRALS

Sudbury has enacted many local options over the years in order to expand on tax relief opportunities for its seniors. These options include lowering age and income requirements for certain programs in addition to increasing the actual dollar amounts given on various exemptions. Sudbury has also significantly reduced the interest rate for Senior Deferrals from the State mandated 8%.

Sudbury's current senior tax relief options (relating strictly to age and income factors) are as follows:

1. Clause 41C. Elderly person over age 64. Exemption of \$1,000.
2. Clause 17E. Elderly person over age 70 or surviving spouse. Exemption of \$273.56
3. CPF Surcharge Exemption. Exemption up to 100% of surcharge. (Automatic 100% exemption for Senior Deferral program participants).
4. Clause 41A. Senior Tax Deferral. Deferral allowance up to 100% of tax. 2.5% simple interest. Payback only at sale or transfer of property.
5. Clause 18. Hardship Exemption. Exemption amount given at discretion of Board of Assessors.
6. Clause 18A Deferral. Temporary Hardship Deferral. Deferral allowance up to 100% of tax for 3 years. 8% statutory interest. 2 year grace period before payback.
7. Tax Work-Off Program. Relief of \$750 property tax per year. May be combined with other program benefits.
8. Pending legislation for a local Senior Tax Exemption meant to reduce property tax liability based on income.

Table 1 Sudbury's History of Age/Income Restricted Exemptions and Deferrals

The following table provides a five-year history of all age-based tax relief options provided.

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>5-YRS</u>	<u>5-YR AVG</u>
<u>Exemptions:</u>							
41C	60,026	53,264	56,833	58,044	59,198	287,365	57,473
17D/E	7,401	4,758	4,572	4,578	4,449	25,759	5,152
CPF	23,643	35,033	38,195	38,353	33,920	135,224	33,829
18	20,895	15,500	16,752	11,670	10,061	74,878	14,976
Work-Off	36,094	33,343	36,236	35,104	34,133	174,909	34,982
	148,059	141,898	152,588	147,749	141,760	698,134	146,411
<u>Deferrals:</u>							
18A Temp Hardship Deferral	19,589	33,427	12,870	13,040	-	78,926	15,785
Senior Deferral	322,677	343,617	435,354	466,071	436,999	2,004,718	400,944
	342,266	377,044	448,224	479,111	436,999	2,083,644	416,729

Note that exemptions are applied against the Town's tax Overlay Reserve account. **Overlay Reserve** is an account established annually to fund anticipated property tax abatements, exemptions and uncollected taxes in that year. The overlay reserve is not established by the normal appropriation process, but rather is raised on the tax rate recapitulation sheet. The Town uses Overlay to budget for less than the total amount of taxes levied. Overlay represents a potential write-off of taxes levied very much like an allowance for uncollectible receivables in the private sector. What is budgeted for in Overlay represents tax dollars that we commit every year but will not receive. Tax deferrals on the other hand represent tax dollars that we will eventually collect at some point in the future.

STATISTICS FOR SUDBURY'S SENIOR TAX DEFERRAL PROGRAM

Table 2 Senior Tax Deferral Receivable Balance Information as of June 2012.

	Count of Parcel	Min of Unpaid Principal	Max of Unpaid Principal	Average of Unpaid Principal	Sum of Unpaid Principal
1993	1	\$ 3,165	\$ 3,165	\$ 3,165	\$ 3,165
1994	1	\$ 3,189	\$ 3,189	\$ 3,189	\$ 3,189
1995	1	\$ 3,262	\$ 3,262	\$ 3,262	\$ 3,262
1996	1	\$ 3,495	\$ 3,495	\$ 3,495	\$ 3,495
1997	1	\$ 3,645	\$ 3,645	\$ 3,645	\$ 3,645
1998	2	\$ 1,767	\$ 3,645	\$ 2,706	\$ 5,412
1999	2	\$ 3,295	\$ 4,766	\$ 4,030	\$ 8,061
2000	3	\$ 2,039	\$ 5,311	\$ 3,618	\$ 10,853
2001	3	\$ 3,489	\$ 5,829	\$ 4,299	\$ 12,896
2002	4	\$ 536	\$ 6,402	\$ 3,429	\$ 13,718
2003	8	\$ 1,870	\$ 6,915	\$ 4,224	\$ 33,790
2004	12	\$ 1,424	\$ 6,809	\$ 4,362	\$ 52,346
2005	14	\$ 301	\$ 6,809	\$ 3,973	\$ 55,616
2006	33	\$ 790	\$ 7,427	\$ 4,322	\$ 142,621
2007	49	\$ 972	\$ 9,701	\$ 4,569	\$ 223,896
2008	52	\$ 1,358	\$ 10,210	\$ 4,891	\$ 254,333
2009	54	\$ 1,414	\$ 9,176	\$ 4,996	\$ 269,770
2010	69	\$ 1,637	\$ 16,055	\$ 5,683	\$ 392,095
2011	70	\$ 1,889	\$ 16,029	\$ 6,065	\$ 424,526
2012	72	\$ 1,161	\$ 16,356	\$ 6,069	\$ 436,999
Grand Total	452	\$ 301	\$ 16,356	\$ 5,207	\$ 2,353,686

(Above exhibit summarized by fiscal year of deferral. Statistics represent current remaining parcels and tax amounts deferred)

As the above table indicates the Town is currently carrying senior tax deferral receivables on the balance sheet that stretch as far back as 1993. So far in FY12, 72 senior tax deferrals were created totaling \$436,999. The majority of the deferral bills represent 100% of the taxpayers' property tax liabilities for the year. As of the date of this report, eight tax deferrals were paid off in full during FY12 totaling \$170,843. Although this count is consistent with the number of payoffs that occurred in the prior year there was an increase of \$57,000 due to sizes and numbers of bills paid by participants this year. Over the years, no clear pattern for payoffs has emerged. However it is interesting to note that we have seen an increase in the number existing participants that are looking to refinance or take out mortgages on their properties. As more mortgage companies will not allow senior tax deferrals we may experience an increase in payoffs over the next few years. We have already noticed a slight reduction in new or continuing deferral participation in the program because mortgage companies are refusing to sign-off on deferral agreements. The State does not have any legislation that requires banks or mortgage companies to allow Massachusetts' homeowners to defer taxes for any reason. Consequently, many lenders choose to protect their underlying investment by requiring all property taxes be paid in full since any tax lien

(including those secured by tax deferral agreement) automatically puts the Town's right to collect taxes or foreclose on a property in front of any other parties regardless of any underlying debts, liens or legal proceedings.

Chart 1 Senior Tax Deferral Receivable Aging of June 2012.

Sudbury's current tax deferral receivables include balances across 19 fiscal tax years generating from **90 different parcels**. History shows that once someone has entered the deferral program they will continue to defer for several years. The chart below shows the duration of all parcels in the program as of June 2012. The average duration of the program increased from 4.41 to 5.02 years in FY12. Current estimates suggest that the likely maximum range for a deferral could be anywhere from 18 -22 years.

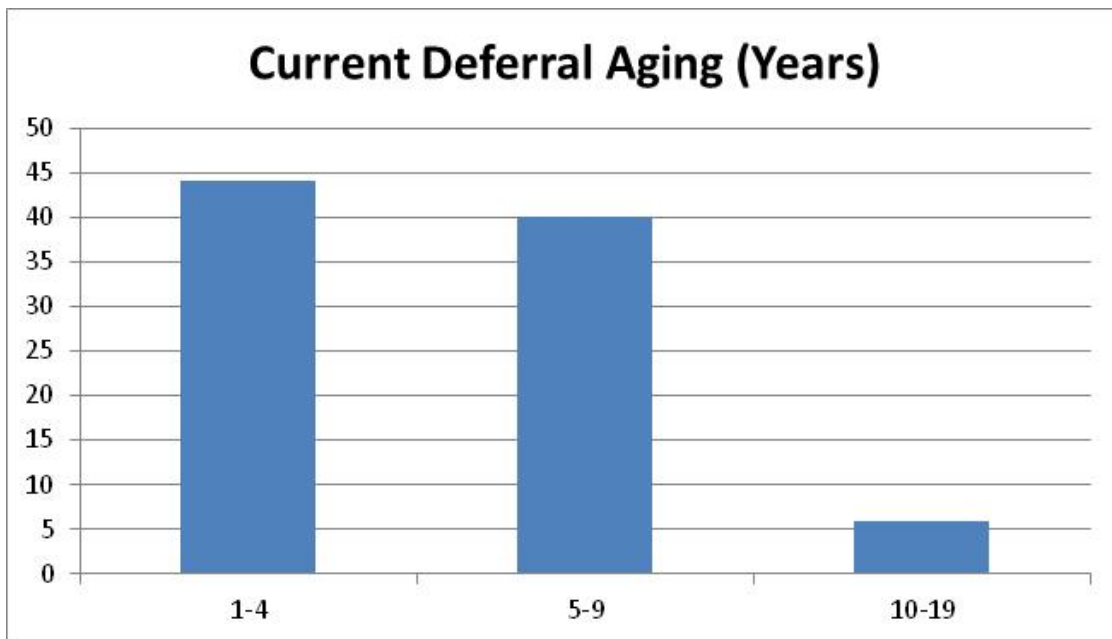
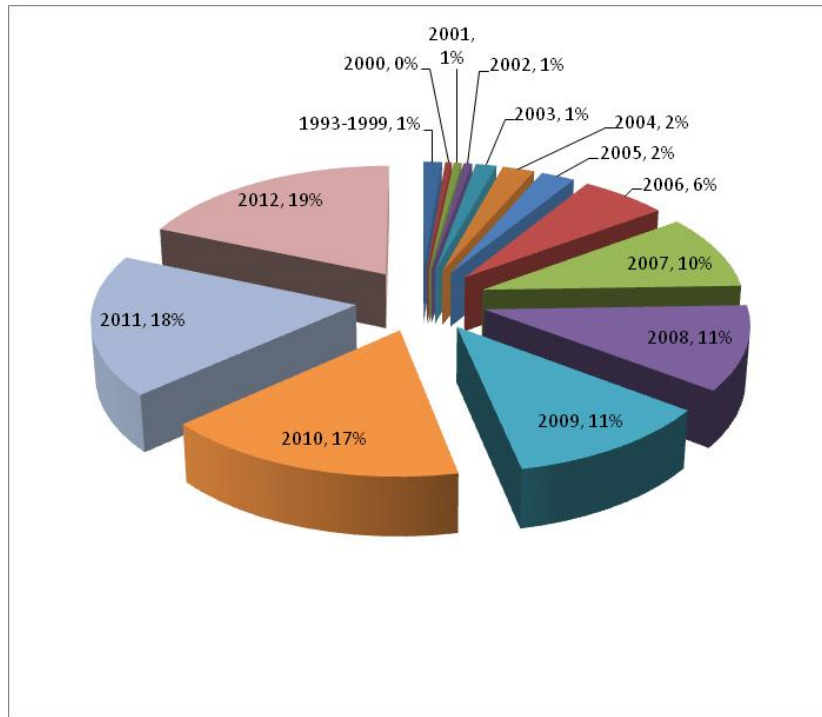


Chart 2 Deferral Receivable Balance Information as of June 2012.

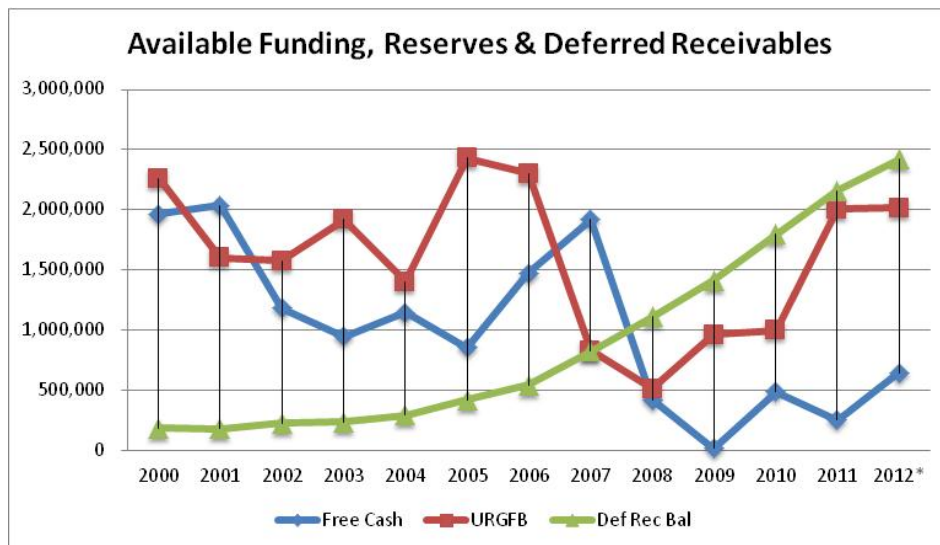
The Town continues to experience a steady growth in total tax deferral receivables. The current net increase of \$258 thousand in deferrals and accumulated deferral receivable balance of \$2.42 million represents **.42%** and **3.86%** of the FY12 total residential tax levy, respectively. The total number of new deferrals went 76 in the prior year to 72. The \$95K decline in net additions this year can be attributed to the larger amount of payoffs and a couple of longtime deferrers opting out in FY12 due to deed or mortgage restrictions. Lastly, the Town did not have anyone qualifying for temporary hardship deferrals for the first time since 2007. The chart on the next page provides a snapshot of the Town's total current tax deferral balance as of June 2012.



(Note that the Town's deferral account also includes any 18A temporary hardship deferral balances. As of June FY12 there is a balance of a little over \$66,000 in hardship deferrals remaining that span FY07 to FY11)

Chart 3 Cash flow, Reserves & Receivables

Maintaining a very large deferral program presents some unique albeit worthwhile financial challenges for the Sudbury. We can make reasonable assumptions each year regarding how many people will apply for deferrals and possibly for how much. However, as mentioned earlier we do not have a way of including this financial information in the municipal budgeting and tax rate setting processes. Below is a chart showing the trend in deferral receivables along with Free Cash and unrestricted General fund balances.



(*Free Cash certified as of October 2011, other FY12 final results pending year-end audit)

It may be interesting to note here that the bulk of our tax deferral receivables balance has come about in recent years during a prolonged period of economic difficulties and budgetary constraints.

As mentioned earlier some other states the legislature has established (in the State Treasury) a senior property tax deferral revolving account to be used for the purpose of making the payments to municipal tax collectors of property taxes as amounts are deferred. Upon payment of the deferred receivables the tax liens are redeemed and the amounts collected including interest are transmitted back to the State Treasury. The State of Oregon for example has been running its deferral reimbursement program for several decades paying out in upwards of \$14-\$15 million in annual reimbursements to the various counties where the tax deferrals range anywhere from 3 to 1,900 accounts. In all cases the State charges interest on deferrals presumably to help pay for program administration as well as borrowing costs, where necessary. Washington, Minnesota and Idaho are also among the list of other States taking an active *financial* role in advancing senior tax deferral programs by providing local property tax authorities with what amount to very low cost loans to qualifying homeowners so that municipalities do not have to; thereby are not forced to suffer any cash flow crises in an effort to help seniors.

INTEREST ON DEFERRALS

Table 3 Deferral and Market Rate History

Participation Year	Deferral Rate	15 -yr FMR*	New or Ongoing Deferrers
2002	8.00%	6.86	14
2003	4.00%	6.21%	23
2004	2.00%	4.84%	26
2005	2.50%	5.81%	33
2006	2.50%	5.35%	49
2007	2.50%	6.35%	62
2008	2.50%	6.41%	65
2009	2.50%	6.38%	66
2010	2.50%	5.41%	77
2011	2.50%	4.02%	76
2012	2.50%	3.32%	71

*Source: HSH Associates Financial Publishers

We continue to offer our seniors an exceptional alternative to any consumer-based borrowing opportunities available. Sudbury's deferral program remains very popular in comparison to all other communities surveyed in FY11, including those charging little or no interest.

It has been suggested that we should further lower or even eliminate charging interest as a means of increasing participation in the deferral program. While taxpayers that defer would most likely prefer not to pay any interest there is no evidence indicating that what we are charging is unreasonable or poses any undue financial hardship when paid. Instead what we have heard time and again from taxpayers that may qualify for the program is that they simply do not want to take on any principal debt against their home's future equity. Reducing or eliminating an interest charge completely would be somewhat beneficial to existing participants but would not serve to encourage others to take advantage of the deferral program when taking on debt at any cost is unacceptable. Instead, if the Town wishes to increase participation in its senior deferral program (rather than further benefitting those already included at a very reasonable

cost) a better option might be to further relax the income and age requirements, so as to invite a much larger segment of taxpayers that may be more inclined take on low cost secured debt.

APPENDIX 1: AN UPDATE ON OTHER COMMUNITIES

According to the DLM's last report (2005), there were only 146 out of 353 communities in Massachusetts with senior tax deferral activities. Their study indicated the number of active deferrals ranged from only 1 to a high of 82, with the average participation being 8. Sudbury at that time had 26 active deferrals ranking us 8th in the State only behind much larger communities such as Newton, Quincy, Hingham and Lynn. An update of these statewide statistics is not yet available so we conducted our own survey back in 2011.

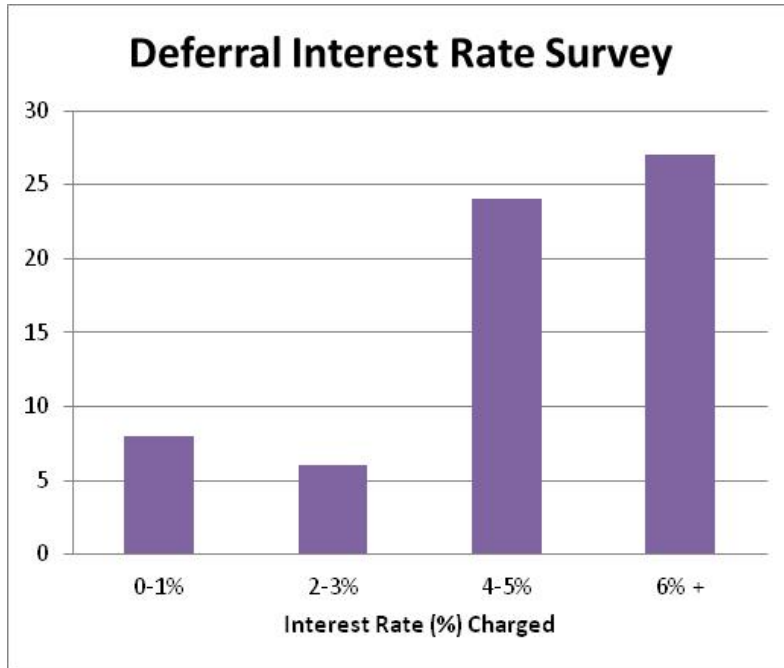
Table 4 What other Communities are charging for interest on senior deferrals

The table below is an update to the survey conducted in 2011. Communities marked with an asterisk have been added or information updated as of June 2012.

Town	Rate	Town	Rate	Town	Rate	Town	Rate
Acton	0.50%	Hamilton	5.00%	Newton *	0.75%	Wayland	3.50%
Amherst *	4.00%	Harvard	2.00%	Northborough	8.00%	Wellesley *	0.50%
Arlington	6.00%	Hingham	1.00%	Norton	4.00%	Westborough	0.00%
Ashland	4.00%	Hopedale	5.00%	Norwell	8.00%	Westford	8.00%
Bedford	8.00%	Hopkinton	5.00%	Plymouth	2.25%	Weston	4.00%
Bellingham	8.00%	Hudson	8.00%	Province Town	8.00%	Winthrop	8.00%
Bolton	8.00%	Ipswich	4.00%	Quincy	4.00%	Worcester	8.00%
Boston	4.00%	Lexington	0.26%	Saugus	8.00%	Yarmouth	8.00%
Boxborough	8.00%	Lincoln *	4.00%	Scituate *	8.00%		
Cambridge	4.00%	Lunenburg	4.00%	Sharon *	3.00%		
Canton *	8.00%	Lynnfield	4.00%	Southborough	4.00%		
Carver	8.00%	Marlborough	8.00%	Sterling	8.00%		
Chicopee	4.00%	Marshfield *	0.00%	Stoneham	8.00%		
Concord *	4.00%	Maynard	2.00%	Sturbridge	8.00%		
Dedham *	6.00%	Medway	0.20%	Sudbury	2.50%		
Dover *	8.00%	Merrimack	4.00%	Swampscott *	8.00%		
Duxbury	4.00%	Natick	4.50%	Tewksbury	5.00%		
East Brookfield	8.00%	Needham	4.00%	Waltham	5.00%		
Framingham *	4.00%	Newbury	8.00%	Watertown	8.00%		

Chart 4 Survey Results – Interest Rate Frequency

Of the communities surveyed, only 11 are currently charging a **lower** interest rate than Sudbury. Responses indicate that many of these communities have simply opted to adjust their rates annually based on short-term investment benchmarks. The city of Newton adopted a special ordinance in 2006 to charge the Federal Reserve Banks' discount rate charged for primary credit, effective as of June 30 of the prior fiscal year not to exceed 8%. Whereas Wellesley has adopted special legislation that uses the monthly two year constant maturity Treasury published in July each year. To date, **only two** communities in Massachusetts, Marshfield and Westborough have opted to reduce their rate to 0% by Town Meeting vote.



APPENDIX 2: MARKET INTEREST RATE REFERENCES

Rate Type	Current	1 Year Ago
MMDT	.28%	.20%
6 mo. CD's	.47%	.28%
State & Local Bonds	3.81%	4.49%
Bank Prime	3.25%	3.25%
1 yr CMT	.21%	.18%
5 yr CMT	.76%	.72%
10 yr CMT	1.76%	3.00%
20 yr CMT	2.44%	3.89%
15 yr FRM	3.74%	3.62%
30 yr FRM	4.55%	4.38%
10 yr COFI (Federal Cost of Funds) index	3.2-3.9%	6.0-6.8%
10 yr MTA (Federal Cost of Funds) index	3.1-3.8%	5.8-6.6%