

MEMORANDUM

TO: Board of Selectmen

CC: Maureen Valente, Town Manager

FROM: Andrea Terkelsen, Finance Director/Treasurer/Collector

DATE: July 5, 2014

RE: Senior Tax Deferral Rate Request for FY15

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 FY15 and will remain in effect until that year's deferral amount has been paid in full. Deferral program interest is charged on a per diem basis against the principal balance (e.g. does not account for the effects of interest compounding).

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.

At a later date we will come to you for your decision to set the cap (% of levy) for the FY15 Senior Tax Exemptions. However, what is interesting to note about this new program in relation to deferrals is that the reduction in tax liability for 118 qualifying seniors nearly equaled in total dollars for FY14 deferrals. Of the 54 new deferrals issued in FY14, many participants also took advantage of the new tax exemption program. Due to privacy concerns I do not wish to comment further but to say that the new exemption program has effectively reduced the current and future tax liability of several seniors in Sudbury.

At the same time, the tax levy requirements for the Town continue to grow which means that any tax liabilities reduced or deferred into the future must be paid by someone. In the case of the new senior tax exemption those tax dollars are being paid by all current residential homeowners. In the case of senior deferrals, the principal along with any modest interest charges are paid by the property owners themselves or their heirs at some time in the future.

Although we have seen a drop off in senior deferrals since a peak in 2010 the program remains popular amongst those who have been in it for several years and/or new participants that do not have a mortgage on their property. Since 2010, most consumer lenders will not allow their customers to enter into any tax deferral programs. Consequently, some seniors cannot take advantage of Sudbury's deferral program regardless of the any special payment or interest terms we offer.

In my decade tenure of administering this program, I remain convinced that for those who are able and willing to participate in a long-term deferment program, the modest interest they will be charged is inconsequential to their decision to make large payment(s) in the future towards tax principal using their home's equity, whether or not that value is newly generated or more often than not may have accumulated over a "lifetime" in Sudbury.

Vote Request

That the Board of Selectmen vote to approve a senior tax deferral interest rate for fiscal year 2015 of **2.0%**.

For your consideration

The reasons for charging interest to senior deferral participants remain the same. By way of quick review, charging a modest interest rate to a selective group of taxpayers for an extended period of time:

- reflects the tenor of the 2002 Town Meeting when voters gave the Board the ability to lower the interest rate from the State mandate of 8% but did not vote to abolish charging interest on senior deferrals,
- reflects the actions taken by of most municipalities; all of those with deferral programs at or below Sudbury's program in popularity, size and duration,
- provides some parity between a selective group of taxpayers and all other taxpayers who qualify for this program except for meeting the age requirement,
- defrays the costs associated with administering the senior deferral program along with several other local tax relief options in Sudbury.

Lowering the senior deferral rate to only 2% for FY15 deferrals would do the following:

- considers the current trend in consumer rates which remain historically low but are showing signs of stabilizing,
- remains at or below the majority of other Massachusetts' communities with an active deferral program,
- continues to offer participants a very low cost alternative to any consumer, market-based borrowing options,
- matches the program's lowest rate since 2005
- reduces the participant's cost of borrowing from \$25 to \$20 per thousand
- reduces the Town's deferred interest income for FY15 deferrals to approximately \$6,000 per year,
- limits are total deferred receivables interest income to approximately \$70,000 or less.

REPORT – SUDBURY'S SENIOR TAX DEFERRAL PROGRAM DETAILS

PROGRAM INFORMATION AS OF JUNE 30, 2014

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 \$2.45 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 \$16,972.

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.

Now that Sudbury's Special Act for a Senior Citizen Exemption has become law how will this impact the senior tax deferral program? This new tax exemption does 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 was still being considered by Massachusetts' Legislature. Town maintains 2.5% interest rate based on longer-term Constant Maturity Treasury rates. **72 senior tax deferrals issued in FY12. Total of 90 parcels in the program, total receivable increases to \$2.35M.**

2013 Town's Special Act of STM 2011 for Senior Tax Exemption was passed by Massachusetts' Legislature as a pilot program to operate from FY14 through FY16. **See the Town's website for further information on this new program.**

2014 We had **118 participants in the new Senior Tax Exemption program for a total of \$289,152.** Total receivables for senior deferrals have leveled off at \$2.45 million due to nearly an equal amount of payoffs as new deferrals during FY14. Not only has the number of new deferrals declined from a few years ago but many participants have also taken advantage of Sudbury's new Senior Tax Exemption program reduce their overall tax liability.

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 a Special Act for senior tax relief in 2011. This groundbreaking legislation which was enacted into law this year establishes 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. The annual benefits provided under this new program would be borne entirely at the local level by all residential taxpayers.

How does senior tax relief impact finances at a local level? Senior tax relief programs reduce the amount of taxes collected (exemptions), delay the collection of taxes (senior and temporary hardship deferrals) for years or even decades, or shift the burden of one segment of taxpayers onto the rest of the tax base (Sudbury's 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 using available reserves as necessary, or on building balances for the future.

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 from its reserves. 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 senior tax relief programs 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. Maximum benefit of \$2,000.
2. Clause 17E. Elderly person over age 70 or surviving spouse. Maximum benefit of \$563.18
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 \$800 property tax per year. May be combined with other program benefits.
8. *New* local Senior Tax Exemption to reduce property tax liability based on income.

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

	2010	2011	2012	2013	2014	5-YRS	5-YR AVG
<u>Exemptions:</u>							
41C	56,833	58,044	59,198	52,502	44,251	270,828	54,166
17D/E	4,572	4,578	4,449	4,224	4,293	22,117	4,423
CPF	38,195	38,353	33,920	31,360	32,082	173,909	34,782
18	16,752	11,670	10,061	4,000	-	42,483	8,497
Work-Off	36,236	35,104	34,133	36,626	38,891	180,989	36,198
Sr. Residential Exemption	-	-	-	-	289,152	289,152	57,830
	152,588	147,749	141,760	128,712	408,669	979,478	195,896
<u>Deferrals:</u>							
18A Temp Hardship Deferral	12,870	13,040	-	-	-	25,910	5,182
Senior Deferral	435,354	466,071	436,999	369,129	311,622	2,019,174	403,835
	448,224	479,111	436,999	369,129	311,622	2,045,084	409,017

Note that tax 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 (and works similar to 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 by FY, as of June 1, 2014

FY	Parcel Count	Min Def A/R Bal	Max Def A/R Bal	Avg Def A/R Bal	Total Def A/R Bal
1993	1	\$ 3,165.12	\$ 3,165.12	\$ 3,165.12	\$ 3,165.12
1994	1	\$ 3,189.05	\$ 3,189.05	\$ 3,189.05	\$ 3,189.05
1995	1	\$ 3,261.63	\$ 3,261.63	\$ 3,261.63	\$ 3,261.63
1996	1	\$ 3,494.86	\$ 3,494.86	\$ 3,494.86	\$ 3,494.86
1997	1	\$ 3,644.74	\$ 3,644.74	\$ 3,644.74	\$ 3,644.74
1998	1	\$ 3,644.74	\$ 3,644.74	\$ 3,644.74	\$ 3,644.74
1999	1	\$ 4,766.12	\$ 4,766.12	\$ 4,766.12	\$ 4,766.12
2000	2	\$ 2,038.98	\$ 5,311.21	\$ 3,675.10	\$ 7,350.19
2001	2	\$ 3,577.97	\$ 5,828.78	\$ 4,703.38	\$ 9,406.75
2002	3	\$ 535.72	\$ 6,401.91	\$ 3,175.12	\$ 9,525.36
2003	6	\$ 1,869.69	\$ 6,915.04	\$ 3,923.12	\$ 23,538.72
2004	8	\$ 1,423.59	\$ 6,809.41	\$ 3,981.64	\$ 31,853.08
2005	13	\$ 301.22	\$ 6,809.41	\$ 3,718.25	\$ 48,337.23
2006	28	\$ 139.40	\$ 7,426.76	\$ 3,977.23	\$ 111,362.54
2007	40	\$ 972.38	\$ 9,700.93	\$ 4,408.82	\$ 176,352.74
2008	40	\$ 1,357.73	\$ 10,210.19	\$ 4,669.97	\$ 186,798.70
2009	43	\$ 1,414.26	\$ 9,176.27	\$ 4,874.72	\$ 209,613.17
2010	56	\$ 1,561.84	\$ 11,909.20	\$ 5,235.39	\$ 293,181.79
2011	56	\$ 1,889.14	\$ 16,028.64	\$ 5,840.45	\$ 327,064.98
2012	58	\$ 2,000.00	\$ 16,355.68	\$ 6,002.38	\$ 348,137.80
2013	58	\$ 1,469.00	\$ 14,381.21	\$ 5,925.09	\$ 343,655.01
2014	53	\$ 1,117.63	\$ 17,370.10	\$ 5,730.82	\$ 303,733.66
Grand Total	473	\$ 139.40	\$ 17,370.10	\$ 5,190.44	\$ 2,455,077.98

Table 2a Senior Tax Deferral Payments Made in FY2014 as of June 30, 2014

Deferral Payments Made in FY14	
1998 \$	49,227
2004	8,993
2006	19,124
2007	13,141
2008	18,493
2009	68,694
2010	90,805
2011	4,552
2013	19,119
Total \$	292,148

Fourteen tax deferrals were paid for a total \$219,822. The number of payoffs is nearly double from 8 last year but the total amount increased by only \$50,000.

Over the years no clear pattern for payoffs has emerged. However we have seen an increase in recent years in the number existing and eligible participants that have mortgages are looking to refinance or take out reverse mortgages on their properties. Often mortgage companies do not allow senior tax deferrals. Consequently we are seeing a reduction in new or continuing deferral participation.

Massachusetts does not have legislation that would require banks or mortgage companies to accept or allow tax deferrals.

Therefore many lenders choose to protect their underlying investment by requiring all property taxes be paid in full at all times regardless of age, income or local options that otherwise enable someone to defer property taxes.

Chart 1 Senior Tax Deferral Receivable Aging of June 2014

Sudbury’s current tax deferral receivables include balances that stretch across 19 years generated from **76 different parcels**. History shows that once someone has entered the deferral program they will generally continue to defer for several years. The chart below shows the current duration of participation in the program. The average duration of the program increased slightly from 5.70 to 6.22 years in FY14. We expect a likely maximum range for deferrals of 20-25 years.

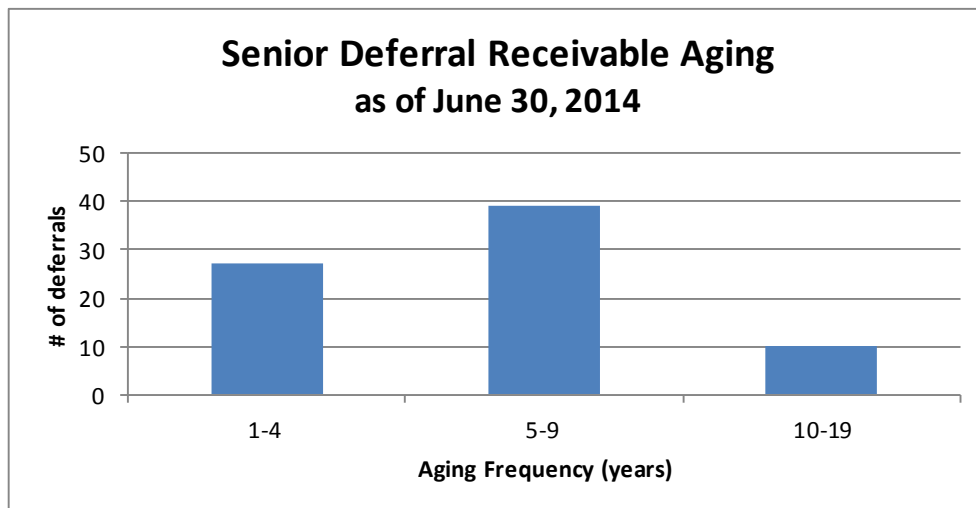


Chart 2 Deferral Receivable Balance Information as of June 2014

As mentioned earlier, the Town experienced a significant amount of payoffs verses new deferrals in FY2014 which led to the smallest net growth in total tax deferral receivables to date at only \$19,454.

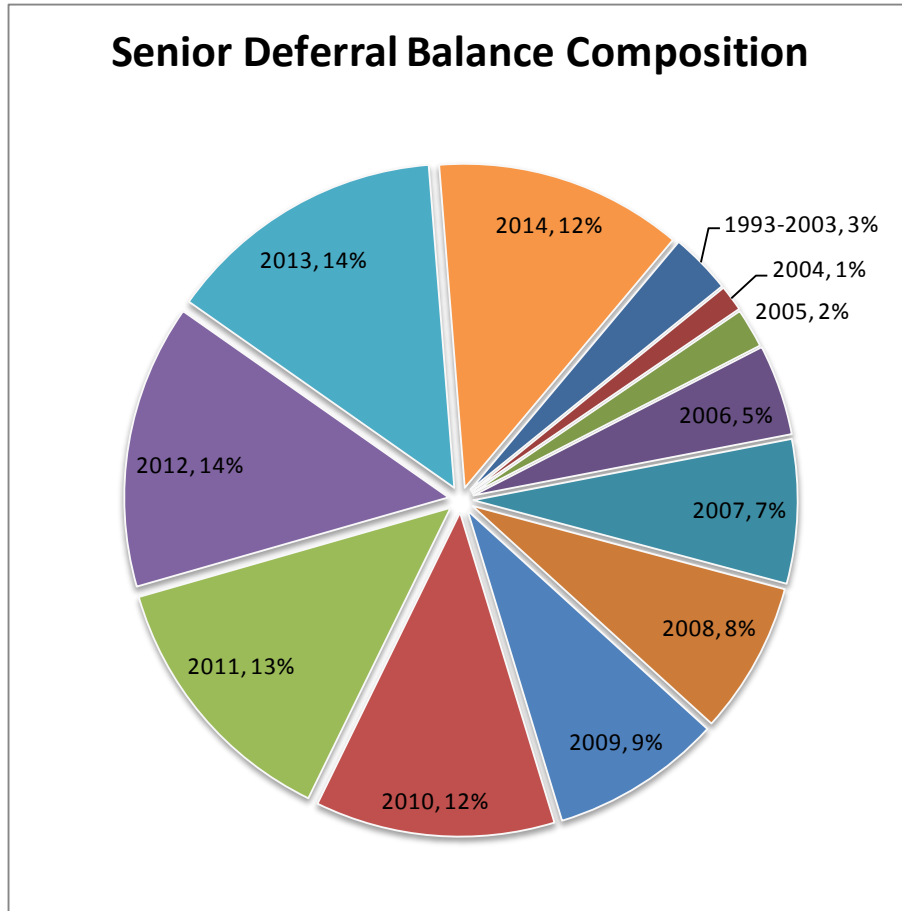


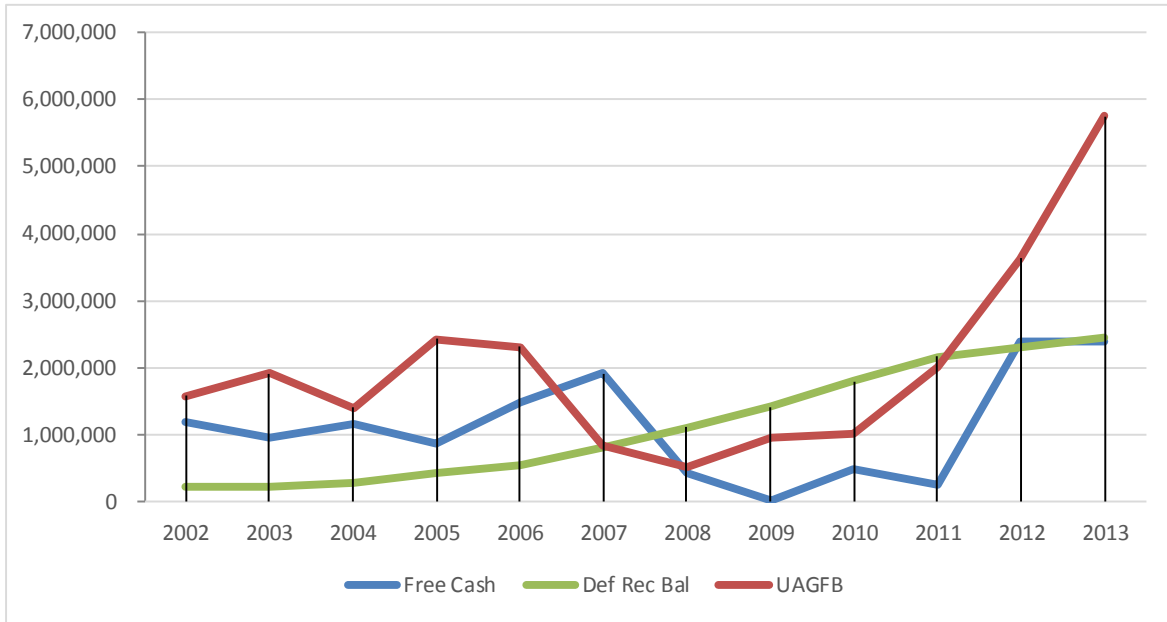
Chart 3 Cash flow, Reserves & Receivables

Maintaining a very large deferral program presents some unique albeit worthwhile financial challenges for 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. The next chart shows a history of deferral receivable balance, Free Cash and Available General Fund Balance (AGFB). Other factors which contribute to changes in reserve levels are not included.

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 conditions improve so too may our ability to absorb even *greater* deferral participation but much will depend on our reserve levels going forward, as well as, any major complex, competing uses (as identified in the Town's preliminary strategic financial plan issued April 2013).

Some other states have established 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 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 by deferring large amounts of taxes levied (and budgeted for each year) that may not be paid off for 20 years.



INTEREST ON DEFERRALS

Table 3 Deferral and Market Rate History

Participation Year	Deferral Rate	15-yr FMR	New/Ongoing Deferrals
2002	8.00%	6.11%	14
2003	4.00%	4.63%	23
2004	2.00%	5.66%	26
2005	2.50%	5.17%	33
2006	2.50%	6.31%	49
2007	2.50%	6.34%	62
2008	2.50%	5.91%	65
2009	2.50%	4.90%	66
2010	2.50%	4.18%	77
2011	2.50%	3.69%	76
2012	2.50%	2.95%	71
2013	2.50%	3.17%	62
2014	2.50%	3.27%	54

Source: Mortgage rates from Freddie Mac

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, 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 undoubtedly prefer not to have to pay any interest there is no evidence to suggest that a modest, *per annum* interest charge is considered a financial hardship or otherwise discourages participation in our program. Instead what we have heard time and again from senior taxpayers that qualify for the program but do not participate is that they:

- a) Do not want any sort of arrangement that constitutes a long-term liability of accumulating tax principal for themselves (or their heirs).
- b) Cannot take advantage of income tax deduction or circuit-breaker credit when deferring their property taxes.
- c) Cannot refinance or obtain either a mortgage or a reverse mortgage on their property when deferring their taxes.

OTHER MARKET INTEREST RATE REFERENCES

Rate Type	Current	1 Year Ago
MMDT	.18%	.15%
6 mo. CD's	.15%	.26%
State & Local Bonds (20 yr)	4.29%	3.93%
Bank Prime	3.25%	3.25%
1 yr CMT	.10%	.14%
5 yr CMT	1.72%	1.04%
10 yr CMT	2.63%	2.12%
20 yr CMT	3.18%	2.93%
15 yr Fixed Rate Mortgage	3.13%	2.88%
30 yr Fixed Rate Mortgage	4.08%	3.91%

CMT: The Constant Maturity Treasury rates are also known as "Treasury Yield Curve Rates". Yields on Treasury securities at "constant maturity" are interpolated by the U.S. Treasury from the daily yield curve, which is based on the closing market bid yields on actively traded Treasury securities in the over-the-counter market.