2013 – The Year in Review: Colorado and New Jersey Tax Lien Sale Results and Projections (Part I)

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Greetings tax lien colleagues! We will be doing this article in two parts. The second installment will follow next month. At the end of February 2014 I gave a presentation on tax lien sale results at the annual NTLA conference in Miami. We specifically looked at results and projections for 2013 lien sales in both Colorado and New Jersey. I strongly believe that there are some items of interest here for everyone. Whether you are a seasoned "tax lien veteran" or a "tax lien newbie", this type of industry information can offer value to you.

Colorado

The sale process

Before we dive into some of the numbers and sales results, I think it makes sense to first review the sale process that is specific to Colorado:

1. Once liens are sold, the liens accrue at a 10% fixed interest rate per annum (this is per statute: the rate is 9% plus the federal discount rate [.75%] rounded to the nearest whole percent). Please note that tax lien interest is always "simple" interest and not compounding interest.

2. Colorado is an "overbid state" – there are "premiums" that are often paid over and above the face value of the lien itself. These premiums do not accrue interest. These premiums are NOT recoverable. You do not receive your premiums back upon redemption of the lien. Paying these premiums to acquire liens is a sunk "cost of doing business".

Denver & Weld County Sale Results

We looked at the summary results for both Denver and Weld Counties:

Denver: a total of 1,809 sold liens were analyzed. The total lien pool was $4,533,901. However, in addition, the buyers of these liens had to pay a premium of $309,882 (or 6.83%) to acquire these liens. The total purchase price (cash paid) was therefore $4,843,783 or 106.83% of the lien pool itself.

Weld: Interestingly, Weld had very similar results from a premium perspective. In Weld, a total of 2,652 sold liens were analyzed. The total lien pool was $1,964,237. However, in addition, the buyers of these liens had to pay a premium of $118,993 (or 6.06%) to acquire these liens. The total purchase price (cash paid) was therefore $2,083,230 or 106.06% of the lien pool itself.

Combined, the two counties totaled 4,461 sold liens with a lien pool of $6,498,138, a 6.60% premium of $428,875 and a combined purchase price of $6,927,013.

I was a bit surprised that both counties had premiums of more than 6% (and an aggregate premium of 6.60%) - especially given that the statutory interest rate is set at only 10% per annum. This being the case, I decided to take a quick look at some other Colorado sale results to determine if this was an anomaly or a trend. Teller County had a 7.14% premium; Alamosa County was a 6.52% premium; and, Pueblo County was at 4.75%.

One of the other presenters at the NTLA conference was on an "acquisitions panel" and he had mentioned that "premiums in Colorado were on the rise …" . This statement was most certainly confirmed in the number analysis as well.

Denver & Weld – Some Projections

Now that we know the sale results the question becomes: "What does this really tell us?" Put into other words – how would we expect these portfolios to perform given these known parameters?

One very simple way to look at it would be to assume that everything (all liens) redeemed after only one year. We know that this is not how typical lien portfolios "behave", but we need to start somewhere to get an idea of what type of yields or returns we might expect. Assuming full redemption after only one year, we would receive $453,390 (10% of the lien amount) in interest for our Denver portfolio. However, we must now account for the premiums paid and subtract $309,882 from our interest received. This equates to a net gain ("asset profit") of $143,508 or 3.17% of the lien amount. This makes perfect sense since the buyers paid a premium of 6.83% which leaves only 3.17% of the 10% interest left over as net "asset profit". This $143,508 net gain equates to a yield of 2.96% (the ROI on the total purchase price which includes both the premium and the lien amount).

Assuming full redemption after one year in Weld leads to similar results. The net gain in Weld would be $77,430 or a 3.72% yield (ROI on total investment).

Pushing out our redemption parameters to allow for a two (2) year redemption period, we do see some significant changes to the yield calculations. Assuming full redemption after two years the Denver yield jumps to 6.16% (annualized) and in Weld to 6.57% (annualized). The presenter on the Colorado acquisition panel had also mentioned that "quick redemptions in Colorado tend to hurt yields while slower payoffs tend to increase yields." Once again, we see this born out explicitly in the numbers themselves.

Understanding that lien portfolios don't just wait to payoff all at once, I decided to employ some more complex Internal Rate of Return (IRR) analysis which accommodates for dynamic cash flow patterns. Assuming partial portfolio redemptions at regular intervals (every six months) over two years we see IRR yields for Denver at 4.15% IRR and Weld at 4.75% IRR. These IRR yields probably bring us much closer to the truth of what some potential yields on these two entire portfolios might be over a two year time horizon.

Denver Conclusions:

Given the impact that these "non-recoverable premiums" have on the portfolios, it is easy to see that "quick pay redemptions" for Colorado produce lower yields and IRR's while "slower pay redemptions" produce better yields and IRR's. This makes sense as the accruing interest needs time to "win back" the sunk cost of the premiums required to purchase the liens in the first place. From a pure, dynamic cash flow perspective, we are looking at projected IRR yields probably approaching 5% for both portfolios over time. Next month we will take a look at New Jersey – a very different type of lien state with a much different sales process and different portfolio variables.