What is a property tax lien?

A real estate tax lien is a claim against a property for unpaid taxes.

Just as mortgage companies place liens against a property to perfect their claims for unpaid mortgage payments, municipalities can perfect their claims by filing tax liens for unpaid taxes. The danger to homeowners and their lenders is that the lien of a municipality, or any taxing authority including the IRS, is superior to any other claims. This means that in order to perfect an interest in a property for future buyers or lenders, real estate tax liens must be satisfied. These are liens of the highest priority, meaning that when they are bundled for sale, they are a very secure kind of investment. When real estate taxes become delinquent, not only is the amount of the past due real estate taxes determined, but they also accrue penalties and interest to the taxing authority. Once the lien has been filed, the taxing authority will issue a tax certificate. Municipal tax certificates are usually then sold at auction to investors who specialize in that kind of investment.

How are tax liens profitable?

In most circumstances the taxing authority will auction these real estate tax certificates off. Investors in real estate tax certificates bid by offering to accept the lowest interest rate penalty from the property owner. In today's interest rate environment, while the certificate rate could be anywhere from 4% to 36%, bidders will either purchase the certificates at a premium or a discount to arrive at a more reasonable competitive rate typically in the area of 10% to 12%. This interest rate is much better than what may be offered for bank certificates of deposit or Treasury securities, but while an investment in real estate tax certificates is generally secure, there are some risks as well.

What are some of the risks in tax lien investing?

The market for real estate tax certificates is very well organized and populated with the savviest investors. In order to be able to thoroughly assess the value of a real estate tax certificate the bidder should be familiar with the neighborhood the property is located in, and the actual property itself. It is a fact that there are properties that have tax liens that outpace the value of the property securing them. A property may have been destroyed, and where there was once a building securing the lien, there is now a vacant lot. If the property has environmental concerns such as leaky storage tanks or a chemical spill, such things can drop the property value to near zero, or even to the negative. The property may be a worthless piece of swamp land or desert, and even if the winning bidder can negotiate for a 25% interest rate on his certificate, if the underlying property has no value, so does his certificate.

Can tax liens lead to ownership of the property?

In very rare instances a real estate tax lien can be foreclosed and the certificate holder can take title to the property. This foreclosure will wipe out all junior liens including real estate mortgages. Through this process the certificate holder will own the property free and clear of all other liens. While this would be a bonus to the certificate holder, it rarely ever happens on properties that have any real value.

Things to remember when considering purchasing real estate tax lien certificates:

- Real Estate tax certificates are secured by a first lien position on a property
- Real estate tax certificates are usually awarded to the bidder who is willing to accept the lowest return
- Many investors in real estate tax certificates are sophisticated and the market is very competitive
- Not all properties securing real estate tax certificates have value
- In order to make a wise investment in a real estate tax certificate the investor should inspect the property and research any negative factors affecting its value such as environmental issues or non-conforming use

Real estate tax liens can be a profitable investment for the person who is willing to do his homework, research the property that has a lien, and, preferably, personally inspect the property. Once the due diligence has been performed and an informed decision has been made that the lien is secured by reasonably fit property and title, free of environmental concerns, then the bidding on a tax lien can be safe and profitable.

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