

LEGISLATIVE FISCAL ESTIMATE
ASSEMBLY, No. 3940
STATE OF NEW JERSEY
219th LEGISLATURE

DATED: MAY 7, 2020

SUMMARY

Synopsis: Modifies interest rates and accrual of interest on certain unpaid water and sewer utility bills and delinquent municipal taxes, assessments, and other municipal liens and charges.

Type of Impact: Annual decrease to local government revenue.

Agencies Affected: Local governments

Office of Legislative Services Estimate

Fiscal Impact	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>
Local Revenue Decrease		Indeterminate	

- The Office of Legislative Services (OLS) estimates that local government units will realize an indeterminate annual decrease in revenues due to a reduction in the interest rates that they will be permitted to charge on delinquent property taxes and utility bills. The extent of the reduction is unclear because the new rates are linked to the prime rate and the prevailing municipal bond yield, which are variable. Currently, rates charged by local government units vary across entities but generally do not exceed 18 percent. A lack of information about the amount of revenues that are based on the 18 percent rate or from lower statutory rates makes it difficult to estimate the magnitude of lost revenue that local government units will face.
- The extent of the estimated annual decrease in local revenue is also uncertain because it is unknown how taxpayers and ratepayers will respond to the changes in interest rates. It is unclear whether new rates that are lower and more consistent across local government units will result in greater or reduced compliance in making timely payments. The lower rates under this bill may allow payers to catch up on their delinquent payments to local units whereas before they were unable to keep up with the penalties and subsequently defaulted. Lower rates could also result in individuals making a strategic choice to temporarily defer payment in order to prioritize other bills, which could result in local government revenue delays. However, the significant repercussions of prolonged property tax and utility charge payment deferrals (e.g. foreclosure, suspension of utility service) makes it likely that these delinquencies will eventually be paid.

BILL DESCRIPTION

The bill modifies the interest rates and provides for the deferral of interest permitted to accrue on unpaid water and sewer service bills issued by certain public providers of water and sewer services as well as unpaid municipal taxes, assessments, and other municipal liens and charges.

Specifically, the bill provides that the interest rate permitted to accrue on unpaid municipal taxes, assessments, and other municipal liens or charges due to the governing body of a municipality, or a third-party lien holder, will not exceed three percentage points above the prime rate, and will be assessed for each month or fraction thereof, based upon a 360 day calendar year, from the date the tax was payable until the date payment is made. The current interest rate on unpaid municipal taxes, assessments, and other municipal liens or charges is fixed by statute at a rate that cannot exceed 8 percent per annum on the first \$1,500 of the delinquency and that cannot exceed 18 percent per annum on any amount in excess of \$1,500. The prime rate is determined by the Director of the Division of Taxation for purposes of setting and assessing interest due and required to be paid in connection with a delinquent or deficient payment of a State tax. During the first week of December 2019, the prime rate as determined by the Director of the Division of Taxation for purposes of setting and assessing interest was 4.75 percent.

The bill similarly amends various sections of the law concerning municipally-owned sewer and water utilities to stipulate the interest rates and penalties due on service charges required to be paid to municipalities or a water or sewerage commission of a municipality. Under the bill, interest and penalties will be charged and assessed at the same rates permitted for unpaid municipal taxes, assessments, and other municipal liens or charges.

The bill also provides that the interest rate permitted to accrue on unpaid service charges due and required to be paid to a sewerage authority or a municipal authority will be equal to the prevailing municipal bond yield, and will be assessed for each month or fraction thereof, compounded annually at the end of each year, from the date the service charge was due until the date the charge is paid. The prevailing municipal bond yield will reflect the Bond Buyer 20-Bond Municipal Bond Index prevailing during the first week of December in the calendar year immediately preceding the calendar year in which the charges were due. The current interest rate on unpaid charges is fixed by statute at a rate of 1 1/2 percent per month. During the first week of December 2019, the prevailing municipal bond yield was 2.77 percent.

The bill amends the Municipal and County Sewerage Act and the County and Municipal Water Supply Act to provide that the interest rate permitted to accrue on unpaid rates, rentals, connection fees, or other charges due and required to be paid to a local unit or units operating a county or municipal sewerage facility or a county or municipal water supply will also be equal to the prevailing municipal bond yield. The current interest rate on unpaid charges is set by statute at a rate that is at least equal to the monthly index for the immediately preceding month for 20-year tax exempt bond yields as compiled by the Bond Buyer or a similar index.

The bill also supplements the New Jersey Water Supply Authority Act to establish that the interest rate permitted to accrue on unpaid charges required to be paid to the authority for water sold from, or for the use of services of, a water system project will be equal to the prevailing municipal bond yield. Currently, interest accrues on unpaid charges at two separate rates set by regulations: the authority charges interest on unpaid payments related to the sale of water from the Raritan Basin System at a rate tied to the interest rate accruing on the authority's short-term deposits and charges interest on unpaid payments related to the sale of water from the Manasquan Reservoir Water Supply System at a rate that cannot exceed 18 percent per annum.

In addition, the bill amends the sewerage authorities law and the municipal and county utilities authorities law and supplements the New Jersey Water Supply Authority Act to specify the period of time required to elapse before interest accrues on unpaid utility bills issued by those public

providers of water and sewer services. The bill requires at least 30 days to elapse following the date the payment or charge is originally due before interest on the unpaid balance is permitted to accrue.

The bill takes effect immediately and applies to all charges, rates, rents, fees, and payments and all municipal taxes, assessments, and other municipal liens and charges that become due or otherwise are first required to be paid on or after the first day of the first fiscal year, of the sewerage authority, municipal authority, governing body or bodies of a local unit or unity, municipality, or authority to which the charge, rate, rent, fee, municipal tax, assessment, or other municipal lien or charge is due or otherwise required to be paid, beginning at least 120 days after the date of enactment.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS estimates that local government units will realize an indeterminate annual decrease in revenues due to a reduction in the interest rates that they will be permitted to charge on delinquent payments. The bill would reduce the rates of interest that accrue on unpaid water and sewer service charges as well as unpaid municipal taxes, assessments, and other municipal liens and charges. This reduction will result in lower revenues for the local government units collecting these fees. The lower interest rates may also result in decreased tax sale participation by private sector actors who are currently drawn to tax sales by the significant potential income resulting from higher interest rates. This potential decrease in tax sale participation could lead to less frequent payment of these delinquent charges to local government from private third-party tax sale bidders.

The magnitude of the impact of reduced rates is uncertain, preventing OLS from providing an estimate for the revenue decrease. The main reason for the uncertainty is that the new rates are not fixed but are based on the prime rate and the prevailing 20-year municipal bond yield, which are variable rates. As these rates rise and fall, the amount of revenues lost by local units will rise and fall as well. Uncertainty about the United States Federal Reserve Bank's future policy actions add to the ambiguity, as its choices regarding monetary and fiscal policy have a significant impact on the prime rate and the prevailing municipal bond yield. Monetary and fiscal policy actions have been considerable in recent weeks due to the effects of the COVID-19 pandemic on the economy.

Additionally, the rates charged by local units vary by jurisdiction with rates generally being set at 18 percent or below. The penalty for municipal property taxes is fixed by statute at an annual rate of 8 percent on the first \$1,500 of the delinquency and at an annual rate of 18 percent on any amount above \$1,500. Information is not available to the OLS across municipalities about how much penalty revenue comes from balances at the 8 percent level and at the 18 percent level. Without information about the rates at which various local penalty revenues are collected, it is not possible to measure the magnitude of the impact on local units, even with an estimate for the new rates over the next three years.

An additional level of uncertainty that factors into the indeterminate finding is that there is little data to indicate how consumers will respond to a change in rates. Many of the penalty rates have been in place since 1982, so there is no data available to indicate whether a reduction in rates

would result in a greater or reduced level of individuals paying their taxes and fees on time. Individuals choosing not to pay on time due to a lower penalty rate negatively impacts municipal governments by requiring them to maintain higher reserves for uncollected taxes and creating uncertainty about the amount of funds available in their annual budgeting process.

Additionally, it is not clear how many additional individuals will be able to catch up on their unpaid fees and taxes due to the lower rates that would have otherwise been subject to a foreclosure or other punitive action due to unpaid taxes and fees. A local unit is only able to realize additional revenue from penalties if the individual subject to the penalty eventually makes all payments. There are also substantial negative externalities tied to defaults and foreclosures in a community that result in indirect local revenues losses when an individual is unable to meet their tax and fee obligations. These indirect impacts could include neighborhood blight and reduced property values. To the extent that lower penalty rates result in lower default rates, the benefits to municipal governments could be greater than the direct revenue impact.

While the total impact on local governments is not clear, the OLS estimates that penalty rates charged by local government units will be lower overall, and there will be a corresponding reduction in revenues realized by these units.

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This legislative fiscal estimate has been produced by the Office of Legislative Services due to the failure of the Executive Branch to respond to our request for a fiscal note

This fiscal estimate has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).