



Improved But Still Problematic: Tax Sales in Alabama

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Ad valorem tax sales in Alabama can present problems for mortgage lenders. Becoming more familiar with the tax sale process in general can assist loan servicers in identifying common pitfalls. The tax year in Alabama is October 1- September 30 with taxes due on October 1 and delinquent after December 31. Unlike many states, delinquent taxes are sold every year in Alabama. Sales are generally held in April and May, and these delinquent taxes can be purchased by the state or a third-party. There is an initial three-year redemption period which is extended as long as the borrower remains in possession of the property. Back taxes, interest at a rate of 12%, fees and penalties must be paid to redeem the property. Additional fees for personal property assessments and costs for insurance and improvements are also required in certain circumstances.

At the tax sale, a third-party bidder is allowed to bid an amount greater than the taxes due, usually referred to as an “overbid.” Interest on the overbid amount (up to 15% of the assessed value of the property) is also charged at a rate of 12% and must be paid to redeem the property from the tax sale. The handling of the overbid funds after the tax sale has posed a problem to lenders in the past. Previously, many tax officials would pay the overbid only to the party who assessed the property, which is usually the borrower. In some instances large overbids were paid to the borrower either before or after redemption, which resulted in the lender having to pay the overbid amount to complete the redemption with little hope of recovering the overbid funds from the borrower. Effective August 1, 2013 the statute was changed to avoid this outcome. Alabama Code § 40-10-28 requires the overbid to be held in a separate account in the county treasury during the initial three-year redemption period and thereafter, if no redemption has been made, in the general fund. A redeeming party can claim the overbid up until 10 years after the tax sale. The section further provides that the overbid shall be paid to any person or entity entitled to redeem the property, which includes the mortgage holder.

Another common area of dispute is the value of preservation or permanent improvements. Usually in situations where the borrower has abandoned the property, the tax purchaser may take possession of the property and demand reimbursement from the lender, as redeeming party, for improvements. The statute does require payment of insurance premiums and the value of all permanent improvement made on the property if the property is located within an *urban renewal or development area* and payment of all insurance premiums and the value of all preservation improvements made on property which *contains a residential structure*, regardless of the location. Preservation improvements are defined as improvements made to keep the property in repair for its proper and reasonable use. In many instances the improvement value claimed lacks solid factual proof. However, often the amount demanded by the tax purchaser is such that lenders opt to pay the funds rather than incur the cost of defending.

A mortgage holder is entitled to redeem the property after a tax sale in Alabama. However, because the cost to redeem property from a tax sale can be much greater than the amount of back taxes alone, servicers should monitor the ad valorem tax status closely on their Alabama properties, especially in situations where the borrower no longer occupies the property. In situations where back taxes have been sold to an individual, immediate review by your tax department is needed and a quick redemption is usually the best route to avoid paying a high interest rate on an overbid or a protracted dispute as to the value of improvements.