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MAYOR



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DIRECTOR
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DEPUTY DIRECTOR

July 29, 2008

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CITY COUNCIL
HONOLULU, HAWAII

The Honorable Todd K. Apo, Chair
and Members of the Budget Committee
Honolulu City Council
530 South King Street, Room 202
Honolulu, Hawaii 96813

Dear Chair Apo and Councilmembers:

We oppose Resolution 08-156 urging the Department of Budget and Fiscal Services (BFS) to establish procedures to permit the use of credit and debit cards for payment of real property tax assessments.

BFS continually examines the financial feasibility of accepting credit and debit cards (herein referred to as "cards") as a payment method. The Government Finance Officers Association (GFOA) recommends that governments evaluate whether acceptance of cards as a payment option is reasonable and appropriate for the type of charge or fee being paid and the customer service level desired. Based on the considerations established by GFOA, BFS' evaluations continue to show that cards as a payment method offers no tangible benefit to either the taxpayer or the City.

The most immediate concern is cost. For an average annual residential real property tax levy of \$1,780, current payment methods would incur bank and lockbox service fees of \$1.01 compared to bank and merchant discount fees of \$37.53 for card payments. Convenience fees to recoup those card-related transaction costs often serve as a disincentive because it is an additional, potentially significant, charge that the taxpayer must pay. Accepting card payments for mandatory charges like real property taxes that have a secured, paramount lien would not increase the amount of revenue received and may actually reduce net revenue if transaction costs are not recovered. These are only some of the immediate concerns that BFS has with accepting cards as a payment method. Below is a detailed summary of BFS' findings.

1. **State, provincial and local laws.** Governments should first review applicable laws to determine whether card acceptance is an option.

BFS Finding: Card acceptance is an option under the Revised Ordinances of Honolulu, 1990, as amended (ROH), Section 2-4.2(b)(3) that states "The director of finance may accept payments of city taxes and other amounts owed to the city made by electronic means, which in the director's discretion are determined acceptable to the city."

2. **Merchant discount fees.** The costs charged by the card issuer per transaction typically vary between one and three percent of the value of the transaction. Governments should negotiate the lowest possible fee to minimize the financial impact to the government or to the customer, whichever party will ultimately pay the fee. With adequate controls in place, discount fees may be recovered by using a third party to process the payment. Governments should weigh the cost of paying the merchant discount fee versus the cost of processing cash, checks, fees for checks returned for insufficient funds, and collection efforts. In order to make this comparison, governments need to have a solid understanding of their dollar volume of transactions, number of transactions, and potential participation rate among customer.

BFS Finding:

The City competitively bid for card acceptance services and contracted with the lowest bidder that offered a merchant discount fee of 2.10% on total card sales per month. There is also an ACH Credit fee of \$0.015 for depositing each credit card payment. In comparison, the cost of processing checks through the third party lockbox services is \$0.13 per payment plus \$0.08 for each check deposited and \$0.80 for each deposit for a total of \$1.01. Based on an average annual residential tax levy of \$1,780, card acceptance would cost \$37.53 (representing the 2.10% merchant discount fee of \$37.38 and the \$0.015 deposit charge and excluding any fees if a third party is used to process the payment), while payment by check using the third party lockbox services is \$1.01.

Past experience has been that the number of checks returned for insufficient funds was negligible, averaging about 250 checks each fiscal year out of the approximately 170,000 payments received or less than one-tenth of one percent. Bank fees and collection costs related to returned checks are recovered through the City's \$20 returned check fee.

More than 50% of the 250,000 residential properties have mortgages where the mortgage company remits their real property tax payments, thereby significantly reducing the potential number of taxpayers that would use the card payment option. The participation rate would probably be even lower if a convenience fee were assessed to recover the merchant discount fee (see #5 below).

3. **Type of payment.** Governments should consider whether they want to accept cards for mandatory charges which citizens must pay (such as taxes and utility bills), for discretionary charges which citizens elect to pay (such as recreation fees and performing arts admissions), or both. Acceptance of cards as a method of payment for mandatory charges may not significantly increase the amount of revenue received by the government, and may actually reduce net expected revenues if the government pays the merchant discount fee. Acceptance of cards as a method of payment for discretionary charges and absorption or payment of the related merchant discount fees may facilitate collection of such charges. The volume of internet transactions may increase as a result of the acceptance of cards.

BFS Finding: Real property taxes are mandatory charges. Acceptance of cards as a method of payment will not increase the amount of revenue received by the City and may actually reduce net revenues if the City pays the merchant discount fee without assessing a convenience fee. Further, real property taxes are secured liens, unlike income taxes and other forms of taxes. Properties with delinquent real property taxes are subject to foreclosure by the City where the entire tax plus any penalty, interest and foreclosure costs are recovered once the property is sold. Since 1999, delinquent real property taxpayers have had the option to pay by credit card without being charged a convenience fee. The rationale behind foregoing the convenience fee was that the penalty and interest would offset the merchant discount fee. The participation has been poor even without a convenience fee, averaging about two transactions per month.

4. **Administrative costs.** Governments should consider the costs of equipment and the associated personnel necessary to process card transactions, including associated costs Payment Card Industry (PCI) compliance. They should also consider the administrative cost savings compared to receiving and processing cash or check transactions.

BFS Finding: Currently, the City uses lockbox services during the installment periods to process payments. The costs are nominal and the services are timely and proven. Acceptance of cards as a payment option would add to the administrative cost of collecting real property taxes by increasing the number of data file transfers and the related reconcilements required. These tasks can consume the same amount of resources whether the data file contains one entry or 1,000 entries. Consequently, if the participation rate for card payments is low, the per-transaction cost may be considerably greater than the high volume lockbox payment processing.

5. **Convenience fees.** Governments should consider whether or not to charge a convenience fee for transactions. The advantage of convenience fees is that they can be used to recoup the cost of merchant discount fees. A disadvantage of convenience fees is that they may deter some users from paying with a card.

In addition, card companies have strict regulations that limit the use of convenience fees (for example, payments made by telephone or via a third-party processor). In most instances, the major card companies do not allow governments or businesses to pass on merchant discount fees directly to customers.

BFS Finding: A convenience fee would need to be assessed in order to realize the entire amount of real property tax levy. It can only be applied to payments made by telephone or by the internet or via a third-party processor. Unless all payment methods have the same fee, over-the-counter, walk-in card payments cannot be charged a convenience fee.

Generally, the convenience fee is set to recover both the merchant discount fee and any administrative cost. From #2 above, for an average annual residential real property tax levy of \$1,780, the convenience fee would need to set above the \$37.53 to ensure that the City realizes the entire real property tax levy. For many, a convenience fee of that amount in addition to the tax would be a deterrent.

6. **Payment Card Industry (PCI) Compliance.** Governments are responsible to ensure that transactions are PCI compliant to avoid significant financial penalties.

BFS Finding: The PCI compliance standard aims to stop the cause of online financial and identity theft from its source by ensuring the systems which process and store customer details and transaction information are secure.

Organizations which process transactions made through credit or debit cards must observe a set of requirements to ensure that correct measures are taken to secure all data, both internally and externally exposed. PCI compliance becomes more difficult as the number of annual transactions processed increases. All businesses which apply the PCI compliance procedures must use the services of approved companies to perform compliance security scans. Severe penalties may be imposed on businesses which suffer a security breach as a result of lack of compliance to the PCI standard.

Currently, the City engages a third-party vendor to perform quarterly compliance security scans to obtain its compliance certification. The City may be subject of more stringent requirements and higher administrative costs with a greater volume of card payments.

Therefore, as provided in ROH Section 2-4.2(b)(3) and based on the considerations discussed above, it is my determination, as BFS Director, that accepting credit and debit card payments for real property taxes is not acceptable at this time. We will, however, continue to review these and other forms of electronic payments to

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and Budget Committee Members
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ensure we optimize the collection of real property taxes while making it convenient for taxpayers.

Please call me at 768-3901 if you have any questions.

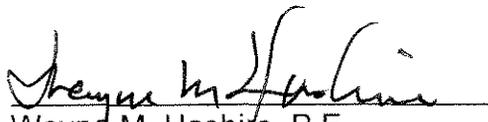
Sincerely,



Mary Pat Waterhouse, Director
Department of Budget and Fiscal Services

MPW:est

APPROVED:



Wayne M. Hashigo, P.E.
Managing Director

cc: Office of the Mayor