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Is the 2017 Tax Law the Reason Home Sales Are Not Booming?

Many blame rising home prices, construction and land costs, and a lack of inventory, but a large part of the reason for this disconnect between home sales and the economy may be due to changes in the 2017 Tax Cuts and Jobs Act (TCJA) that either reduced or eliminated the tax advantage of purchasing a house rather than renting one.

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The economy is booming, unemployment is at a near historic low, and mortgage interest rates are falling, but this apparently good news for the housing industry does not appear to be translating into an increase in housing sales. The U.S. Census Bureau says that the U.S. home ownership rate is down 0.27% from a year ago, the National Association of Realtors announced that existing home sales fell 1.7% in June, and the Commerce Department reported that single family home construction starts are down 1% on an annualized basis from 2018. In years past, the housing market typically marched in lock-step with the economy. Many blame rising home prices, construction and land costs, and a lack of inventory, but a large part of the reason for this disconnect between home sales and the economy may be due to changes in the 2017 Tax Cuts and Jobs Act (TCJA) that either reduced or eliminated the tax advantage of purchasing a house rather than renting one.

The higher-end home market is being impacted by four provisions in the TCJA: a $10,000 limit on deducting state and local taxes, which for many prospective higher-end homebuyers will limit the amount

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of real property taxes that can be deducted; a reduction in the amount of a mortgage on which interest can be deducted—down to $750,000 from the pre-TCJA ceiling of $1 million; the elimination of interest deductions for home equity loan mortgages, which had provided a tax advantaged method of financing other purchases; and lower tax rates in general which reduce the value of these deductions. When these limitations on the tax benefits of purchasing a home are combined, it might cause a prospective homeowner pondering a housing upgrade to think twice about the additional after-tax cost.

However, the TCJA's bigger impact on housing purchases very well might be in the lower to middle markets, especially the entry level market, as the result of the large increase of the standard deduction.

For decades, the tax code incentivized families to purchase homes rather than renting because mortgage interest and property taxes are deductible, but rent is not. This tax deduction benefit often made it more affordable to buy a home on an after-tax basis rather than to rent one. However, when the TCJA nearly doubled the standard deduction to $24,000 for a married couple, the after-tax benefit to purchase rather than rent evaporated for many because their total deductions, including mortgage interest and real estate taxes, would not reach the $24,000 standard deduction amount, with or without any home ownership-related deductions.

Let's take the example of a home in South Florida priced at $450,000, purchased with a down payment of 10% and a $405,000 mortgage at 4% interest. The interest payments for the first year would be close to $16,000, and property taxes would be about $7,000, for a total potential deduction of $23,000.

Before the TCJA was enacted, the standard deduction for a married couple filing jointly was $12,700 so that the purchaser in our example would have received a net tax deduction of $10,300 over and above the old standard deduction (total interest and real property taxes of $23,000 less the $12,700 standard deduction), resulting in a tax savings of about $2,575, which the family would not have had if they merely spent $23,000 a year in rent. However, after the TCJA, the prospective purchaser now has a standard deduction of $24,000, so the deduction of $23,000 in interest and property taxes would not result in any tax savings, eliminating the tax incentive to purchase rather than rent for many prospective homebuyers. A December 2017 study by Zillow estimated that this increase in the standard deduction would result in a tax benefit of buying rather than renting coming into play for only 14% of homes on a national basis, down from 44% of all U.S. home sales before the change in the law.

Congress had a worthy goal in mind when it nearly doubled the standard deduction in order to benefit all taxpayers—not merely homeowning taxpayers. However, in doing so, it reversed a decades long policy of encouraging home ownership through tax policy, which builds wealth over the long-term and makes for stronger communities because residents who own their homes are invested in their neighborhoods—they have "skin in the game" to a greater extent than renters do.

Of course, it would be unfair to reduce the standard deduction to fix this conundrum (not to mention politically impossible). A potential solution, which would maintain the current standard deduction but also encourage families to buy rather than rent, would be a tax credit for first-time homebuyers. In 2009, at the low point of the housing crash, Congress enacted a 10% tax credit for first-time homebuyers, capped at a maximum credit of $8,000. This incentive did, in fact, spur sales in the then near-dead market—a fact which was highlighted when the credit came to an end in May 2010, resulting in an immediate drop in housing sales that month. A similar tax credit could be enacted by Congress to spur home sales in the entry level market. The law could be structured as a refundable credit—which would allow the credit even if the homebuyer does not owe enough taxes to use it up—and allow the credit to be used toward the down payment. Such a tax credit limited to first-time homebuyers would encourage young families to get on the

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path to home ownership, and continue the time-honored policy of encouraging home ownership through tax policy, just like the good old days.

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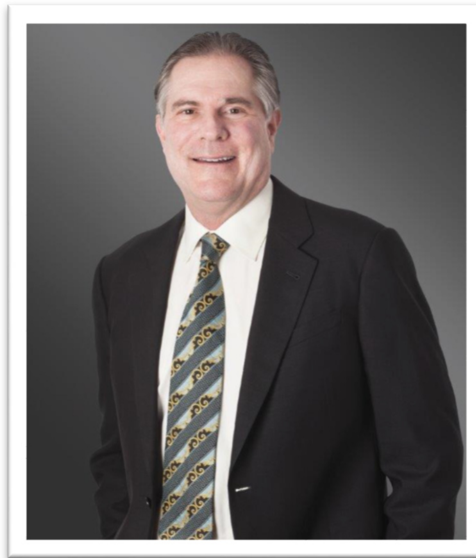

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