Tax Reform Promises Mixed Impact on Housing Sector

The Tax Cuts and Jobs Act is the most monumental tax change in 30 years. What does it mean for multifamily?

by Laura Jackson | Mar 14, 2018

The Tax Cuts and Jobs Act (TCJA) was signed into law on Dec. 22, 2017. This sweeping tax reform is the most monumental tax change in 30 years and will have an impact on the single-family and multifamily housing markets.

The TCJA widens the individual tax brackets while lowering the top tax bracket from 39.6 percent to 37 percent and maintaining the bottom tax rate at 10 percent.

Pre-TCJA, taxpayers could claim a personal exemption of $4,050 for themselves, their spouse and each dependent. The TCJA suspends all personal exemptions. The standard deduction is increased from $12,000 to $24,000 for families, and the child tax credit is increased from $1,000 to $2,000.

Under prior law, homeowners could deduct mortgage interest up to $1 million of home mortgage indebtedness and $100,000 of home equity line of credit. The TCJA limits the mortgage interest deduction on mortgages secured after Dec. 15, 2017 to interest incurred on only $750,000 of indebtedness. Debt incurred on or before Dec. 15, 2017 is grandfathered. Any refinancing of grandfathered debt must not exceed the lower of $1 million or the amount of the existing grandfathered debt.

State and local taxes (SALT) such as individual income, property and sales and use taxes are limited to a combined deduction of $10,000 on federal income tax returns. Previously the deduction was only limited by the alternative minimum tax (AMT), which remains in effect with higher minimum thresholds. The SALT deduction historically allowed individuals to itemize deductions, especially those in high tax states such as New York, New Jersey, California, Connecticut and Illinois. The lower individual rate brackets, increase in the standard deduction and doubled child tax credits will not be enough to offset the SALT limitation in these high tax states.

Because of the tax reform in high tax states, homeowners could be economically less equipped to buy or sell a home or to refinance into a new mortgage. Most homebuyers factor in the deductibility of interest expense and real estate taxes into pricing and affordability. As a result, there is an anticipated slowdown in the nationwide housing market putting pressure on the over $750,000 price point.

This disadvantage for the single-family housing market in high tax states could create an opportunity in the multifamily market. Renters considering purchasing a home may defer a year and renew their lease to wait out the effect of the new tax law. Although, this wait-and-see approach could wear off causing a market recalibration.

Those living in high tax states and feeling the largest burden of the tax reform may consider moving to lower tax states but other factors will come into play, such as the availability of comparable jobs. Residents moving from urban to suburban areas or high tax to low tax states because of tax reform may not be realistic.

High-tax states are scrambling to create legislation to reduce the burden to residents. California introduced a measure to allow residents to make a charitable contribution to a new state-run nonprofit group in exchange for an offsetting credit to their state tax liability. New York and Connecticut have attempted to circumvent the new tax rules by shifting away from income tax to a statewide payroll tax, paid by employers.

DEVELOPMENT

Residential development slowed in anticipation of tax reform, which is expected to reduce the growth of affordable housing over the next decade. Developers are scrambling for new financing as the Low Income Housing Tax Credits (LIHTC) market has taken a dive. LIHTC was created under the Tax Reform Act of 1986 to encourage the investment of private equity in the development of affordable housing for low-income households. The drop in the corporate tax rate from 35 percent to 21 percent has decreased the value of the credits used to finance housing. This

will exacerbate the already prominent affordable housing crisis. Some states or localities, such as New York City, are working to find solutions for affordable housing such as opening rental of basement units.

For those residents in the lower income tax brackets and lower tax states, the tax reform could provide additional cash to acquire a new home or invest in the local economy. Further, many in these states are not likely to own a home valued over the $750,000 threshold and may not be as negatively impacted as those in high tax states.

Residential market predictions are dependent upon many factors which remain very fluid, one of them being that most individual TCJA changes sunset in 2025. The additional government debt to be incurred to finance the TCJA will require a rise in interest rates, driving down housing prices. It remains to be determined over the next few years if new job creation, increased minimum wage to employees and overall market stimulation can positively drive up residential values.

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