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Rethink the Housing Tax Credit: Stimulus Plans Should Think Past the Needs of Special Interest

Ronald D. Utt, Ph.D.

As the United States Senate recently surveyed the wreckage of the economy in search of victims needing government assistance, several stumbled upon a heretofore neglected corner of human misery: the plight of America's very rich families who are unwilling to use their own vast resources to trade up to a bigger, higher quality house.

Senator Johnny Isakson (R–GA) was one of the first to recognize the source of their anguish: Their high incomes and existing real estate wealth made them ineligible for the soon-to-expire first-time buyer housing tax credit enacted as part of the American Recovery and Reinvestment Act of 2009. Senator Isakson wants to correct this oversight by replacing the expiring tax credit with a new one for which most members of America's financial elite would be eligible. This is a costly and unnecessary scheme. If it is ultimately passed, President Obama should veto it to demonstrate that even some legislation can challenge the relaxed standards of fiscal responsibility common to his Administration.

Plan Focused on the Rich. Under the expiring law, the housing tax credit is available only to first-time homebuyers with annual household incomes no higher than $150,000 (for a married couple). Although an income of this magnitude puts the household comfortably within the top 20 percent of earners, census data show that the homeownership rate among households with incomes in excess of $100,000 is about 88 percent, meaning that few in this income class would qualify as first-time buyers. As a consequence, most of those eligible for the first-time buyer tax credit were the still-employed, still-solvent households of more modest incomes. In turn—and anecdotal evidence seems to support this—many of the homes sold to credit-eligible buyers, especially the new homes, were of the more modest sort.

While this may have added some boost to the home sales and building markets, not all in the industry benefited as much as they would have liked. Purveyors of antique heart pine flooring, marble showers, granite counter-tops, Jacuzzis, stainless steel appliances, dual zone climate-controlled heating and cooling, two-story foyers and stone facades—to name just a few of the amenities common to more expensive houses—were left out in the cold. Also adversely affected were mortgage origination, title insurance, and real estate sales commissions, which relate directly to the value of the property sold and financed.

Senator Isakson's proposal would make sure that the next government-subsidized rising tide lifts not just the little boats but the sleek yachts too, so he has proposed that the $8,000 housing tax credit be extended until June 2010 and that eligibility be expanded to include (1) households with incomes

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of up to $300,000 (for a married couple) and (2) those who already own a home. To put this in perspective, only 2 percent of American households earn more than $250,000, so this new subsidy would be available to all but a handful of the super wealthy. The Joint Tax Committee estimates that this tax credit extension will cost taxpayers almost $17 billion over the next five years.[1]

At a time when so many are suffering from an unemployment rate nearing 10 percent, and with the federal budget deficit over the next 10 years projected to total $13 trillion, this new tax credit proposal seems extravagant even by federal standards, such as they are. And added to these legitimate cost concerns is the growing evidence that the housing market is on the mend and that factors beyond the boost provided by the expiring tax credit may also have contributed to the small boost in house sales and construction over the past year.

Housing Market on the Mend. As federal and industry data reveal, single-family housing starts in September were running at a seasonally adjusted annual rate (SAAR) of 590,000, up 23 percent from the April low of 479,000 units. Sales of existing homes are also increasing, rising to an SAAR of 4.89 million units in September, up 9.4 percent from August and 7.7 percent year over year. In part, this improvement is due to the self-correcting forces of a market economy now wringing out the excesses of prior years. Over the past year (second quarter of 2008 to second quarter of 2009), the National Association of Realtors reports that median sales prices of existing homes fell from $206,000 to $174,000, or by $32,000. In comparison to the $8,000 tax credit, this price decline would have been the bigger attraction and benefit to first time home buyers, and the expiring tax credit merely hastened the decision to buy.

Similarly, the National Association of Homebuilders reports that their housing affordability index—called the Housing Opportunity Index (HOI)—is at a record high, meaning that home buying, in comparison to incomes, is the most affordable since the HOI series was created in 1992. According to the HOI, 73.2 percent of all new and existing homes sold in early 2009 were affordable to families earning the national median income, compared to only 40.6 percent at the peak of the real estate bubble in 2006.

Put the Focus on the Economy, Not the Influential. With housing affordability at the best it has been, and with buyers responding accordingly, the only negative for the housing market is worsening unemployment and a sluggish economy. Despite this risk, both Congress and the Administration have kept the focus of their stimulus efforts on haphazard support of politically influential groups at the expense of efforts yielding a stronger, overall impact on an economic recovery, such as a broad-based tax cut benefiting all.

To date, more than a trillion dollars have been squandered on preserving and enhancing the role of failed financial institutions and on a stimulus package pandering to politically influential constituencies. That package focused more on diddling federal, state, and local government bureaucracies rather than on stimulating recovery within the private sector, where most Americans work. Added to these were the $80 billion provided two dying car companies, $45 billion to prop up Fannie Mae and Freddie Mac, billions more on two Cash for Clunkers programs, $250 bonuses to all Social Security recipients, and more billions for two (and now maybe three) housing tax credit schemes. In the process, America has wasted vast and valuable resources on the dead and dying at the expense of this nation's future.

At some point, a few in Congress and the Administration will recognize the folly of all of this and begin thinking beyond next month's consumer spending report. Perhaps that time is now, and a good way to start the process is by refocusing attention on the nation as a whole.

—Ronald D. Utt, Ph.D., is Herbert and Joyce Morgan Senior Research Fellow in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

1. Press release, "Isakson Urges Senate to Extend, Expand Home Buyer Tax Credit," Office of Senator Johnny Isakson (R–GA), October 20, 2009, at *http://isakson.senate.gov/press/2009/102009hbtc.htm* (November 4, 2009).