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# Why Homeownership Should Continue to Be Incentivized by Our Federal Tax System

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## Executive Summary

Every American should have the opportunity for prosperity and financial security, and for many Americans, homeownership is the best way to achieve these goals. Sustainable and affordable homeownership improves long-term net worth and financial security through accumulated savings, appreciation in the value of the home, and predictable monthly housing expenses. In the wake of the Great Recession, however, the homeownership rate in the U.S. fell precipitously, wiping out the gains achieved during the prior three decades and undermining progress toward the American Dream for millions of households nationwide, most notably middle-income, minority and millennial households.

- In addition to improving long-term net worth and financial security for American families, bolstering homeownership is a key to sustaining the current economic expansion and returning the United States to a path of robust economic growth.
- The implications of continued low levels of homeownership for the critical groups identified above are far reaching for all Americans because ongoing housing market challenges not only undermine the ability of middle-income households to accumulate wealth, but also represent a substantial hurdle for the national economy.
- After beginning to improve gradually a few years ago, homeownership rates for middle-income, minority and millennial households have stalled once again. The recent reduction in tax incentives for homeownership compounds the issue for these large groups of potential homeowners.
- No longer providing a tax incentive for buying a home versus renting is a fundamental policy shift for tens of millions of households. This group includes a larger number of households in the middle-income, minority and millennial groups, which were already slowest to recover from the struggles of the financial crisis, and continue to face the greatest headwinds to increased homeownership.
- In order to ensure that U.S. tax policies support access to the American Dream of owning a home—a goal that we can and should continue to stand for as a society—it is imperative that homeownership should continue to be incentivized in the federal tax system.
- Moreover, a clear and equitable new tax incentive that is broadly available to a wide range of households around the country would provide considerable benefits for the economy at large.

As an institution that is vital to American hopes and dreams, the strength of our communities and the vibrancy of our economy, homeownership should be a national priority once again.

### *Economic Benefits of Homeownership*

Bolstering homeownership in a safe and sound way is not just about helping households to secure greater financial stability, but may be the single most important key to sustaining the current economic expansion and returning the United States to a path of robust economic growth.

*Residential Investment, Construction & GDP Growth*

- During the past three decades, total housing-related spending accounted for more than one-sixth of all economic activity in the nation. Since the Great Recession, however, ongoing challenges in the housing sector were major factors that contributed to keeping GDP growth well below the 3% historical trend.
- As of September 2019, there were approximately 537,000 fewer workers employed in construction and specialty trades for residential buildings nationwide than at year-end 2006.
- If the pace of homebuilding and for-sale housing activity returned to a more normalized level, consistent with the long-term average, RCG estimates that $220 to $400 billion dollars would be added to the economy. Over four years, this would translate to 0.25% to 0.50% in additional GDP growth per year.
- This increased economic activity would translate to roughly $35 to $64 billion per year in additional federal tax revenue.
- The positive economic benefits would accrue broadly, as increased spending and construction activity creates new jobs and supports income growth for both renters and homeowners.

*The Homeownership Wealth Effect, Entrepreneurship & Small Business Growth*

- As homeowners build equity the increased wealth leads to greater consumer spending that spurs business activity and provides a positive multiplier effect that creates jobs and income throughout the economy.
- Every 10% increase in total housing market wealth would translate to approximately $147 billion in additional consumer spending, or 0.8% of GDP, as well as billions of dollars in new federal tax revenue.
- Owning a home enables new entrepreneurs to obtain access to credit to start or expand a business and generate new jobs by using their home as collateral for small business loans.
- Small businesses employed 58.9 million people, or 47% of the workforce in 2015. Policies to support homeownership would

help to encourage entrepreneurship and the growth of new businesses.

### *Household, Social & Community Benefits*

*Wealth Building & Financial Predictability*

- Sustainable and affordable homeownership is the single best opportunity most households will ever have to improve their long-term net worth and financial security through: 1) accumulated savings by building equity; 2) appreciation in the value of the home; and 3) predictable monthly housing expenses.
- The median family net worth for all homeowners ($231,400) increased by nearly 15% since 2013, while net worth ($5,000) actually declined by approximately 9% since 2013 for renter families.

*Psychological Benefits, Happiness & Well-Being*

- The personal satisfaction and sense of accomplishment achieved through homeownership can enhance psychological health, happiness and well-being for homeowners and those around them.
- Americans' belief in the benefits of homeownership has not changed significantly in the wake of the Great Recession. In fact, 80% of renters still want to own a home at some point in the future.

*Social & Community Benefits*

- Homeowners have a clear vested stake in the community because their home is an investment, and so the value of that investment is linked to the condition of the neighborhood in which it is located.
- Increased homeownership can contribute to greater stability and social cohesion, lower crime rates, more civic engagement, improvements in children's development and stronger educational systems—all factors that add to the strength and vibrancy of American communities.

### *Impact of the Tax Cuts and Jobs Act of 2017*

- The Tax Cuts and Jobs Act of 2017: 1) Reduced the maximum indebtedness for the Mortgage Interest Deduction (MID) from $1 million to $750,000; 2) Capped the previously unlimited State and Local Tax (SALT) Deduction at $10,000 for single and married filers; and 3) Increased the standard deduction from $6,350 and $12,700 for single and married filers, to $12,000 and $24,000, respectively.
- By making it significantly more difficult to reach the threshold to itemize their deductions, these changes effectively eliminated the tax incentive for homeownership for millions of households. This marks an abrupt shift in federal tax policy after more than 100 years of supporting the dream of homeownership.

*Disproportionate Impact on Middle-Income, Minority & Millennial Households*

- In total, the number of filed tax returns that itemized declined by 27.5 million through the first 30 weeks of 2019 (which accounted for 90.6% of all returns), compared with the same period in 2018, according to the IRS.
- Of particular concern, the households most affected by these changes in the tax code—middle-income, minority and millennial households—are the very groups of households which have struggled the most to achieve homeownership in the aftermath of the Great Recession.
- The $50,000 to $200,000 income group accounted for two-thirds of the total decline in itemized returns. Among this group, the number of filers taking the SALT deduction decreased by 18.3 million, or 70%, while the number of filers taking the real estate tax deduction and the MID dropped by 15.4 million and 13.5 million, respectively, from the prior year.
- As of 2018, households with incomes between $50,000 and $150,000 included 5.5 million African American households, 7 million Hispanic households and nearly 20 million households in the prime, first-time homebuyer age cohort (25 to 44 years). Moreover, households in this middle-income bracket accounted for 39 million homeowners as of 2018 and an estimated 12.5 million additional potential homeowners who were still in the rental market.
- The reduction in homeownership tax incentives from the TCJA prevents many middle-income, minority and millennial households from realizing a direct tax benefit to owning a home. These groups were already slowest to recover from the struggles of the financial crisis and continue to face the greatest headwinds to increased homeownership.

*Future Inflation Adjustments*

- Based on the TCJA, the IRS will adjust the standard deduction annually for inflation. However, this adjustment does not apply to the MID and SALT deductions. Each year, this will make it even more difficult for filers to reach the threshold needed to itemize deductions, further reducing homeownership tax incentives.
- The IRS adjusted standard deductions from $12,000 in 2018 to $12,200 in 2019 and $12,400 in 2020 for single filers and from $24,000 in 2018 to $24,400 in 2019 and $24,800 in 2020 for

married joint filers. Based on the historical average inflation, RCG projects that the standard deduction could increase to $13,600 for single filers and $27,200 for married filers by 2025.

- For 2018 tax returns filed through the first 30 weeks of 2019, the average value of itemized deductions (for the relatively small group of filers still itemizing) was $28,900 for filers with $50,000 to $200,000 of income and $27,300 for filers with incomes of $50,000 to $100,000 of income, according to the IRS. As the standard deduction continues increasing in the coming years, millions of additional homeowners are likely to stop itemizing, particularly middle-income, minority and millennial households. Thus, the negative impact on these groups will grow even worse.

***Possible Solutions and Proposals***

- It is imperative to restore middle-income, minority and millennial homeownership incentives in the tax code, and to ensure that U.S. tax policy equitably supports access to the American Dream of owning a home.
- Amendments to the tax code should help support these groups that are no longer itemizing their deductions and have therefore lost the incentive benefits of the MID and SALT deductions.
- Given the revised standard deduction, it is critical to structure any new federal tax policy that incentivizes homeownership as a tax credit rather than a deduction, so that the benefit can be taken without the need for itemizing deductions. This would better support the large and rapidly growing groups of households which have struggled to gain access to homeownership during the last decade and have now been largely excluded from the annual federal tax incentives for owning vs. renting.
- In order to ensure that the goal of supporting sustainable homeownership in an effective and equitable way, major objectives that should be at the forefront of federal homeownership tax policy include: 1) support for first-time buyers and middle-income households transitioning to homeownership; 2) geographic equity across markets and regions of the country; 3) alignment of tax incentives with local and national economic benefits; and 4) freedom for households to choose the best tax option for their situation.

In many ways, the institution of homeownership epitomizes the American Dream for success and a better future. Homeownership supports financial opportunities for households, the strength and growth of communities across the country, and the vitality of our national economy. Progress toward the American Dream was, however, wiped out for millions of households nationwide during the Great Recession and remains stalled even after more than a decade of economic recovery. It is time to reestablish homeownership as a national priority that we can and should continue to stand for as a society.

## Introduction

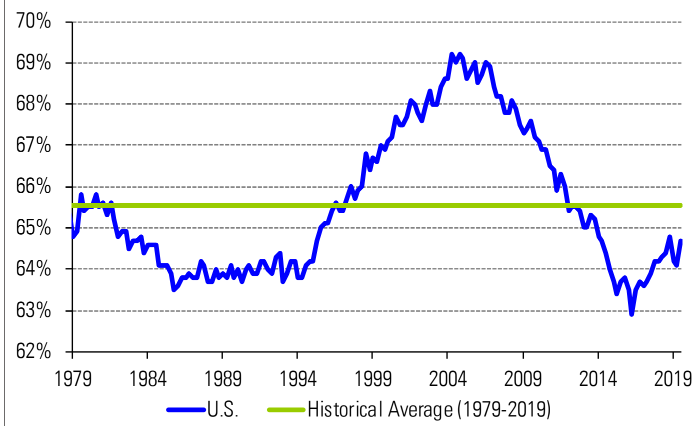
The homeownership rate in the U.S. fell precipitously in the wake of the foreclosure crisis and Great Recession, wiping out the gains achieved during the prior three decades and undermining progress toward the American Dream for millions of households nationwide. By mid-2016, the U.S. homeownership rate reached the lowest level in more than 50 years, then gradually improved through 2018, before the homeownership rate decreased once again in the first half of 2019.[1] Thereafter, a significant decrease in mortgage rates helped support stronger home sales and contributed to a somewhat higher homeownership rate in the third quarter of 2019, albeit still notably below the long-term historical average and far below the peak prior to the financial crisis.

Homeownership rates for two of the largest minority groups, African Americans and Hispanic Americans, remain significantly below prior peaks. The total number of African American households in the nation increased to more than 17.1 million as of March 2019, while the number of Hispanic households increased to more than 17.5 million households, according to the Census Bureau.[2] Altogether, minority groups accounted for 43.9 million households. However, the rate of homeownership among African Americans was 42.7% as of the third quarter of 2019, 6.4 percentage points lower than the prior peak, and only one-half of a percentage point greater than the first quarter of 2018.[3] The homeownership rate among Hispanic households was 47.8% as of the third quarter, which was still nearly 2 percentage points lower than the prior peak, and 0.6 percentage points lower than in the beginning of 2018. By contrast, the homeownership rate among White households was 73.4% in the third quarter of 2019, which was nearly 31 percentage points higher than among African American households and 25.6 percentage points higher than among Hispanic households.

The rate of homeownership also recovered slowly in recent years for younger households, particularly those in the prime, first-time homebuyer category. Many younger households are struggling with the burdens of large amounts of student debt and have delayed major life choices, such as starting families and buying homes—trends that have negatively impacted the homeownership rate. In addition, affordability challenges represent a major hurdle for young households, especially in major coastal markets. As a result, the youngest group of millennials, those in the 25 to 29 age cohort, continued to have one of the weakest levels of homeownership at 33.9%, as of the third quarter of 2019, compared with the pre-recession peak of nearly 42%. The two older age cohorts of millennials, those ranging in age from 30 to 44, also had homeownership rates nearly 10 percentage points lower than their respective peaks. Of particular concern, in the past year, the homeownership rates among households age 30 to 34 and age 35 to 39 have decreased by 0.5 percentage points and 2.4 percentage points, respectively.

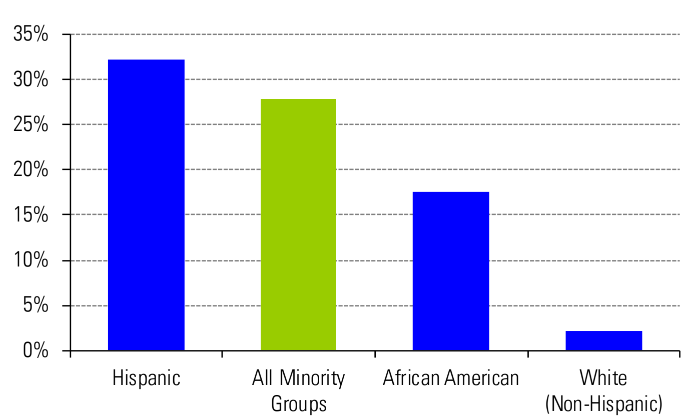
The final group to experience major setbacks in homeownership during the past decade was middle-income households. Although there is no single definition of middle class, and incomes vary widely across regions of the country, many of these households fall in the 40th to 80th percentile of income, which translates to approximately $50,000 to $150,000 of annual household income, based on 2018

**U.S. Homeownership Rate**




Note: Latest data as of 3Q19
Source: Census

**Cumulative Household Growth (2009-2019)**



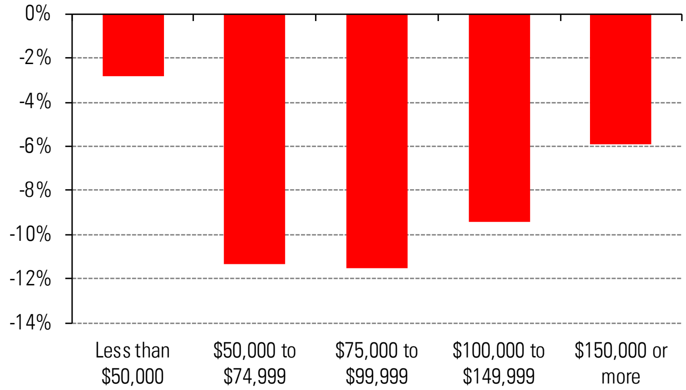

Note: Hispanic may be any racial group, and may overlap with the African America category.
Source: Census

**Homeownership Rates by Household Type**

| Household Type | Peak | Current | Percentage Point Change |
|---|---|---|---|
| Under 25 Years Old | 25.7% | 24.3% | -1.4% |
| **25 to 29 Years Old** | **41.8%** | **33.9%** | **-7.9%** |
| **30 to 34 Years Old** | **57.4%** | **47.9%** | **-9.5%** |
| **35 to 44 Years Old** | **69.2%** | **56.5%** | **-12.7%** |
| 45 to 54 Years Old | 77.2% | 70.1% | -7.1% |
| 55 to 64 Years Old | 81.7% | 75.1% | -6.6% |
| 65 Years and Over | 81.0% | 78.9% | -2.1% |
| White | 76.0% | 73.4% | -2.6% |
| **African American** | **49.1%** | **42.7%** | **-6.4%** |
| Hispanic American | 49.7% | 47.8% | -1.9% |
| Other Races | 59.9% | 56.0% | -3.9% |

Note: Peak from 2004 to 2007; Current data as of 3Q19
Source: Census

Change in Homeownership by Household Income (2005 to 2018)




Source: Census

data from the Census Bureau.[4] While affordability differs considerably by market, nationally, this group represents many current and potential homeowners. In fact, households in this middle-income bracket accounted for 39 million homeowners as of 2018 and an estimated 12.5 million additional potential homeowners who were still in the rental market.[5] Collectively, this group of current and potential homeowners made up nearly 72% of all households with incomes over $50,000. From 2005 to 2018, homeownership rates among middle-income households declined by 9.6 percentage points.[6] The decrease was even more dramatic among households with incomes of $50,000 and $100,000, with a decline of nearly 11.5 percentage points. In fact, of the nearly 10 million households added to this middle-income income range from 2005 to 2018, more than 7 million were renters. Of particular concern, the homeownership rate for this group continued to fall in recent years, as the rate decreased by another 70 basis points since 2016.

Overall, following the Great Recession, middle-income, minorities and millennials households only began to resume a path towards higher homeownership a few years ago. However, gains in homeownership rates have since stalled, reflecting a combination of factors including: 1) increased affordability challenges; 2) financial market volatility and uncertainty for prospective homebuyers; and 3) the reduced tax incentives for homeownership resulting from the Tax Cuts and Jobs Act (TCJA) of 2017.

**Current and Potential Middle-Income Homeowners**

| Household Type | Number of Households (Mil.) |
|---|---|
| Current Homeowners | 39.0 |
| Potenial Homeowners in the Rental Market | 12.5 |
| **Total** | **51.5** |

Note: Data as of 2018; Freddie Mac Profile of Today's Renter (June 2019) found that 80% of renters want to own a home at some point in the future.

Sources: Census, Freddie Mac, RCG

While these factors all represent areas of concern, this report intends to demonstrate the effects of the major shift in federal tax policy on homeowners and potential homeowners, as well as the wide range of benefits associated with homeownership, in order to highlight the need for a new federal homeownership tax credit that will reestablish homeownership as a national priority that can and should be incentivized in the federal tax system.

Although the TCJA took effect in the beginning of 2018, the impact of changes to deductions were likely not fully realized for the typical household until they filed their 2018 tax returns in early 2019. The reduced incentives, described in detail in subsequent sections of this report, had a particular impact on those who no longer itemized their tax deductions. These factors were layered on top of the fact that the effects of the tax law changes have heavily affected three of the largest groups of potential homeowners (middle-income, minorities and millennials), who have already struggled to make any notable gains in homeownership since the Great Recession—even after more than a decade of economic recovery. The implications of the large declines in homeownership for these critical groups are far reaching for all Americans. Ongoing challenges in the for-sale housing market not only undermine the ability of middle-income households to accumulate wealth, but also represent a substantial hurdle for the national economy. The for-sale housing industry is a key component of GDP growth, and bolstering homeownership in a safe and sound way is therefore not just about helping households to secure greater financial stability, but may in fact be the single most important key to sustaining the current economic expansion and returning the United States to a path of robust economic growth.

## Benefits of Homeownership

The economic and social benefits of homeownership are transformational for households, communities and perhaps most importantly, the national economy. Not only does homeownership benefit individual households, families and communities, as homeowners build equity, grow wealth and invest in their neighborhoods, but safe and affordable homeownership generates increased economic activity and positive economic spillover effects that together represent a major source of growth for the U.S. economy. Indeed, access to sustainable homeownership supports the strength and stability of the housing market, the health, growth and vitality of the national economy and, indeed, the very spirit of the American Dream.

The many benefits of homeownership and the critical role that the housing market plays in the U.S. economy are the reasons that U.S. federal tax law has provided a strong tax incentive to help Americans buy and own their own homes since the very inception of the federal income tax in 1913. The Tax Cuts and Jobs Act of 2017, however, effectively eliminated this incentive for millions of American households. Today, large numbers of middle-income, millennial and minority households lack access to homeownership and are forgoing the wide range of potential benefits. At the same time, ongoing challenges in the for-sale housing market and the issue of affordability are constraining the pace of economic growth for the nation. In this environment, a clear and equitable tax incentive that is broadly available to those no longer able to access the traditional tax incentives for buying and owning a home, would provide considerable benefits for households, communities and the economy at large.

### ***Economic Benefits***

Whereas homeownership benefits households and communities in many ways, perhaps the most significant benefit of homeownership is the positive economic impact of a strong and stable for-sale housing market. The for-sale housing industry is a major driver of the national economy and represents one of the most important determinants of the health and strength of the U.S. economy. In fact, housing is so important to the national economy and the U.S. business cycle that research by University of California, Los Angeles (UCLA) economist Edward Leamer argued that "Housing IS the Business Cycle."[7] While this research focuses on the fact that declines in the housing sector, particularly residential construction and investment, typically precede a broader national economic slowdown, an examination of the current economic expansion highlights the importance of housing and homeownership in supporting the pace of national economic growth. In the wake of the Great Recession and foreclosure crisis, Gross Domestic Product (GDP) growth has remained relatively weak in the low-2% range since 2010, well below the longer-term historical trend in the 3% range per year. The current low level of homeownership and the corresponding challenges in the housing sector represent major factors that contributed to this sluggish pace of growth in recent years. However, a return to a more normalized housing market, supported by a recovery in homeownership and an increase in homebuilding in line with the long-term historical trend, would generate a considerable near- and medium-term boost to GDP growth, as well as positive spillover effects on consumer spending and small business growth for many years to come.

#### *Housing Spending & GDP*

Housing-related spending is divided into two major GDP categories. The first is personal consumption of housing services, which is composed largely of rent and utility payments, as well as the estimated rental equivalent for homeowners, defined as the forgone income that homeowners give up by choosing to live in a house instead of renting it out. Effectively, housing services consumption provide a broad measure of the total payments made by all types of households in a given time period. The second major category of housing-related spending is residential fixed investment, or more simply, residential investment, which includes spending associated with new home construction (both single family and multifamily), as well as remodeling, renovations and brokerage fees. Together, housing services and residential investment spending account for the majority of housing-related expenditures nationwide and represent a substantial driver of national GDP.[8] In fact, during the past three decades, total housing-related spending, including both owners and renters, accounted for an annual average of 16.9%, or more than one-sixth of all economic activity in the nation. More recently, following the large drop in the national homeownership rate and an extended period of moderate-to-weak new home construction, housing-related spending as a share of GDP decreased significantly, falling to 14.6% of GDP as of the third quarter of 2019.

For purposes of calculating the U.S. GDP, residential investment generally includes spending on newly constructed homes and does not account for the purchase price of an existing residence, since the asset is being transferred from one owner to another. However, existing home sales do contribute to residential investment spending in numerous ways through the ancillary costs associated with residential purchases, such as moving costs, closing costs and home improvements or renovations. While a significant portion of residential investment comes from new homebuilding, over time, increased levels of homeownership and greater levels of sales activity across the full spectrum of the for-sale housing market, translate to increased residential investment. In particular, it is common for homeowners to make significant improvements to homes, both in anticipation of selling an existing home, and immediately following an initial home purchase, as the new owner begins to remodel. These expenditures are all considered part of the calculation of residential investment. Together, the purchase of both new and existing homes generates a large, direct positive impact on GDP.

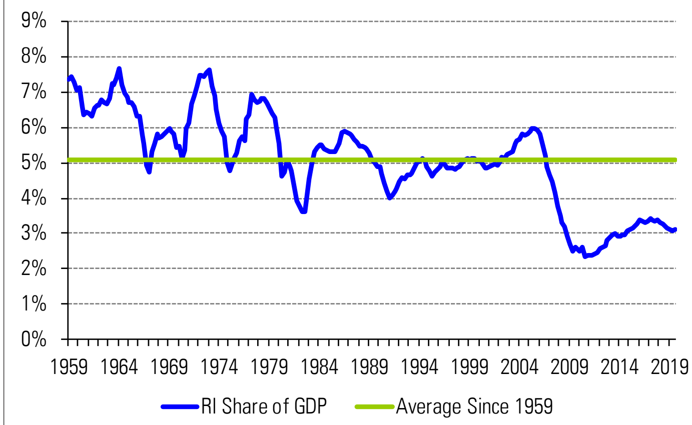
Additionally, spending on the production and sale of residential housing generates further benefits beyond direct contributions to economic growth. Building homes employs millions of construction workers, contractors and numerous other necessary employees, such as architects and various types of material suppliers. On the financing side, the mortgage underwriting and banking services needed to originate and service loans all generate jobs, as does the need for real estate agents, insurance brokers, appraisers and housing inspectors, all of whom receive income and contribute to increased spending money in various ways throughout the economy. In fact, estimates from the National Association of REALTORS® highlight that, including the income generated from real estate industries, the expenditures related to the home purchase, the multiplier effect of housing expenditures and the positive impact of new home construction, the economic impact of a typical, existing home sale totaled nearly $85,000 as of 2018.[9] Indeed, the housing industry sustains and fuels considerable job growth and economic activity across a broad range of complementary industries.

*Construction & Residential Investment*

Consistent with weak homeownership, the for-sale housing market, particularly construction and residential investment, has remained weak throughout the current growth cycle and continues to limit the pace of national economic growth. After dropping by nearly 59% in the aftermath of the Great Recession, residential investment recovered slowly from late 2010 to a recent high point in the fourth quarter of 2017.[10] Thereafter, residential investment decreased notably by 4.2% (inflation-adjusted) through the third quarter of 2019. This trend reflected renewed challenges in the for-sale housing market across the country, resulting from the combination of declining single family affordability, considerable financial market uncertainty and, at least to some extent, the impact of the TCJA tax reform, which went into effect in the beginning of 2018. As of the third quarter of 2019, residential investment in the United States totaled $594 billion, compared with $620 billion in the fourth quarter of 2017 and a peak of $895 billion in the third quarter of 2005. Beyond the recent dip, residential investment has dropped significantly from historical norms as a percentage share of GDP and remains far below the long-term average. During the six decades since 1959, residential investment accounted for an average of 5.1% of total GDP. However, as of the third quarter of 2019, residential investment represented only 3.1% of total GDP, or approximately three-fifths of the historical average.

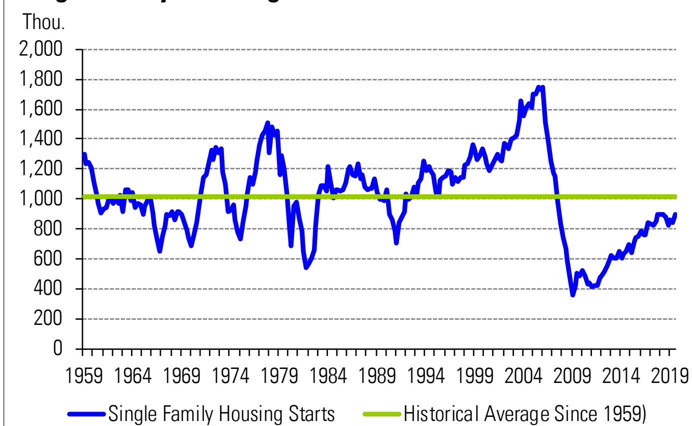
Consistent with the trend in residential investment, ongoing challenges in new and existing home sales activity represent major factors limiting the level of new housing starts and construction employment through the current cycle. As of the pre-recession peak in 2005, there were more than 1.7 million new single family homes started.[11] Since then, homebuilding fell precipitously and then recovered gradually, reaching a seasonally adjusted annual rate of approximately 900,000 new housing starts as of the third quarter of 2019. Even after nearly a decade of economic recovery, the current pace of construction activity remained significantly less than the long-term average of more than 1 million homes per year for the past

**Residential Investment Share of Real GDP**



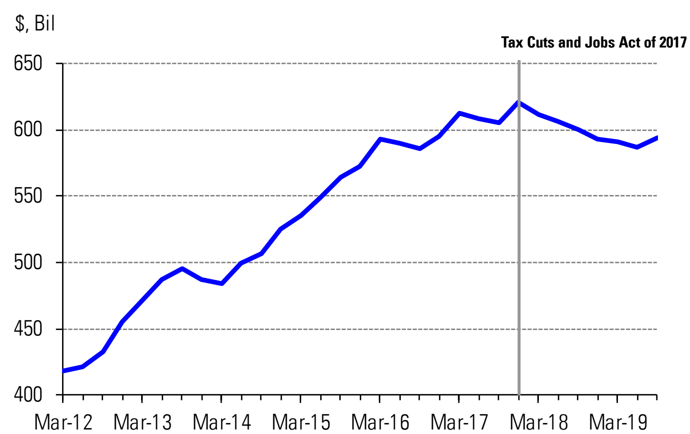

Note: Latest data as of 3Q19
Source: BEA

**Single Family Housing Starts**



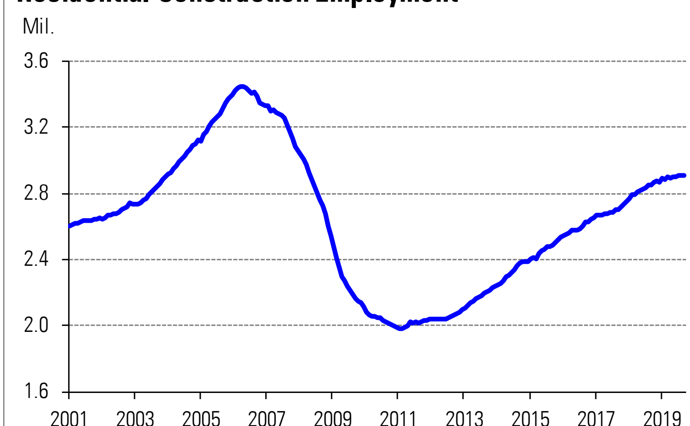

Note: Latest data as of 3Q19
Source: Census

**Real Residential Fixed Investment**




Note: Latest data as of 3Q19
Source: BEA

**Residential Construction Employment**




Note: Includes construction of buildings and specialty trade contractors; latest data as of September 2019
Source: BLS

six decades. The impact on the level of construction employment was also extremely large. In fact, as of September 2019, there were a total of 2.9 million workers nationwide employed in construction and specialty trades for residential buildings, approximately 537,000 fewer workers than the prior peak at year-end 2006, despite a large surge in multifamily development in recent years.

*Potential GDP Growth*

As highlighted in prior research by RCG, considering the importance of the for-sale family housing market for the national economy, if the current sluggish pace of homebuilding and for-sale housing activity returned to a more normalized level, the potential economic benefit for the national economy would be very large.[12] In fact, if the level of residential investment nationally increased from the third quarter of 2019 share of GDP (3.1%) to the long-term average of 5.1% of GDP, RCG estimates that nearly $400 billion dollars would be added to the economy. Even a more modest increase to the 30-year average of 4.2%, would directly add nearly $220 billion dollars in economic activity. Even if this acceleration in construction and renovation activity occurred, for example, over a period of four years, a $220 to $400 billion increase in residential investment, would translate to an estimated 0.25% to 0.50% in additional GDP growth per year. Moreover, consistent with the pro-cyclical trend in government tax revenue, accelerated economic activity would correspond to increased federal tax revenue. According to data from the Tax Policy Center at the Urban Institute and the Brookings Institution, total federal government receipts currently account for approximately 16% of GDP, which would translate to roughly $35 to $64 billion in additional federal tax revenue under the two scenarios described above. Given the current moderate pace of national economic growth, with GDP growth in the low-2% range annually since 2010 and dipping below 2% as of the third quarter of 2019, a return to more normalized housing construction, supported by increased homeownership, greater for-sale housing demand and the accompanying increase in renovation spending, would certainly provide the potential for a substantial boost to the pace of U.S. economic growth and resulting federal tax revenue. Importantly, the positive economic benefits of increased economic activity, as measured by GDP growth, would accrue broadly, as greater levels of construction activity translates to new job opportunities, increased spending

**Potential GDP Growth**

| | 30-Year Trend | 60-Year Trend |
|---|---|---|
| Residential Investment Share of GDP | 4.2% | 5.1% |
| Increased Economic Activity ($, Bil.) | $220 | $400 |
| Addition to Annual GDP Growth | 0.25% | 0.50% |

Note: Annual GDP gowth based on 4-year acceleration in residential investment.
Source: RCG

and income growth for both renters and homeowners. Moreover, considering the current late stage of the cycle and the rising risks of a recession in the coming years, a strong housing sector could help to sustain economic growth, or act as a buffer in the event of a slowdown in other sectors of the economy. Conversely, further challenges in the housing market will not only hold back growth, but could in fact prove to be the harbinger of the next recession.

*The Homeownership Wealth Effect*

Beyond the potential large near- and medium-term impact of a return to more normalized levels of housing construction and investment, there is a considerable additional macroeconomic benefit that accrues as homeowners build equity in their homes. In addition to the direct financial boost for individual homeowners that results from building wealth through home equity, wealthier households have a tendency to spend more money on goods and services, and the positive economic impact of increased spending benefits the broader community and the economy at large through a well-established dynamic known as the *wealth effect*. In economic literature, the wealth effect is a term used to describe the fact that individuals have a tendency to increase their spending habits when their actual or perceived wealth increases. For homeowners, the latent savings achieved by building equity in their home and the growth in home values over time, described in detail later, both contribute to increased net worth. Through the wealth effect, this in turn translates to households having a greater ability and willingness to spend money across a wide range of other types of goods and services that spur business activity and provide a positive multiplier effect that creates jobs and income throughout the economy.

More broadly, this increased consumer spending resulting from the homeownership wealth effect translates to a positive economic benefit for communities and the national economy over time. Indeed, with consumers accounting for approximately two-thirds of all economic activity in the U.S., the medium- and longer-term economic impact of even a small increase in homeownership could be significant. As highlighted in RCG's 2017 report on homeownership, a 2013 paper for the National Bureau of Economic Research, by Karl Case, John Quigley and Robert Shiller, demonstrated that changes in total housing market wealth have a larger effect on consumer spending. As an example, a 10% increase in total housing market wealth—potentially achieved through a combination of expanding the pool of homeowners and home price growth for existing owners—would increase consumer spending by around 1%.[13] Applying this ratio, with real aggregate consumption of $14.7 trillion as of the third quarter of 2019, every 10% increase in total housing market wealth would translate to approximately $147 billion in additional consumer spending, or a cumulative increase over time of approximately 0.8% of GDP, in addition to billions of dollars in increased federal tax revenue. Importantly, the magnitude of the wealth effect is typically strongest among low-to-moderate income households and tends to decrease among higher income households who may be less in need of purchasing additional good and services. As such, to the extent that middle-income households are able to transition to homeownership and begin to accrue wealth, the potential size of the positive wealth effect could, in fact, prove to be considerably larger. With homeownership rates for middle-income, minority and millennial households still very low following the Great Recession and largely remaining stagnant, a large proportion of the population is being locked out of the opportunity to accumulate wealth through home equity, and the economy at large continues to forgo the potentially large stimulating economic benefit of an expanding wealth effect on consumer spending.

*Entrepreneurship & Small Business Growth*

In addition to the broader macroeconomic impacts, over time, homeownership can also encourage increased entrepreneurship and provide greater opportunities for small business owners to finance new business ventures. In fact, home equity is a significant source of capital for many small business owners through a mechanism referred to as the collateral lending channel. Specifically, owning a home enables new entrepreneurs to obtain access to credit to start a new business, or expand an existing business, by using their home as collateral for small business loans or other business liabilities. Reflecting the importance of home equity as a source of collateral, researchers from MIT found a positive relationship between areas with home price increases and the pace of small business growth, including business starts and the number of people who were employed in establishments with fewer than ten employees.[14] A similar increase in employment was not present for large establishments in these same areas, owing to the fact that collateral lending is an important driver of employment creation for small firms, whereas large firms typically have access to other forms of financing. Further supporting the importance of homeownership for small businesses, researchers at Harvard Business School found that increases in the ability to borrow against a home can lead to increased entrepreneurship.[15] According to the most recent data published by the Small Business Administration in 2018, small businesses in the U.S. employed a total of 58.9 million people, or 47% of the private workforce, and created 1.9 million net jobs in 2015.[16] Given the outsized importance of small businesses for job creation, policies that support sustainable homeownership should further benefit the national economy at large over time, by enabling small business owners to leverage their personal wealth, in the form of equity in their homes, to support the growth of new and existing businesses.

## Household Benefits

Buying a home represents the largest investment that most people will ever make in their own future. Indeed, the economic mobility and potential to build wealth that homeownership provides is critical to enabling individuals to improve their own lives and the lives of their families. It is for this reason that homeownership represents a key part of the American Dream for success and a better future.

*Wealth Building & Financial Predictability*

While some have questioned the financial benefits of homeownership in the wake of the Great Recession and foreclosure crisis, the underlying fact, which is well-supported by academic research, is that sustainable and affordable homeownership is the single best opportunity most households will ever have to build equity and improve their long-term net worth and financial security. In particular, there are three primary mechanisms through which owning a home provides financial benefits for individuals and households over time: 1) accumulated savings through building equity; 2) appreciation in the value of the home; and 3) predictable monthly housing expenses.

First, owning a home provides a unique opportunity for households to accumulate savings and grow wealth over time. Most directly, paying down the principal on a mortgage every month, rather than paying rent to a landlord, enables homeowners to allocate a portion of monthly living expenses to building equity in the home. While principal payments represent a small portion of mortgage payments in the first few years of repayment, the share of mortgage payments that go toward reducing principal increases substantially over time. In this way, the purchase of a home acts as a kind of self-imposed, forced monthly savings program, with each monthly payment progressively reducing debt and increasing the value of household assets. A simple example highlights the significant benefits that accrue over time. Assuming a traditional 30-year mortgage of $250,000 with a 5% interest rate, after five years a homeowner would have paid off more than 8% of the mortgage and reduced principal by more than $20,000. In effect, this represents latent savings available to the homeowner upon the sale of the home. Moreover, the savings grow still further over time. After ten years, the same homeowner would reduce principal by approximately $47,000, and by the end of the 20th year, the homeowner would have paid off approximately half of their mortgage, an accumulated $123,500 in latent savings in the form of home equity, excluding any appreciation in the value of the home. These figures are even more substantial with a larger mortgage. With a $500,000, mortgage, a homeowner would accrue $41,000 in five years, $93,000 in ten years and nearly $250,000 in 20 years. If a household purchases a home in their 30s, this accumulated savings will represent a sizeable nest egg by the time they reach retirement age. Indeed, researchers from the Urban Institute and

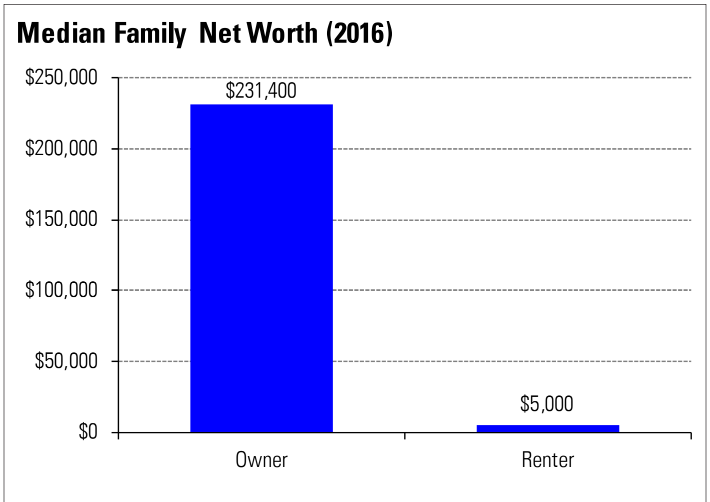
**Accumulated Principal Payments (30-Year Mortgage)**

| | $250,000 Mortgage | $500,000 Mortgage |
|---|---|---|
| Interest Rate | 5.0% | 5.0% |
| Principal Paid in 5 Years | $20,400 | $40,900 |
| Principal Paid in 10 Years | $46,600 | $93,300 |
| Principal Paid in 20 Years | $123,500 | $246,900 |

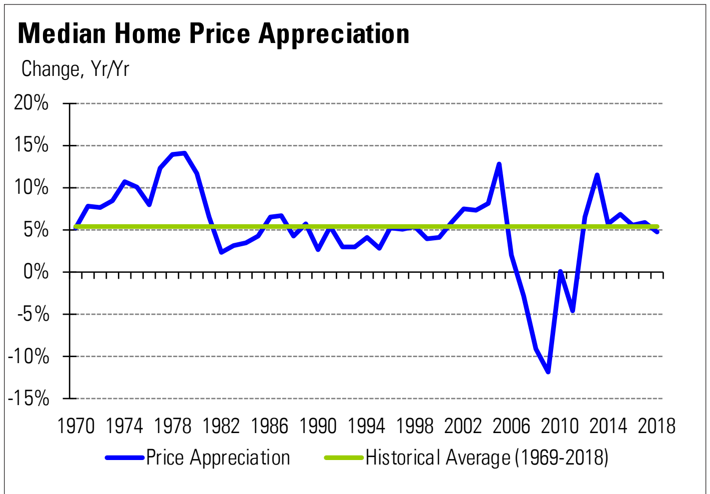
Source: RCG

Columbia University found that "home equity is the principal source of savings for most American households, especially households in the bottom part of the income distribution."[17] Moreover, the same research highlighted the fact that there "is little evidence of an alternative savings vehicle (other than a government-mandated program like Social Security) that would successfully encourage low-to-moderate income households to obtain substantial savings outside of owning a home."

While there are numerous other factors such as income and initial family wealth prior to purchasing a home, the large potential savings achieved through home equity are evident in the most recent data from the Federal Reserve Board's Survey of Consumer Finances, which highlights that the median family net worth for all homeowners was $231,400 as of 2016, whereas the median family net worth for renters was minimal at just $5,000. Moreover, while homeowner net worth increased by nearly 15% since 2013, net worth actually declined by approximately 9% since 2013 for renter families—a factor that significantly emphasizes the difficulty of growing wealth for households who are not able to make the transition to homeownership.



Source: Federal Reserve Board, Survey of Consumer Finances

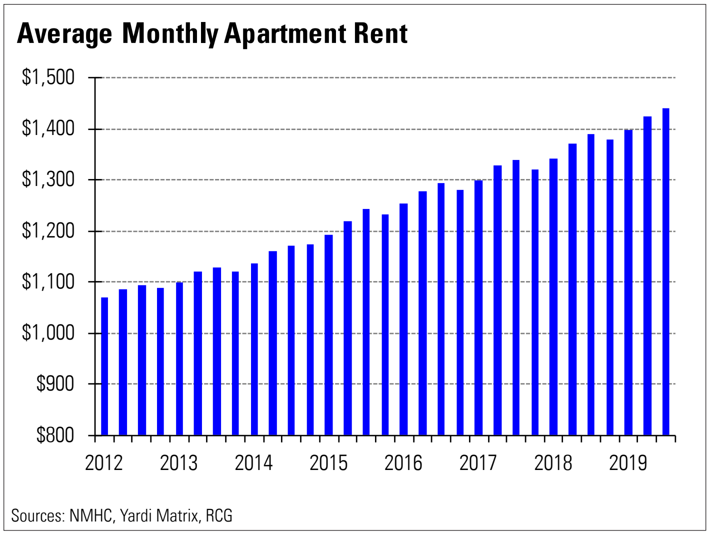


Sources: NAR, RCG

In addition to the advantages of growing savings through making principal payments, purchasing a home provides the homeowner with the potential to significantly increase net worth through home price appreciation over time. In fact, nationally, the median sales price for existing single family homes grew by an average of 5.3% annually for the past 50 years.[18] Compounding this growth rate over time, the price of a home in nominal terms (not adjusted for inflation) would double every thirteen to fourteen years, representing a considerable amount of potential capital appreciation for the homeowner when the home is sold. While home prices have generally increased over the longer term in most areas of the country, and especially in major metropolitan areas, rising prices are certainly not inevitable. Indeed, the Great Recession provided a stark example of the potential for substantial short-term price declines. At the same time, it is notable that this period represented the only time since the Great Depression that home prices in the United States declined nationwide.

There are certainly other risks for homeowners, particularly those who attempt to purchase a home with short-term investment objectives, rather than with the goal of actually living in the home, and those who attempt to purchase a home that is financially out of reach. However, with a firmer foundation for the housing market and a return to more traditional underwriting standards following the last recession, home prices should generally increase in most markets over the medium and longer term, providing considerable wealth accumulation opportunities for homebuyers. Moreover, to the extent that homeownership is broadly accessible, the wealth-building benefits can reduce racial and socioeconomic inequality by providing opportunities for minority and low- or moderate-income households to grow equity. Indeed, recent research examining the financial returns of homeownership found that for buyers purchasing in a relatively normal market (at the end of 2002), with a traditional 20% down payment, "owning a home appears to be generally financially advantageous relative to renting," even before incorporating the benefits for those households who itemize tax deductions.[19] Moreover, these returns appear to be comparable, or even superior to other investments such as stocks or bonds, though the magnitude of returns depended considerably on precise timing of the market and the market location around the country.

Beyond the wealth-accumulation benefits, the structure of a traditional, fully amortizing mortgage provides households with predictable, fixed monthly housing expenses over the term of the loan. In comparison, landlords typically raise the rent for an apartment every year. In fact, excluding the decline and rebound from the Great Recession, nationally the average monthly rent for professionally-managed apartments increased by 37% since year-end 2011. While it is far from a direct comparison, since homeowners take on the costs and risks associated with maintaining a home, as well as the expense of property taxes, over time the consistency of the fixed monthly




mortgage payment can translate to greater financial certainty and stability for families and the potential for financial savings, particularly in a period of rapidly rising rents.

Given the persistently low rates of homeownership among minority groups, many households are currently unable to access the numerous benefits of purchasing a home. Without policies to improve access to homeownership for minority households, this situation is likely to persist. However, to the extent that U.S. policies can support opportunities for homeownership, there is a significant potential to increase both household and intergenerational wealth, which could help to substantively reduce long-term economic inequality.

*Psychological Benefits, Happiness & Well-Being*

In addition to these tangible benefits, homeownership can be linked to relatively higher levels of psychological health and greater happiness for individuals. One aspect of the American Dream has always been achieving a level of financial success that allows an individual to purchase a home. It is a dream deeply ingrained in the American psyche, and so, like any other goal, its attainment innately creates a sense of accomplishment. Homeowners are proud to have reached this level of success and stability, and their elevated pride and self-worth affects the perceived control they have over their environment. They can customize their home environment and can make decisions about whether to move or stay, assuming they remain current on their mortgages. This personal satisfaction and sense of control can enhance a homeowner's psychological health, happiness and well-being—and the well-being of those around them.

The evidence that homeownership provides more financial security than renting has been under intense scrutiny since the 2008 housing crisis. However, studies by Harvard's Joint Center for Housing Studies and the Federal Reserve Bank of Boston have shown that, despite the large drop in home prices and widespread foreclosures, Americans' belief in the benefits of homeownership has not changed significantly in the wake of the Great Recession. In fact, the desire to own a home continues to be very strong. The June 2019 Freddie Mac survey found that 80% of renters want to own a home at some point in the future.[20]

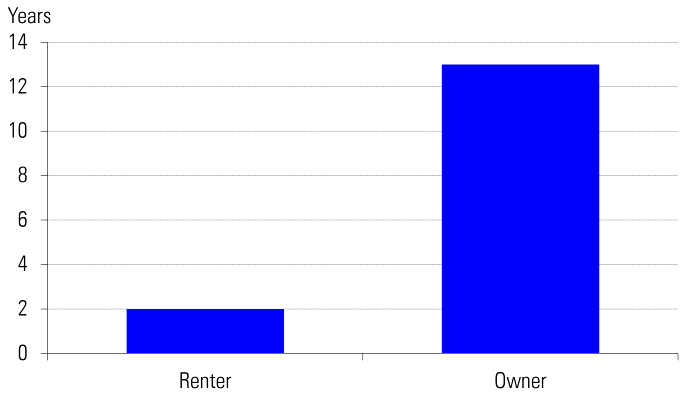
Moreover, while millions of people suffered financial and psychological hardship in the wake of the foreclosure crisis, a 2012 study published in the Social Science Research journal compared a panel of renters to a sample of lower-income homeowners who obtained relatively low-risk, 30-year, fixed-rate mortgages. The study revealed that, although both renters and owners experienced similar levels of financial hardship during the financial crisis, homeowners exhibited a greater perception of being in control and a higher financial satisfaction than renters. While this may not extend to riskier lending practices, this research suggests that, at least with more traditional mortgages, owning a home still gives people a greater sense of financial security, which in turn reduces stress and helps homeowners cope with financial hardships better than renters with comparable income levels. This reduction in severity of stress can also promote psychological well-being for homeowners and their families.

Beyond stress-reduction, control and security, research also shows that homeownership can increase housing satisfaction. In 2009, a professor of economics at Rovira i Virgili University in Spain conducted a study of European households during 1994-2001, a portion of whom had purchased the homes they had previously been renting.[21] Researchers found that renters who become homeowners not only experience a significant increase in housing satisfaction, but also obtain a higher level of satisfaction, even in the same home in which they previously resided as renters. Beyond the numerous financial benefits, the psychological benefits and the sense of accomplishment of achieving the American Dream represent profound benefits for individual households and their communities.

## ***Social and Community Benefits***

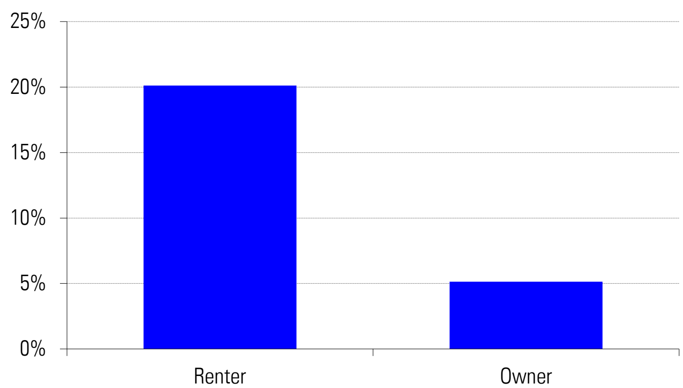
The positive impacts of homeownership on communities are expansive and of limited debate. Most notably, homeowners typically remain in their homes for a much longer time period than renter households, and this greater level of residential stability provides a wide range of benefits, not only to the homeowner, but also for the broader community. As of 2018, the median duration that householders lived in their current homes was 13 years for homeowners, compared with only two years for renters, according to the Census.[22] Moreover, 20% of residents living in rental units had moved during the past year, approximately four times the share of movers among owner-occupied units. In addition to the benefits for individuals and households resulting from the stable costs and environment associated with ownership, the longer residency among homeowners contributes to considerable community benefits through stabilizing long-term interests among neighbors, improvements in child devel-

**Median Duration Householder Lived in Current Home (2018)**




Source: Census

**Share of Households Moving During Past Year (2018)**




Source: Census

opment and education, furthering community engagement and civic participation and increasing housing access for essential workers such as teachers, nurses and first responders.

*Aligning Long-Term Community Interests*

The residential stability created by homeownership allows households to maintain and increase the long-term value of their personal properties and the surrounding community. Buying a home is the largest investment most people make in their lifetimes. The long-term savings and planning necessary to buy a home, as well as the time and money spent on renovations, is a consuming endeavor. Given the significant size of the investment, owners are typically highly motivated at the minimum, to maintain the value of their property. When a home is well-maintained, the investment not only has a direct positive impact on the value of that same home, but may also positively influence the value of neighboring homes in the community. In many ways, this relationship represents a virtuous cycle. If you move into a neighborhood which is well-kept, you are more likely to prioritize the upkeep of your own home, whether that be from a type of positive societal pressure, or because of the broken window theory; visible signs of disorder create an environment that encourages further disorder. If your neighborhood is not well maintained, you may be less encouraged to restore or maintain your home. Similarly, if your neighbor's yard is well maintained, you are more likely to keep up your own yard. In this way, people investing in their homes directly impacts, not only their own home value, but also the value of their neighbors' homes. While many renters may be well-intentioned, homeowners have a clear vested stake in the community because their home is an investment, and so the value of that investment is linked to the condition of the neighborhood in which it is located.

In addition to creating the motivation to maintain the aesthetics of a neighborhood, the stability of homeownership allows households to develop a deeper knowledge of local resources and more extensive social support networks over time, which in turn, builds trust of neighbors and influences the way residents feel about their communities. While not a direct link, homeownership impacts crime rates through an enhanced sense of community. Positive perceptions of neighbors, trust and the belief in the common good all contribute to social cohesion, and further translate to beneficial outcomes such as improved neighborhood safety. This increased residential safety and security not only improves neighborhood property values, but also enhances the quality of life for residents. In fact, numerous academic studies have found that positive perceptions of neighbors, or social cohesion, are correlated with reductions in violent crime within neighborhoods.

Additionally, research by Nobel Prize behavioral economists Daniel Kahneman and Richard Thaler highlights that humans are subject to a phenomenon known as the "endowment effect," whereby people value an object more if they own it, regardless of the underlying dollar value of the object.[23] With a home typically representing the largest purchase most households ever make, homeowners often take great pride in their homes and their neighborhoods. In fact, the time and effort involved in the decision to purchase a home in a specific neighborhood may lead homeowners to see that neighborhood in a more positive light, a factor which will only tend to further reinforce owners' efforts to maintain their own homes, establish relationships with their neighbors and support the upkeep and development of their communities.

*Improving Children's Development and Education*

Children of homeowners and students attending schools in areas with large concentrations of owner-occupied housing benefit from an enhanced sense of community in multiple ways. First, children of homeowners are less likely to move as frequently as children of renters. This longer residency in a neighborhood means children do not change schools as frequently, providing greater stability in the educational environment. Whether it is because of instability involved in moving, or because of external stresses potentially coinciding with a move, children who switch schools frequently have been found to do considerably worse in school than those who have greater stability. In fact, a study from the Federal Reserve Bank of Chicago found that children of homeowners were significantly less likely to drop out of school. Similarly, research conducted by economists at the University of Southern California and University of California, San Diego, found that children of homeowners are generally less likely to drop out of high school by age 17 than children living in rental units.[24] More broadly, the impact on children's early educational success has long-term consequences, which affect not only individual families, but local school districts, communities and the country at large.

Beyond the benefits of stability, the education and lessons learned from homeowners themselves may also positively impact children's development. Homeowners are required to take on greater responsibility than the typical renter in order to physically maintain the home and to build the financial skills necessary to handle mortgage payments. These are skills which may be passed on to their children, either by simply being around the environment or being specifically taught the skills. In addition, as mentioned previously, homeownership provides a sense of stability. Parents who experience more stability maybe experience less stress related to their residence, a factor that can improve parent-child relationships, create a more stimulating environment for children, and positively impact safety and social cohesion. Due to this sense of stability and social cohesion, homeowners may also be more motivated to invest time and energy in their local schools.

*Furthering Civic Participation*

Alongside a motivation to invest in local schools, homeownership enables stronger social ties with neighbors, simply because there is more time to build long-term relationships. Social cohesion and strong ties are paths through which resources for social control are made. This stability and cohesion lead to more participation in local civic organizations, which results in even stronger social networks. Research published by the National Bureau of Economic Research found that, compared with renters, homeowners were 16% more likely to vote in local elections.[25] The same research also found that homeownership had a strong correlation with the number of non-professional organizations respondents belonged to, as well as the number of activities they were involved in, which had been designed to solve local problems.

Moreover, owning a home within a neighborhood increases the likelihood of voting on measures that directly impact the development of one's family and other individuals within the community. For example, homeowners, whose family and social networks are directly impacted, may be more likely to support a new local tax, which benefits their local school district, compared with renters who expect to move again in the near future and therefore may not have a long-term vested interest in the quality of local schools. Ultimately, the types of households and workers who live within the neighborhood play a significant role in determining the growth and stability of the community.

*Increasing Housing Access for Essential Workers*

Given the stability that homeownership provides, ensuring access to affordable homeownership for essential workers ensures long-term stability for the middle-income households who support the growth and vitality of American communities. If essential workers, such as teachers, nurses, police officers and firefighters are able to buy homes, they will be more likely to stay in those neighborhoods. Teachers will be less likely to abruptly or frequently move schools because they can no longer afford the rising rents in the community, or tolerate the long commute from neighborhoods with more affordable rent. Indeed, ensuring access to affordable and stable housing for essential workers through the fixed, monthly housing costs that homeownership can provide, increases the likelihood that these workers will be able to live in the communities where they work, a factor that should strengthen the stake essential workers already have in the community.

Workers who are directly impacted by the success of local initiatives will also be incentivized to maintain and develop them. Teachers who work in better financed and developed schools, or the schools their own children attend, and nurses who work in their own local hospitals will tend to be more fulfilled and stable in their careers. Just as homeowners are more likely to support local programs, so too are individuals working directly for those programs likely to maintain and upkeep the communities in which they live and work.

More broadly, homeownership and the stability that it provides for households has clear short- and long-term, positive benefits for communities. Indeed, increased homeownership would likely translate to greater stability and social cohesion, lower crime rates, more civic engagement and even stronger educational systems, all factors that add to the strength and vibrancy of local communities.

### Benefits for Nation At Large

Beyond the numerous economic and social benefits of homeownership described in this report, homeownership is undeniably the cornerstone of the American Dream, and is inseparable from our national ethos that, through hard work, every American should have opportunities for prosperity and success. It is the stability and wealth creation that homeownership provides that represents the primary mechanism through which many American families are able to achieve upward socioeconomic mobility and greater opportunities for their children.

While the overall trajectory of homeownership in the United States will be influenced by a wide range of factors including interest rates, credit availability, demographic trends and the broader housing finance system, the future of the tax incentives for homeowners will undoubtedly play an important role in determining the cost and affordability of owning a home. As described in detail below, the tax law changes resulting from the TCJA effectively de-incentivized homebuying by reducing or eliminating many of the tax advantages to owning, as compared with renting, for most households. For the millions of households who are no longer able to obtain homeowner tax incentives, the cost of owning a home necessarily increased relative to renting, a factor that is likely to represent an additional hurdle to homeownership over time, particular for middle-income, millennial and minority households. As an institution that is vital to the hopes and dreams of millions of Americans, the strength of our communities and the vibrancy of our economy, homeownership should be a national priority once again.

## Impact of the Tax Cuts and Jobs Act of 2017

### *Major Changes for Homeowners*

The Tax Cuts and Jobs Act of 2017 made substantial changes to the Internal Revenue Code. While many of the reforms were intended to simplify the tax filing process, the changes also resulted in numerous unintended consequences. Most notably, the TCJA inadvertently removed or reduced the tax incentive for homeownership for large groups of people, marking an abrupt shift in federal tax policy that had previously supported the dream of homeownership for more than 100 years. The TCJA included major changes across the tax code, but the most significant impacts on homeownership stemmed from curtailing the limit on deductions for mortgage interest and state and local taxes, as well as the large increase in the standard deduction. The Mortgage Interest Deduction (MID), which has existed in some form since the inception of the tax code, had the maximum indebtedness reduced from $1 million to $750,000. The State and Local Tax (SALT) Deduction, which was previously unlimited, was capped at $10,000 for both single filers and married filers. The SALT deduction allows filers to deduct state and local taxes (a choice of either income or sales taxes) and property taxes up to the set limit. Most importantly, the standard deduction was increased from $6,350 for single filers and $12,700 for married filers, to $12,000 and $24,000, respectively.

**Major Changes in the Tax Code Affecting Large Deductions**

| Year | Event | Effect on Deductions |
|---|---|---|
| 1913 | Constitutional Ammendment creates modern tax code | All forms of interest, state taxes and local taxes are deductible |
| 1917 | War Income Tax Revenue Act | Allows for deduction of charitable donations |
| 1986 | Tax Reform Act | Created the MID by limiting the types of deductible interest; removed sales tax deduction |
| 1987 | Revenue Act | Limited the MID to $1 million of debt |
| 2004 | American Jobs Creation Act | Reinstated sales tax deduction, but allowed filers to only claim state and local income or sales taxes |
| 2017 | Tax Cuts and Jobs Act (TCJA) | Limited the MID to $750,000 of debt; limited SALT deduction, including state and local taxes (income or sales) + property taxes to $10,000 |

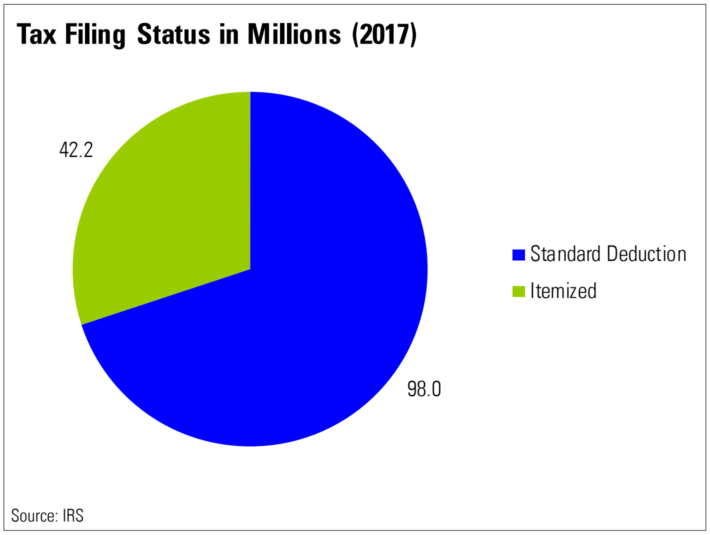
Sources: Tax Foundation, eFile.com, RCG

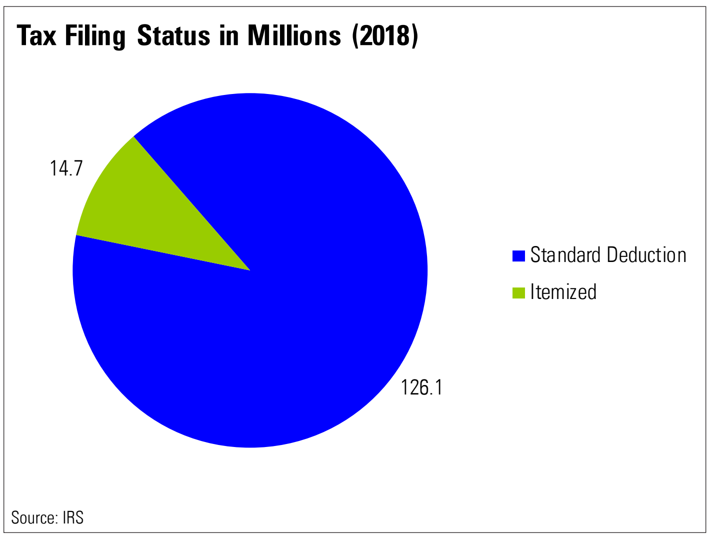
The effect of these changes was to remove the most important tax incentives for owning a home for the majority of households. The increase in the standard deduction made it significantly more difficult for middle-income households to reach the threshold to itemize deductions on their tax returns. This is especially true in large portions of the country where home prices and tax rates are lower than in coastal states. The reduction of the MID and SALT had a similar impact on households in high cost states and regions where relatively higher taxes and home prices contribute to higher mortgage and property tax payments. This translated to far fewer current and potential homeowners being able to take advantage of itemizing altogether, as the largest sources of deductions are typically SALT, MID and charitable donations. For households where these deductions amount to less than the standard deduction, the deductions no longer have any incentive value. Because of this, many groups now face a situation in which there is no longer an annual tax incentive for owning as opposed to renting, marking a stark contrast to the previous century of housing policy.[26]

While the direct effects of this shift for homeowners are described below, it is important to note that the broader, net effects of the new tax law, including changes such as lower marginal tax rates, remain difficult to assess. Many taxpayers benefited from an overall reduction in tax liabilities under the new law, and some may use this savings to help amass a down payment on a home. While beyond the scope of this paper, the extent to which net benefits from the TCJA are realized and whether or not these changes influence consumer savings and access to homeownership represent worthwhile topics for future research.

### *Magnitude of the Impact*

Highlighting the fact that many fewer homeowners are receiving a tax incentive, the number of filers itemizing deductions on their tax returns fell dramatically in response to the TCJA. In total, the number of filed tax returns that itemized declined by 27.5 million through the first 30 weeks of 2019, compared with the same period in 2018, according to the IRS.[27] Moreover, the share of all returns claiming the SALT deduction fell to 9.9% in 2019, compared with 42.1% in 2018. While the portion of itemizing tax filers decreased across all income brackets, the decline was most significant in the $50,000 to $200,000 income group, a key segment of current and potential middle-income homeowners, which accounted for two-thirds of the total decline in itemized returns. Among this group, the decline in the number of filers taking the SALT deduction was most extreme, as the number of deductions decreased by 17.8 million, or 67.3%,

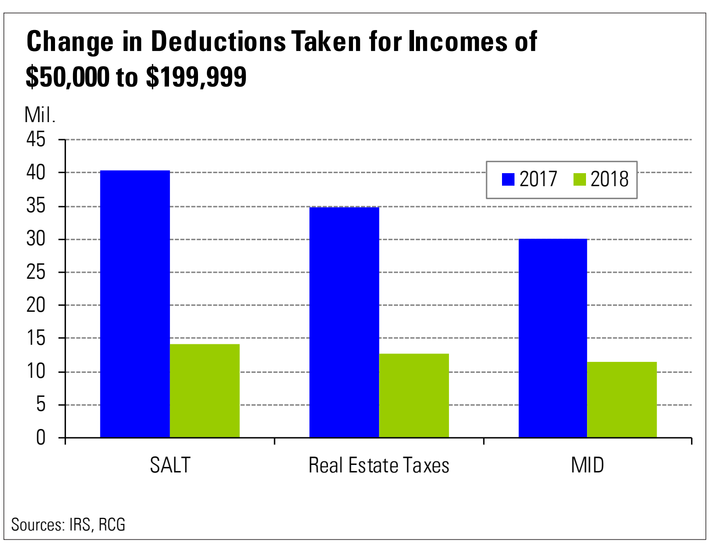


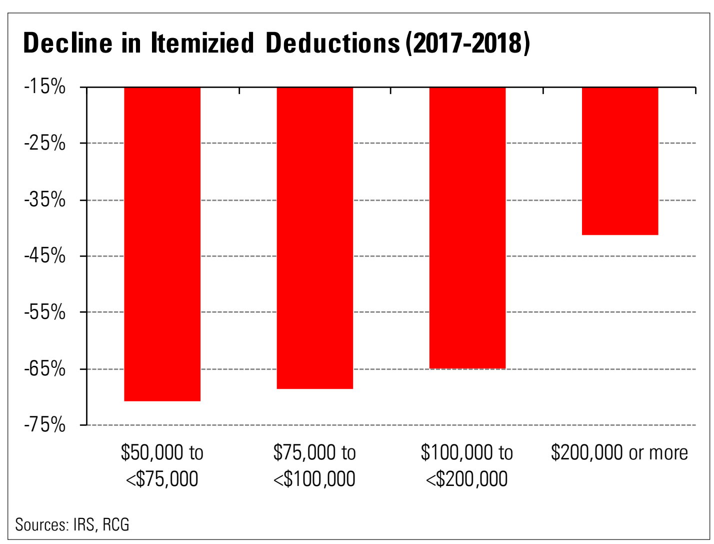




compared with a year prior. The number of filers using the real estate tax deduction and the MID also declined by a similar percentage for this $50,000 to $200,000 income group, with 15.4 million and 13.5 million fewer deductions taken, respectively. The impact of the TCJA is clear in this data, with far fewer filers being able to take advantage of the deductions that support homeowners. In effect, the TCJA practically terminated the annual tax benefits for owning a home for all but the highest income households, overturning a century of U.S. tax and housing policy.

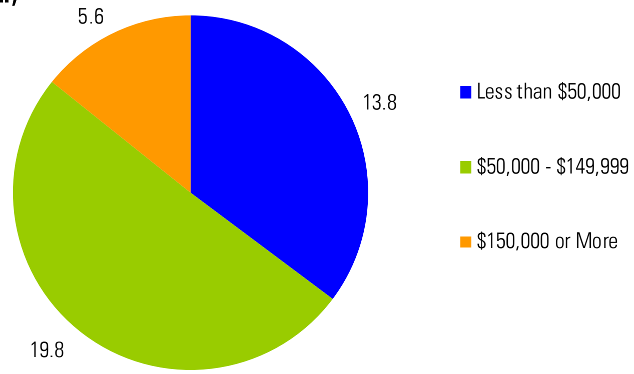
### *Impact on Middle-Income, Minority & Millennial Households*

Of particular concern, the households most affected by these changes in the tax code are the very groups of households, which have struggled the most to achieve homeownership in the aftermath of the Great Recession. Specifically, the tax law changes had an outsized impact on middle-income, minority and millennial households. Although the definition of middle class can vary widely across states and regions of the country, the $50,000 to $150,000 income range available from Census data broadly accounts for the vast majority of middle-income homeowners in most areas of the country. In fact, among households with incomes over $50,000, 72.3% of owner-occupied households had an annual income in this middle-income range, according to the Census.[28] By raising the standard deduction and decreasing the SALT and MID deductions, the tax reform law effectively led many of the households in this group to shift to taking the standard deduction, as they now had insufficient deductions to meet the threshold necessary to itemize. In this way, despite the continued existence of SALT and MID deductions, millions of middle-income households suddenly received absolutely no annual tax benefits for owning a home versus renting one. This situation is clearly evident in the data highlighted above, as not only is this income cohort included in the $50,000 to $200,000 group that experienced the largest declines in itemized deductions, but the middle-income households in this income range also represent one of the largest groups in absolute terms.



**Income Distribution of Households Age 25-44 (Mil.)**




Source: Census

Owing to a significant concentration in these heavily impacted income groups, many minority and millennial households were likewise affected by the changes to the tax code. As of 2018, there were 5.5 million African American households with incomes between $50,000 and $150,000, accounting for 85.4% of African American households with incomes over $50,000, according to the Census Bureau. Hispanics in this income group accounted for more than 7 million households, or nearly 84% of Hispanic households with incomes over $50,000.[29] Finally, among the age cohort containing most millennials, householders age 25 to 44, nearly 20 million households had incomes between $50,000 and $150,000 in 2018. In fact, this income group made up 78% of households with income over $50,000 among this prime, first-time homebuyer age cohort.

No longer providing a tax incentive for buying a home versus renting is a fundamental policy shift for tens of millions of households. This group includes a larger number of households in the middle-income, minority and millennial groups, which were already slowest to recover from the struggles of the financial crisis, and continue to face the greatest headwinds to increased homeownership. In order to ensure that U.S. tax policies support access to the American Dream of owning a home—a goal that we can and should continue to stand for as a society—it is imperative that homeownership should be incentivized in the federal tax system.

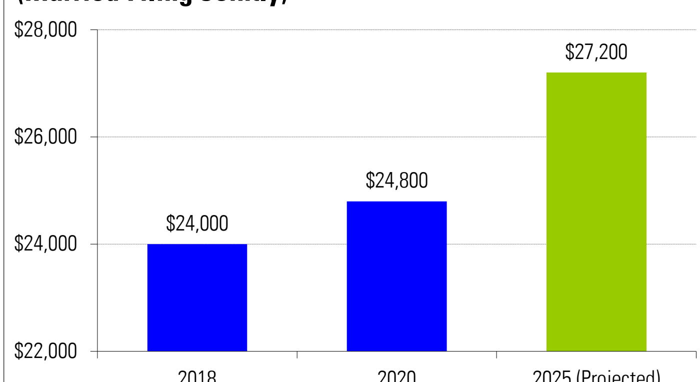
### *Future Inflation Adjustments*

While the large impact of the TCJA on middle-income, minority and millennial households is evident in the most current data on filed tax returns in 2018, it is important to recognize that the impact of inflation is likely to further reduce the number of households who will receive a tax incentive for owning a home in the coming years.

Following the change of methodology adopted as part of the TCJA, the IRS currently calculates inflation for tax purposes based on a measure of consumer inflation in urban areas tracked by the Bureau of Labor Statistics (BLS), which is referred to as the Chained Consumer Price Index. Critically for homeowners, however, while the annual IRS inflation adjustments apply to the standard deduction, the TCJA did not allow for inflation adjustments for the most important homeowner tax incentives—the maximum indebtedness eligible for the Mortgage Interest Deduction (MID) and the $10,000 cap on State and Local Tax (SALT) Deduction. The net effect is that over time it will become even more difficult for tax filers to have enough deductions to reach the threshold needed to itemize, and thereby receive the benefit of an incentive for owning a home. Indeed, following the initial 2018 standard deduction determined by the TCJA, the IRS adjusted standard deductions for single filers from $12,000 in 2018 to $12,200 in 2019 and $12,400 in 2020, increases of 1.7% and 1.6%, respectively. Similarly, the standard deduction for married joint filers increased from $24,000 in 2018 to $24,400 in 2019 and $24,800 in 2020. Looking ahead, based on the historical average inflation of 1.8% year-over-year since the BLS began tracking Chained CPI in 2000, RCG projects that the standard deduction could increase to $13,600 for single filers and $27,200 for married filers by 2025.

When considering the current magnitude of itemized deductions, the impact of this increase in the standard deduction on homeowners is likely to be quite large over time. In fact, based on IRS statistics on filed tax returns through the first 30 weeks of 2019, the average dollar value of itemized deductions for filers with an adjusted gross income of $50,000 to $200,000, was only $28,900, while the average itemized deduction amount was just $27,300 for filers with an income in the $50,000 to $100,000 range. With the two largest categories of itemized deductions for homeowners (MID and SALT) effectively capped, and other itemized deductions such as charitable donations unlikely to substantially outpace inflation, millions of additional homeowners are expected to shift from itemizing to using the standard deduction in the coming years, particularly middle-income households, including a very large number of minority and millennial households.

**Projected Standard Deduction in 2025 (Married Filing Jointly)**




Note: 2025 Projection based on historical average inflation (chained CPI)
Sources: BLS, RCG

## Possible Solutions and Proposals

Reflecting the prolonged impacts of the foreclosure crisis and Great Recession, millions of households have been unable to make significant gains towards realizing the American Dream of owning a home. It is critical to renew a form of tax incentive for groups struggling to gain access to the American Dream. It is important, however, that any future policy changes are carefully crafted to ensure that the goal of supporting sustainable homeownership can be achieved in an effective and equitable way. With this interest in mind, there are a number of major objectives that should be at the forefront when drafting a new way forward for federal homeownership tax policy. These objectives include: 1) support for first-time buyers and middle-income households transitioning to homeownership; 2) geographic equity across markets and regions of the country; 3) alignment of tax incentives with local and national economic benefits; and 4) freedom for households to choose the best tax option for their situation.

### *Policy Objectives*

*Supporting Homeownership for First-Time Buyers and Middle-Income Buyers*

Amendments to the tax code to bolster homeownership should help support the groups that are no longer itemizing deductions on their tax returns and have therefore lost the incentive benefits of the MID and SALT deductions. Specifically, many fewer middle-income, minority and millennial households will itemize going forward because of the increased standard deduction. As such, these households disproportionately lose out on these incentives for homeownership. Given the revised standard deduction, it is critical to structure any new federal tax policy as a tax credit rather than a deduction, so that the benefit can be taken without the need for itemizing deductions. This would better support the large and rapidly growing groups of households which have struggled to gain access to homeownership during the last decade and have now been largely excluded from the annual federal tax incentives for owning vs. renting. In this vein, a credit should also seek to provide enhanced benefits to first-time homebuyers, which would support middle-income individuals or families transitioning to homeownership, as well as the minorities and millennial age cohorts as a whole.

*Geographic Equity*

In the past, the tax code used a one-size-fits-all approach for homeownership incentives, which in effect discriminated against high- or low-cost geographies around the country. A proposed solution should attempt to remedy this by tying benefits from a tax credit to local market and economic conditions. In particular, any new tax policy should link the magnitude and eligibility of tax incentives to local measures such as median home costs and median incomes. Setting adjustable ceilings on the amount of the credit and any income phaseout based on these local factors is crucial, as these can vary dramatically across markets. This would more effectively equalize the benefits of homeownership across communities, while also ensuring that the credit can be used by the intended groups of households most in need of support to gain access to homeownership.

*Aligning Incentives with Economic Benefits*

It is important for any future homeownership tax credit to ensure that the timing of incentives for purchasing a home are aligned with the largest impact on local and national economic activity, and the corresponding fiscal benefit of increased tax revenue generated by stronger economic conditions. Since the largest economic benefit of a home sale represents the direct and indirect spending resulting from income generated in the first years following the sale, aligning the tax incentives would likely include phasing out the value of the tax credit over time. As the economic benefit of a purchase fades over time, this approach would correspond most with the economic benefit. In effect, the true macroeconomic "cost" of the credit can be significantly mitigated by both the boost in economic activity and the resulting increase in tax revenue, to the extent that the timing is aligned. In addition, a phaseout over time would provide an incentive for owners to trade-up to another home over time, generating additional economic activity and potentially freeing up smaller, starter homes for first-time buyers.

*Freedom for Households to Choose*

Changes to the tax code should make a new credit available to those who no longer itemize, while allowing households currently itemizing deductions to continue to do so. To prevent double-dipping, however, a proposed credit should only be available in years when the filer does not claim the MID or SALT deduction. Importantly, each household should have the choice to make a year-by-year determination of what is best for their specific tax situation.

### *Conclusion*

In many ways, the institution of homeownership epitomizes the American Dream for success and a better future. Homeownership supports financial opportunities for households, the strength and growth of communities across the country, and the vitality of our national economy. Progress toward the American Dream was, however, wiped out for millions of households nationwide during the Great Recession and remains stalled even after more than a decade of economic recovery.. It is time to reestablish homeownership as a national priority that we can and should continue to stand for as a society by restoring the homeownership incentives in the federal tax code.

## Endnotes


1. Housing Vacancies and Homeownership, U.S. Census Bureau (October 2019).
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8. Note that the costs of furniture purchases and moving, such as renting a moving truck, are also part of the economic contribution. However, these expenses show up in the measure of the personal consumption expenditure category of GDP.
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26. Note that this discussion specifically references annual tax incentives. Over the longer term, homeowners may still benefit from a substantial tax benefit through the capital gains exclusion on a primary residences.
27. Table 1. All Individual Returns: Selected Income Items, Adjustments, Credits, and Taxes, by Size of Adjusted Gross Income (Through Cycle 21), Internal Revenue Service, (May 2018, May 2019).
28. American Community Survey, U.S. Census Bureau (September 2019). Note: Income brackets provided by the IRS and the American Community Survey (ACS) are not consistent. The ACS does not provide statistics for the $150,000 to $200,000 income group.
29. Ibid.
30. RCG projections; Chained CPI for All Urban Consumers, Bureau of Labor Statistics (December 2019).
31. Table 1. All Individual Returns: Selected Income Items, Adjustments, Credits, and Taxes, by Size of Adjusted Gross Income (Through Cycle 21), Internal Revenue Service, (May 2018, May 2019).