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Recommended Citation

Anderson Center for Economic Research, "The Impact of the House Tax Plan on OC Home Prices" (2017).
Anderson Center Press Releases. 88.
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FOR RELEASE:

November 17, 2017

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THE IMPACT OF THE HOUSE TAX PLAN ON ORANGE COUNTY HOME PRICES

ORANGE, CA—A study conducted by the Anderson Center for Economic Research and Hoag Center for Real Estate and Finance examines the potential impact of the Republican-sponsored House tax-overhaul bill (House bill) on home prices in Orange County.

Although the House Bill grandfathers mortgage interest deductions up to \$1,000,000 for current homeowners, new caps are proposed on housing-related deductions for homebuyers of existing or newly built homes. Those include a new cap on the mortgage interest rate deduction of \$500,000 instead of the existing \$1,000,000. The House bill also proposes that the deductibility of property taxes paid be capped at \$10,000 for new and current homeowners.

In addition to these recommended changes, the House bill calls for other revisions, including changes in tax rates and standard deductions, the elimination of the personal exemption, the elimination of the alternative minimum tax (AMT) and an end to the deductibility of state and local taxes.

This study is based on the assumption that homebuyers evaluate the beneficial tax consequences of purchasing a home and are willing to pay more for a home to reap the resulting tax benefits.

Table 1 below presents the following data relating to the impact of the House bill on a median-priced home in Orange County:

- The median-priced home is currently \$685,000 for single-family homes and condominiums (1).
- To qualify for a 30-year mortgage with the required down payment, the minimum median family income level is \$125,700 (2).
- Based on the existing federal tax code with existing home-related deductions in place, the study’s findings suggest that a family with the required income of \$125,700 will save \$69,000 (3). That is the present value federal tax savings over a 30-year period.
- Under the proposed House bill tax regulations and its caps on home-related deductions, the present value of the tax savings from buying the \$685,000 home drops to \$9,500 (4).
- Buying a home under the House bill tax regulations will, therefore, result in a loss of home-owner tax savings of \$59,500 (\$69,000 less \$9,500) (5).
- If the tax savings from buying a home declines as a result of the proposed revisions in deductibility, so too will the amount a family will be willing to pay for that home. In the case of a median-priced home of \$685,000, a decline in price of \$59,500 represents a drop of 8.7% (6).

Table 1. Impact on Orange County Median Home Price Resulting from Loss of Tax Benefits in Proposed House Bill

	(1)	(2)	(3)	(4)	(5)	(6)
Area	Median Home Price	Qualifying Income	Present Value of Existing Home-Related Deductions	Present Value of Proposed Home-Related Deductions	Net Loss (Column 3 Less Column 4)	Impact on Median Home Price
Orange County	\$685,000	\$125,700	\$69,000	\$9,500	\$59,500	-8.7%

The accompanying Table 2 (see pages 4–5) uses the methodology described above on a city-by-city basis. The cities are ranked in order of lowest to highest median home price. The projected housing price depreciation that would result from the loss in home-related deductions in the House Bill ranges from a low of 1.4% in Midway City to a high of 13.0% in Villa Park. These depreciation rates are also shown graphically in Figure 1.

The high rate of Villa Park’s projected housing depreciation (13.0%) relative to other cities with even higher home prices relates to the proposed change to the tax brackets and the alternative minimum tax (AMT). Under the proposed House bill, the percentage change in the effective tax rate between the existing tax code and proposed House bill increases with higher incomes up to levels that fall just short of triggering the AMT. The percentage change in the effective tax rate at the qualifying income level in Midway City is 0.9%, while in Ladera Ranch, near the middle in home price, it’s 13.2%.

Villa Park's higher median home price requires a higher qualifying income that is just shy of the AMT trigger. This results in a 25.2% change in the effective tax rate (from 12.9% to 16.2%), which means that the proposed changes in home-related deductions are likely to have a more negative effect in Villa Park than in cities with lower median price homes and qualifying income.

But in cities with home prices even higher than Villa Park, like Laguna Beach, Corona del Mar, Newport Beach and Newport Coast, the higher qualifying income triggers the AMT under the current tax code. Newport Coast, with the highest median home price, requires the highest qualifying income. That, in turn, triggers the AMT and results in an effective tax rate of 25.2%. Under the proposed House bill, however, the elimination of the AMT would result in an effective tax rate of 26.3%. This represents a 4.4% change in the effective tax rate, significantly lower than Villa Park's 25.2%. As a result, the impact on Villa Park from the loss of the home-related deductions is greater than the impact on Newport Coast and other cities that have income levels high enough to trigger the AMT.

It might be argued that grandfathering current home-related tax deductions for existing homeowners in the proposed tax plan will limit the potential losses (gains) in home values. That is not the case. Home prices are largely set by new transactions that will reflect the changes under the proposed tax plan, since new homebuyers will be subject to the new caps on mortgage and property tax deductions.

Since selling a home means a loss in potential home-related tax deductions, resale activity will likely decline, reducing the supply of homes for sale. But demand will also decline, since potential homebuyers will have an incentive to stay in their current homes in order to continue benefitting from the housing deduction of the grandfathered provision. New homebuyers will therefore be forced to more narrowly rely on newly built housing to a greater extent. Although these trends are national in scope, the dynamic changes outlined here will be far greater in areas where incomes and housing prices are higher.

**Table 2. Impact on Median Home Price in Orange County Cities
 Resulting from Loss of Tax Benefits in Proposed House Bill**

	(1)	(2)	(3)	(4)	(5)	(6)
Area	Median Home Price	Qualifying Income	Present Value of Existing Home-Related Deductions	Present Value of Proposed Home-Related Deductions	Net Loss (Column 3 Less Column 4)	Impact on Median Home Price
Midway City	\$326,250	\$59,886	\$4,411	–	–\$4,411	–1.4%
Stanton	\$448,000	\$82,234	\$15,501	–	–\$15,501	–3.5%
Rancho Santa Margarita	\$490,000	\$89,944	\$19,845	\$82	–\$19,764	–4.0%
Santa Ana	\$516,000	\$94,716	\$22,586	\$583	–\$22,002	–4.3%
La Habra	\$525,000	\$96,368	\$23,540	\$838	–\$22,702	–4.3%
Anaheim	\$543,000	\$99,672	\$29,675	\$1,330	–\$28,346	–5.2%
Aliso Viejo	\$550,000	\$100,957	\$32,197	\$1,506	–\$30,690	–5.6%
Garden Grove	\$550,000	\$100,957	\$32,197	\$1,506	–\$30,690	–5.6%
Buena Park	\$555,000	\$101,875	\$33,972	\$1,642	–\$32,331	–5.8%
Fullerton	\$592,500	\$108,759	\$46,628	\$2,541	–\$44,087	–7.4%
Westminster	\$627,500	\$115,183	\$56,917	\$4,740	–\$52,176	–8.3%
Orange	\$646,000	\$118,579	\$61,419	\$7,761	–\$53,658	–8.3%
Placentia	\$650,500	\$119,405	\$62,371	\$7,960	–\$54,411	–8.4%
Fountain Valley	\$662,000	\$121,516	\$64,609	\$8,484	–\$56,126	–8.5%
Cypress	\$667,750	\$122,571	\$65,727	\$8,721	–\$57,006	–8.5%
Brea	\$675,000	\$123,902	\$67,140	\$9,038	–\$58,101	–8.6%
Tustin	\$694,500	\$127,482	\$70,945	\$9,875	–\$61,070	–8.8%
Lake Forest	\$700,500	\$128,583	\$72,118	\$10,138	–\$61,979	–8.9%
La Palma	\$710,000	\$130,327	\$73,976	\$10,560	–\$63,417	–8.9%
Mission Viejo	\$710,000	\$130,327	\$73,976	\$10,560	–\$63,417	–8.9%
Ladera Ranch	\$711,000	\$130,510	\$74,172	\$10,600	–\$63,572	–8.9%
Laguna Hills	\$715,000	\$131,245	\$74,956	\$10,763	–\$64,193	–9.0%
Yorba Linda	\$742,000	\$136,201	\$80,257	\$11,905	–\$68,352	–9.2%
Foothill Ranch	\$743,250	\$136,430	\$80,503	\$11,956	–\$68,547	–9.2%
Seal Beach	\$760,000	\$139,505	\$83,806	\$12,644	–\$71,162	–9.4%
Costa Mesa	\$769,000	\$141,157	\$85,586	\$13,037	–\$72,549	–9.4%

**Table 2. Impact on Median Home Price in Orange County Cities
 Resulting from Loss of Tax Benefits in Proposed House Bill**

	(1)	(2)	(3)	(4)	(5)	(6)
Area	Median Home Price	Qualifying Income	Present Value of Existing Home-Related Deductions	Present Value of Proposed Home-Related Deductions	Net Loss (Column 3 Less Column 4)	Impact on Median Home Price
Huntington Beach	\$780,000	\$143,176	\$87,767	\$13,481	-\$74,286	-9.5%
San Juan Capistrano	\$800,000	\$146,847	\$91,752	\$14,306	-\$77,447	-9.7%
Laguna Niguel	\$815,000	\$149,600	\$94,753	\$14,924	-\$79,838	-9.8%
Silverado	\$815,000	\$149,600	\$94,763	\$14,924	-\$79,838	-9.8%
Irvine	\$825,500	\$151,528	\$96,875	\$15,347	-\$81,528	-9.9%
Capistrano Beach	\$826,000	\$151,620	\$96,976	\$15,367	-\$81,608	-9.9%
Dana Point	\$857,500	\$157,402	\$103,313	\$16,658	-\$86,655	-10.1%
Trabuco Canyon	\$860,000	\$157,861	\$103,816	\$16,758	-\$87,058	-10.1%
San Clemente	\$875,000	\$160,614	\$106,834	\$17,361	-\$89,473	-10.2%
Los Alamitos	\$900,000	\$165,203	\$111,864	\$18,380	-\$93,484	-10.4%
Villa Park	\$1,200,000	\$220,270	\$179,381	\$23,301	-\$156,080	-13.0%
Laguna Beach	\$1,620,100	\$297,384	\$198,461	\$33,929	-\$164,532	-10.2%
Corona del Mar	\$1,876,500	\$344,448	\$203,682	\$34,320	-\$169,362	-9.0%
Newport Beach	\$2,055,000	\$377,213	\$206,208	\$34,554	-\$171,655	-8.4%
Newport Coast	\$3,050,500	\$559,946	\$170,681	\$35,137	-\$135,544	-4.4%

Figure 1. Projected Impact on Median Home Price by City

