THE RISE AND FALL OF HOUSING'S FAVORED INVESTMENT STATUS

(Published in the Journal of Housing Research (Volume 11, Issue 2'. By Patric H. Hendershott and Michael White of the University of Aberdeen, Scotland.)

Commentary by Edward Dodson, Cherry Hill, NJ

The authors of this paper examine the impact of "taxation and subsidization of investment in owner-occupied and rental housing," concluding as follows:

"Worldwide, the fundamental subsidy to owner- occupied housing is that the returns -- imputed rents and capital gains – are very lightly taxed. In countries allowing the home mortgage interest deduction, the tax advantage is extended to lower-wealth households who cannot finance their houses totally with equity. ... Given the light taxation of owner-occupied housing, the only available way to limit the subsidy is to adopt a flatter tax rate schedule with fewer deductions."

This paper is worth reading (and can be downloaded from the Fannie Mae Foundation website). The authors seem to have a rather good understanding of how real world markets actually work and how public policy influences housing markets. With respect to tax policy they state two principles worthy of discussion. One, is the "[c]apital gains taxes should be levied as the gains accrue, not when they are realized, and at the full regular income tax rate." Another is that "[a]ll capital goods should be taxed similarly. ... More specifically, if owner-occupied housing is largely untaxed ... then other capital should also be lightly taxed." They do, of course, define what they include in their definition of "capital."

The authors reference a 1999 study published by the National Tax Association (U.S.) that concluded "all owner-occupied housing subsidies are fully capitalized into urban land prices" so that "declines in real after-tax interest rates, including those caused by the introduction of interest rate subsidies, would raise land prices, not housing consumption and the homeownership rate." Hendershott and White comment that this conclusion "would not hold in less urban areas where additional land can be readily developed." I am not clear whether they are thinking of gross vacant land available for development, or the net amount not held for speculation by investors with deep pockets.

Another study referred to by the authors touches on a subject I have thought about, which is the reduced mobility of labor where homeownership rates are very high. Thus, in an recessionary downturn a region's level of unemployment would tend to remain higher when unemployed workers have mortgage obligations and must dispose of a home rather than simply relocating at the expiration of an apartment lease.

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