

real estate insights

November 2005

Real Intelligence –
Real Advantages

In This Issue

Existing-home sales posted 7.28 million seasonally adjusted annualized units in September. Resales of single-family, townhomes, condominiums and co-ops were unchanged from August, but at their second highest level ever and 7.2 percent above the level in September 2004. The near-record activity was supported by spiking home sales in areas surrounding the Hurricane Katrina disaster zone. The national median existing-home price for all housing types was \$212,000 in September, a 13.4 percent increase from September 2004. Total housing inventory levels inched up 0.3 percent at the end of September to 2.85 million existing homes available for sale, a 4.7-months supply at the current sales pace. Home prices will continue to rise faster than historic gains until there is sustained improvements in the supply of homes. [Read more.](#)

Stay calm. There are some folks who are about to panic because interest rates are rising, home heating costs are predicted to go – well – through the roof. And if that weren't enough, the President's Tax Reform Panel wants to eliminate some of the housing-related tax benefits that have helped propel the U.S. homeownership rate to record levels. But stay calm. While home sales and home price appreciation are expected to slow, residential real estate will continue to be a good investment for households. [Read more.](#)

The Taxing Issue. Proposals to eliminate or change the mortgage interest deduction as well as the deductibility of property taxes have been recommended by the President's Tax Reform Panel. NAR is poised to fight any changes in these well-established tax benefits that help boost homeownership and thus maintain housing's critical role in the U.S. economy. Our Market Intelligence feature this month discusses the impact of eliminating the property tax deduction. [Read more.](#)

No “storm” warning. The just released third quarter state home sales report shows that despite Katrina, Rita and Wilma, home sales can weather the storm. State resale activity – reflecting sales of single-family detached homes, townhomes and condominiums – showed no signs of slowing in the last quarter. [Read more.](#)

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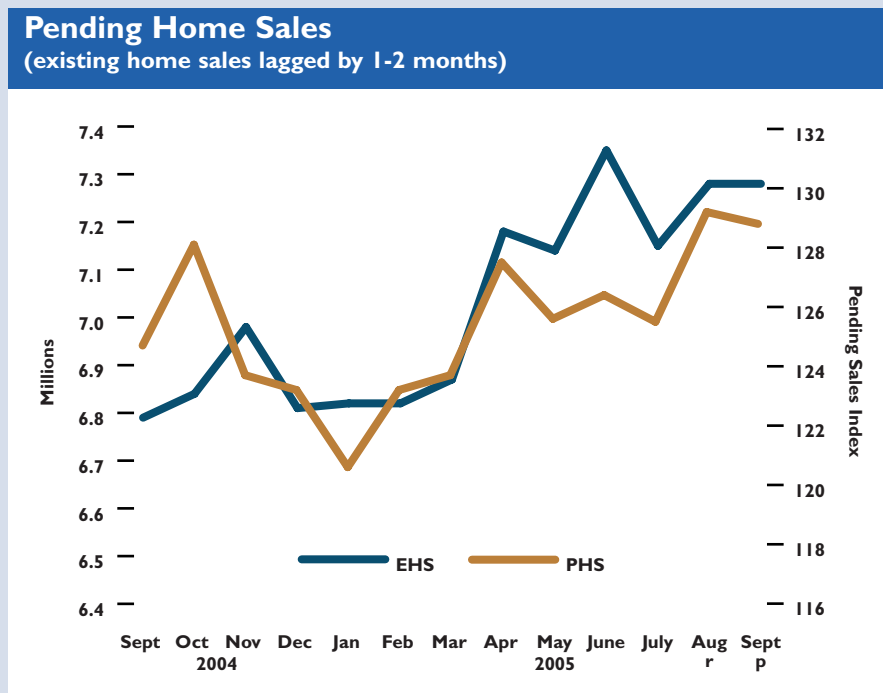
Real Estate Monitor

Monthly Indicator	Recent Figures	Likely Direction Over the Next Six Months	Forecast
<p>Mortgage Rates The 30 year fixed-rate mortgage posted above the six percent mark to 6.07% in October, the highest levels since June of 2004. Interest rates continue to trend upward, but the increases are relatively inconsequential. Sales of homes are expected continue its strength as fence-jumpers want to take advantage of still favorable rates. Read more.</p>	Aug 5.82 Sept 5.77 Oct 6.07		Creeping upwards
<p>Existing-home sales maintained their pace in September, posting 7.28 million seasonally adjusted annualized units, their second highest level on record. Large declines in the areas affected by Hurricane Katrina were offset by spiking sales from displaced victims who relocated to nearby regions. The inventory of homes for sales increased to 2.85 million units and supply is at a 4.7 months level. Read more.</p>	July 7,150 Aug 7,280 Sept 7,280		Moderation in 2006
<p>New home sales After a decline in August, new home sales rose in September to 1.22 million seasonally adjusted annualized units – a 2.1% increase. The three-month moving average of 1.26 million units is strong. The sales level reflects continued strength in the housing market. The inventory of new homes for sale was unchanged at a 4.9 months' supply. Read more.</p>	July 1,354 Aug 1,197 Sept 1,222		Generally more cyclical than existing homes
<p>Housing starts breached the 2.1 million-unit mark in September, rising 3.4% from August. This is only the third time since the 1970s that starts posted over 2.1 million. Single-family units rose to 1.75 million and multifamily units posted 361,000 units. The need to rebuild properties destroyed by Hurricane Katrina will likely keep starts elevated for the next 12 months. Read more.</p>	July 2,062 Aug 2,038 Sept 2,108		Builders getting cautious of rising unsold new home inventory
<p>Employment In September, 56,000 new jobs were created. The latest payroll data indicates a strengthening job market. Hurricane-related rebuilding efforts in early 2006 are likely to spur job gains to about 200,000 per month. Read more.</p>	Aug 148 Sept -8 Oct 56		Katrina and Wilma rebuilding efforts lift jobs
<p>Purchase applications Mortgage applications declined in October to 469.4 – a 5.0% drop from September's level. Despite the slowdown in activity, the purchase application index is still strong compared to its level last year. Read more.</p>	Aug 489.3 Sept 493.9 Oct 469.4		Well off recent highs
<p>Housing affordability September's housing affordability index rose 3.6% to 119.4. That signals some good news for homebuyers in light of rising interest rates. The seasonal decline in home prices as well as an increase in median family income offset those rate increases. Read more.</p>	July 118.8 Aug 115.3 Sept 119.4		Seasonal stability through winter, but to be measurably lower by spring
<p>Inflation The Consumer Price Index rose 1.2% in September, primarily as a result from increased fuel prices in the wake of Hurricane Katrina. The good news is that the core index (excluding food and energy) rose only 0.1%. Still, the combined effect of high fuel costs and rising core prices will result in a projected average monthly rate of 0.5% for the next three months. Read more.</p>	July 0.5% Aug 0.5% Sept 1.2%		Gasoline prices become more manageable

Notes: All rates are seasonally adjusted. Existing home sales, new home sales and housing starts are shown in thousands. Employment growth is shown as month-to-month change in thousands. Inflation is shown as a month-to-month percent change in the Consumer Price Index. Sources: NAR, Bureau of the Census, Bureau of Labor Statistics, Mortgage Bankers Association and Freddie Mac. This report reflects data as of November 4, 2005.

NAR's Pending Home Sales Index

Pending home sales eased slightly in September. NAR's Pending Home Sales Index (PHSI), based on contracts signed in September, decreased 0.3% to 128.8, but was still at its second highest level on record. September's index was 3.3 percent higher than that of September 2004. The index is derived from pending sales of existing homes. A sale is listed as pending when the contract has been signed but the transaction has not closed; pending home sales typically are finalized within one or two months of signing. An index of 100 is equal to the average level of contract activity during 2001, the first year to be examined. 2001 was the first of four consecutive record years for existing-home sales, with activity in that year being fairly close to the higher level of home sales projected for the coming decade relative to norms during the mid-1990s. A Pending Home Sales Index of 100 coincides with a historically high level of home sales. September's PHSI indicates a lot of momentum. And there is still a post-Katrina boost in home sales activity. Many post-Katrina sales in the region surrounding the disaster zone were bulk sales by companies that were obtaining housing for employees; some of those sales closed quickly in September with others expected to be recorded in data for October and November. Looking forward, the market is entering a period of transition in which there will be a somewhat slower but more sustainable pace of home sales.



Source: NAR Research

Welcome, Chairman Bernanke

by David Lereah, *Chief Economist*

It took two people—Jay Leno and David Letterman—to replace the legendary Johnny Carson in the competitive world of late night television. But there will be only one person replacing the legendary Alan Greenspan to chair the Federal Reserve—Benjamin Bernanke. Mr. Bernanke's challenge may be even more daunting than replacing the king of late night media. Chairman Greenspan has been held in high esteem among financial market leaders not only in the U.S. but across the globe for the past 18 years. He has arguably become the most recognizable economist since Adam Smith wrote *The Wealth of Nations* back in the late 1700s.

The simple truth is you don't replace a Greenspan, you follow him.

Mr. Greenspan was in Mr. Bernanke's shoes once. Back in 1987, Greenspan also followed a legend—Fed Chairman, Paul Volcker. As many of you may recall, Volcker was an imposing six foot six inch cigar-smoking Chairman beating down inflation. When he walked into a room, all eyes were on him awaiting his pronouncements.

To his credit, Greenspan did not try to replace Volcker, duplicate his style or his imposing manner. He merely followed him. Over time Mr. Greenspan earned the respect of financial markets and other sectors of the U.S. economy, becoming a Fed Chairman with his own unique style of management and leadership.

Mr. Bernanke takes center stage in January of next year. On the surface, he has all the skills and experience to make a fine Fed Chairman: an Ivy League education, a Princeton professor, a credible expert on monetary policy, a three year stint as a Governor of the Fed and a brief tour of duty as the Chair of President Bush's Council of Economic Advisors. More importantly, Wall Street has approved his anointment to the Fed throne with calm and patience.

A closer look at Bernanke indicates that his management style will be similar to Greenspan's. It is likely that he will read from the same script with regard to conducting monetary policy. He will be careful, deliberate, and absorb as much information and data about the economy before making decisions. But there also will be differences. The new Fed Chairman may lead a more transparent Fed than Greenspan, publicly announcing inflation targets and discussing more openly the reasons for decisions.

And remember, the Fed also has supervisory responsibilities for the nation's largest banks. On the regulatory side, Bernanke shares his predecessor's views on the importance of expanding bank pow-

ers – he favors banks getting into the real estate brokerage business. Bernanke also has made it known that he will express his views on fiscal policy issues as well, including the federal budget deficit, tax reform and Fannie Mae/Freddie Mac reform, to name a few.

It is curious to point out that Mr. Bernanke may be chairing a less influential Fed than Greenspan. The world is more globalized today than when Greenspan took the Fed's reigns eighteen years ago. The U.S. economy is no longer as dominant today vis-

à vis other nation's economies as it was two decades ago. India, China, and the emerging Euro economy are all gaining market share in the world of international trade and finance. And international investors no longer gravitate to the U.S. dollar in times of crisis. International currency holdings are becoming more diverse. A Bernanke-led Federal Reserve may find itself competing with other central banks, rather than leading and advancing international policy initiatives.

The true test for the new Chairman will be how he responds to a financial crisis.

Financial crises come with the territory for a Fed Chairman. Mr. Greenspan certainly had his fill: the technology bust, stock market bubble, several large financial company bankruptcies, and the international financial crisis of the late 1990s to name just a few. Make no mistake, Bernanke will also have his fair share of crises, and investors around the world will be grading his performance.

From a real estate perspective, we wish the new Chairman well, and hope that he focuses most of his attention and activities to conducting monetary policy. Providing the housing markets with a favorable backdrop of a growing economy and relatively low interest rates are in the best interests of the U.S. economy and housing markets. Unfortunately, Chairman Greenspan veered of course a bit during his final few years at the Fed. He became political, publicly voicing his views on a number of non-monetary policy issues (as stated above), including Fannie/Freddie regulatory reform, tax reform and tax policy, budget deficits, and social security reform. He even got into the minutia, commenting on the applicability of the 30-year, fixed-rate mortgage product.

Suffice it to say, the U.S. economy and financial markets are best served with a Federal Reserve focusing all of its attention to its core mission: conducting monetary policy. We hope Mr. Bernanke appreciates this approach, and we look forward to sharing our views with him on issues affecting real estate and real estate professionals.

A Bernanke-led Federal Reserve may find itself competing with other central banks, rather than leading and advancing international policy initiatives.

Want more insights from NAR Chief Economist David Lereah? Visit REALTOR.org to see some of his latest comments from press interviews and speeches at www.REALTOR.org/Research.nsf/Pages/housingoverview

THE FORECAST

by Lawrence Yun, Senior Forecast Economist

The sharpest recession since the Great Depression. Rampant foreclosures. Financial lending institutions straining to survive. A loss of \$20,000 to \$30,000 for a typical family. Not a pretty picture. This scenario is not a market correction after a housing bubble, but rather a likely possibility if all the elements of the new proposed tax reform were to go into effect.

The President's Tax Advisory Panel has recommended a sharp curtailment in mortgage interest deductions. Instead of the current maximum deduction of 33% of mortgage interest on a loan limit of \$1 million, the panel suggests a reduction to only 15% on a loan limit of \$172,000 to \$312,000, depending upon local area. Local property tax deductions are also on the chopping block, with the panel recommending their full elimination. These proposed reductions would, in effect, significantly decrease the "dividend" streams to the nation's housing sector. A preliminary analysis suggests a loss of home values by 10% to 15%. At the 2005 median price of \$208,000, the loss of such a magnitude means a loss of \$20,800 to \$31,200. (For more details, see the "Market Intelligence" article in this issue of *Real Estate INSIGHTS*.)

The loss will also mean that the loan value of many recent homebuyers will be higher than the value of the home. Many homeowners will be forced to foreclose. Banks and other lenders will then come under pressure. Interest rates will have to rise – significantly – which chokes off business spending and commercial real estate construction. Consumer spending, which has shown remarkable resiliency thanks to the robust gains in housing equity of the past few years, will undoubtedly turn negative.

And there's another issue involved in eliminating or reducing these housing-related tax benefits. Limiting deductions will adversely affect every homeowner, not just those who itemize. Even though

only about half of the nation's homeowners itemize deductions on their 1040 forms (with many mortgages already paid off), home price declines will not discriminate. Because two similar homes located on the same street cannot have measurably different prices, home values will decline *regardless of the filing status of the owners of those two homes*.

The panel's housing-related tax reduction proposals are puzzling. President Bush has promoted the "ownership" society since coming to office. He has been a great supporter of housing and homeownership, and has often stated that homeownership is great for families, great for local communities, and great for the U.S. economy. Indeed, during his term in office, homeownership rose by 2.7 million households to reach an all time high of 74.6 million homeowners – or nearly 70 percent. This is an accomplishment to be proud of. The National Association of REALTORS®, as well as many other housing organizations, is concerned if the President is now saying "sorry about the home value declines, sorry for changing the rules in the middle of the game, and sorry for misleading you, but the country needs a new tax code." Our job in the REALTOR® community is to make sure that homeowners fully understand the consequences of the tax reform package.

Thankfully, we live in a democracy. Politicians will not dare mess with 70% of the U.S. population. And research has shown that homeowners have a higher incidence of voter participation. And so it is likely that the recommendations proposed by the President's tax reform panel will likely be "dead on arrival", at least in their present form. That also means that we can forecast trends in housing and the economy under normal parameters.

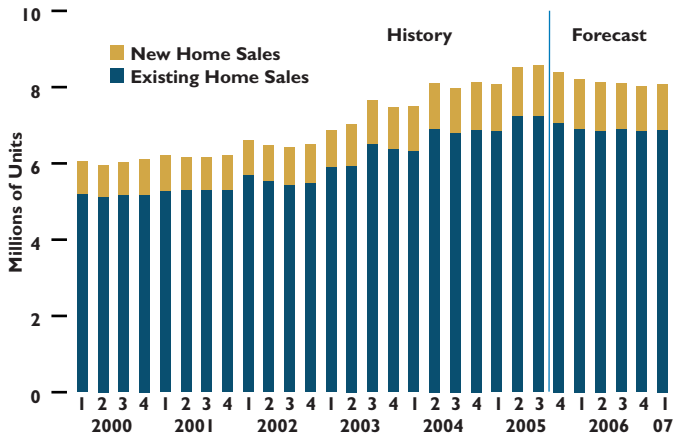
The good news is that economic momentum is solid. GDP growth will accelerate from 3.5% expansion rate to near 4% in 2006. Business spending has

been rising at a double digit pace. The usual laggard in the business spending component – private non-residential construction – is set to rise after having been essentially flat in the past year. The housing wealth gain of nearly \$4 trillion in the past five years is providing the financial wherewithal for consumer spending to move ahead. Job creation to the tune of 2 million in the past 12 months also helps. And our international trade position has been steadily improving.

The expanding economy is, however, introducing some negative elements -- higher inflation and higher interest rates. Mortgage rates will rise to 6.7% by the end of 2006 after resting comfortably below 6% in the past three years. Higher rates will knock few homebuyers off the market. Investor demand will also taper off as carrying costs of mortgages get heavier. Existing home sales will decline by 3.5% in 2006, while the more cyclical new homes will fall by 4.5%. Home price growth will measurably slow. Rather than the double digit rate of price increases, homeowners should anticipate a more normal 5% price increase.

Home Sales

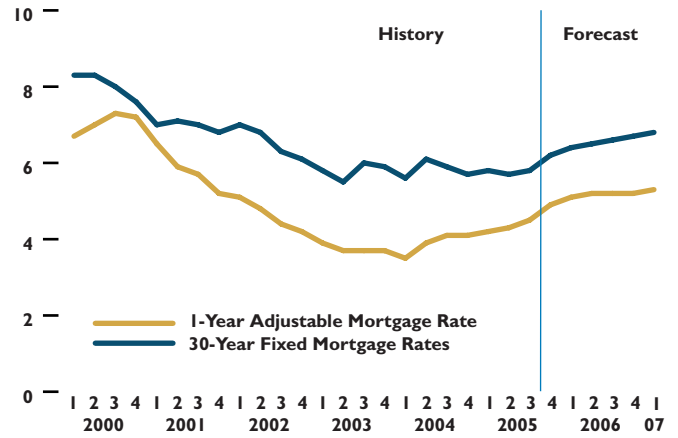
Back to more sustainable levels



Sources: NAR, Bureau of the Census, NAR Forecast

Mortgage Rates

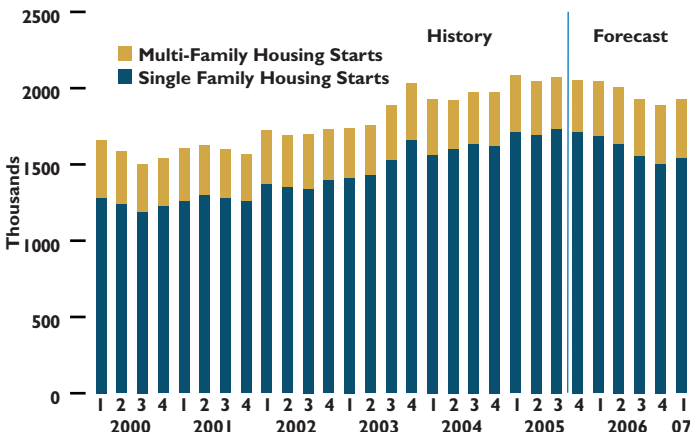
Expected increases, but still below 7 percent



Sources: Freddie Mac, NAR Forecast

Housing Starts

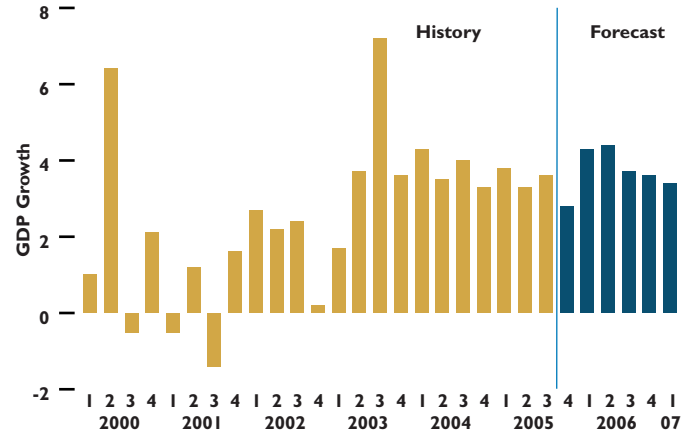
Higher interest rates impact builders



Sources: Bureau of the Census, NAR Forecast

Economic Growth

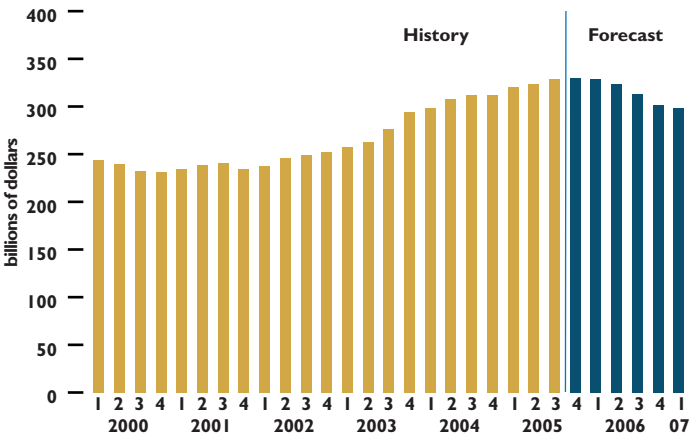
Back on the expansion track in 2006



Sources: Bureau of Economic Analysis, NAR Forecast

Residential Construction

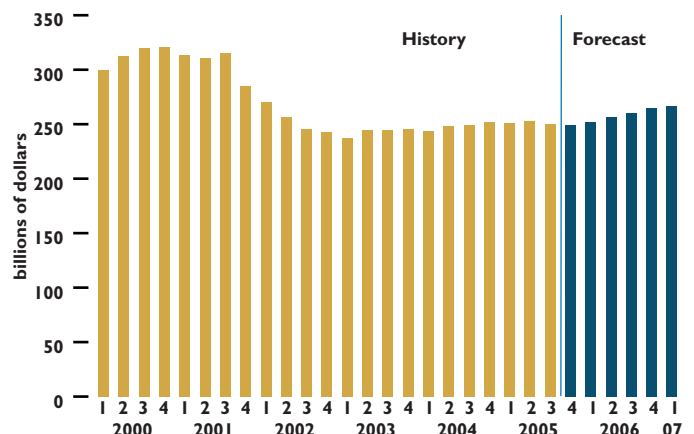
Builders will still be building



Sources: Bureau of Labor Statistics, NAR Forecast

Private Non-Residential Construction Spending

Steady, then rising slightly



Sources: Bureau of Labor Statistics, NAR Forecast

U.S. ECONOMIC OUTLOOK

November 2005

	2004 IV	I	2005 II	III	IV	I	2006 II	III	IV	2007 I	2003	2004	2005	2006
U.S. Economy														
<i>Annual Growth Rate</i>														
Real GDP	3.3	3.8	3.3	3.6	2.8	4.3	4.4	3.7	3.6	3.4	2.7	4.2	3.5	3.8
Nonfarm Payroll Employment	1.7	1.6	1.9	1.3	0.9	1.9	1.9	1.8	1.6	1.3	-0.3	1.1	1.6	1.6
Consumer Prices	3.6	2.4	4.2	5.1	4.3	0.7	2.4	2.2	2.3	2.1	2.3	2.7	3.4	2.7
Real Disposable Income	9.1	-3.4	1.5	-1.5	4.1	7.2	4.7	4.5	3.9	4.9	2.4	3.4	1.5	4.1
Consumer Confidence	96	104	102	99	98	99	101	104	105	106	80	96	101	102
Percent Unemployment	5.4	5.3	5.1	5.0	5.1	5.1	5.0	4.9	4.9	4.9	6.0	5.5	5.1	5.0
<i>Interest Rates, Percent</i>														
Fed Funds Rate	2.0	2.5	2.9	3.4	4.1	4.3	4.3	4.3	4.3	4.3	1.1	1.3	3.2	4.3
3-Month T-Bill Rate	2.0	2.5	2.9	3.4	4.0	4.1	4.1	4.1	4.1	4.1	1.0	1.4	3.2	4.1
Prime Rate	4.9	5.4	5.9	6.4	7.0	7.4	7.4	7.2	7.2	7.2	4.1	4.3	6.2	7.3
Corporate Aaa Bond Yield	5.5	5.3	5.1	5.1	5.6	5.8	6.0	6.1	6.1	6.2	5.7	5.6	5.3	6.0
10-Year Government Bond	4.2	4.3	4.2	4.2	4.6	4.8	4.9	5.0	5.0	5.1	4.0	4.3	4.3	4.9
30-Year Government Bond	4.9	4.7	4.5	4.4	4.9	5.1	5.2	5.3	5.3	5.4	5.1	5.1	4.6	5.2
<i>Mortgage Rates, percent</i>														
30-Year Fixed Rate	5.7	5.8	5.7	5.8	6.2	6.4	6.5	6.6	6.7	6.8	5.8	5.8	5.9	6.5
1-Year Adjustable	4.1	4.2	4.3	4.5	4.9	5.1	5.2	5.2	5.2	5.3	3.8	3.9	4.5	5.2
Housing Indicators														
<i>Thousands</i>														
Existing Home Sales*	6,877	6,837	7,223	7,237	7,057	6,897	6,853	6,883	6,842	6,875	6,183	6,784	7,108	6,860
New Single-Family Sales	1,243	1,249	1,297	1,333	1,318	1,297	1,267	1,212	1,179	1,208	1,086	1,203	1,299	1,241
Housing Starts	1,973	2,083	2,044	2,068	2,051	2,049	2,003	1,928	1,884	1,931	1,854	1,950	2,062	1,966
Single-Family Units	1,621	1,709	1,693	1,731	1,712	1,684	1,635	1,554	1,502	1,538	1,505	1,604	1,711	1,594
Multifamily Units	352	374	351	337	339	364	368	373	382	392	349	345	350	372
Residential Construction**	571	584	599	609	613	613	609	598	587	585	509	562	601	602
<i>Percent Change – Year Ago</i>														
Existing Home Sales	8.1	8.2	4.7	6.5	2.6	0.9	-5.1	-4.9	-3.0	-0.3	9.8	9.7	4.8	-3.5
New Single-Family Sales	10.8	5.0	7.8	14.5	6.1	3.8	-2.3	-9.0	-10.6	-6.9	11.9	10.8	8.0	-4.5
Housing Starts	-3.1	8.0	6.3	4.7	4.0	-1.7	-2.0	-6.8	-8.1	-5.8	8.4	5.2	5.7	-4.6
Single-Family Units	-2.2	9.4	5.9	5.9	5.6	-1.4	-3.5	-10.2	-12.3	-8.7	10.3	6.6	6.7	-6.9
Multifamily Units	-7.0	1.9	8.6	-0.7	-3.6	-2.6	4.8	10.8	12.7	7.7	0.6	-0.9	1.4	6.2
Residential Construction	6.6	7.7	6.1	7.0	7.4	4.9	1.6	-1.7	-4.3	-4.6	8.4	10.3	7.0	0.0
Median Home Prices														
<i>Thousands of Dollars</i>														
Existing Home Prices	189.3	190.3	209.3	216.0	211.8	202.4	220.7	227.3	221.5	211.1	169.5	185.2	208.1	219.2
New Home Prices	227.8	229.9	228.0	221.1	243.7	246.7	245.3	237.2	260.8	262.5	195.0	221.0	230.2	247.0
<i>Percent Change – Year Ago</i>														
Existing Home Prices	9.7	10.2	13.4	14.1	11.9	6.3	5.4	5.2	4.6	4.3	8.5	9.3	12.4	5.3
New Home Prices	14.4	8.0	5.3	3.3	7.0	7.3	7.6	7.3	7.0	6.4	3.9	13.3	4.1	7.3
Housing Affordability Index	132	133	121	118	118	120	111	108	110	113	138	133	123	112

Quarterly figures are seasonally adjusted annual rates. / * Existing home sales of single-family homes and condo/coops; ** billion dollars / Source: Forecast produced using Macroeconomic Advisers quarterly model of the U.S. economy. / Assumptions and simulations by Dr. David Lereah and Dr. Lawrence Yun.

State Resales Set Another Record

by NAR Staff

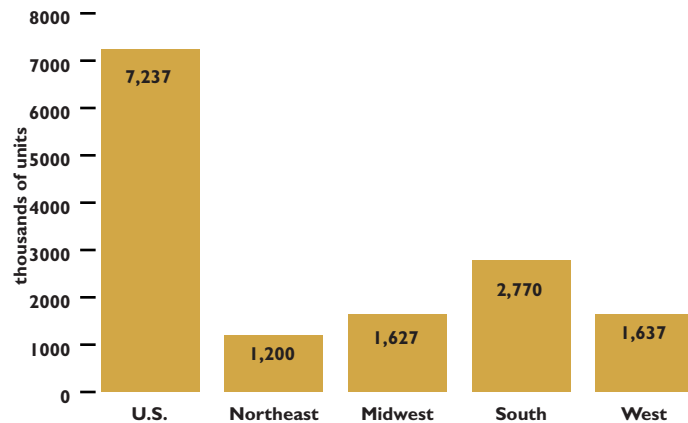
Home sales in the third quarter of 2005 certainly weathered the storms. Total state existing-home sales set a record in the third quarter. The National Association of REALTORS® third quarter state existing home sales report shows 44 states and the District of Columbia recording higher sales compared to the third quarter of 2004. NAR's quarterly report on total existing-home sales, which include single-family and condos, shows that the national seasonally adjusted annual resale rate* was 7.24 million units in the third quarter, up 6.5 percent from 6.80 million in the third quarter of 2004. The previous record was 7.22 million units in the second quarter of this year.

The strongest increase was in Arkansas, where the third-quarter sales activity rose 32.1 percent compared with the third quarter of 2004. Utah existing-home sales increased 26.6 percent from a year earlier, and Washington State resales were up by 20.0 percent. Fourteen other states recorded double-digit sales gains.

Behind the Numbers

Third quarter home sales will likely prove to be the high point of the five-year housing boom. Driving the activity are favorable housing affordability conditions combined with strong fundamental demand. Low interest rates are also a factor. Although mortgage interest rates are expected to gradually rise, they will remain historically low.

State Existing Home Sales Third Quarter 2005



Source: NAR Research

Regional Differences

In spite of three major storms – Katrina, Rita and Wilma – **the South** recorded the strongest annual increase of all four regions of the country, with an existing-home sales pace of 2.77 million units in the third quarter, up 8.2 percent from a year earlier. After Arkansas, the strongest increase in the region was in South Carolina, up 18.1 percent from the third quarter of 2004, followed by Georgia, where existing-home sales rose 14.4 percent, and Texas, where home sales increased 13.9 percent.

The Northeast experienced a third quarter existing-home sales rate of 1.20 million units, up 6.9 percent from the third quarter of 2004. Massachusetts

experienced the strongest increase in the region with sales activity 11.2 percent above a year ago, followed by Connecticut, up 8.3 percent, and New York, which increased 7.0 percent.

In **the Midwest**, total existing-home sales in the third quarter increased 5.0 percent to a 1.63 million-unit annual pace compared to a year ago. North Dakota led the region, up 19.3 percent from the third quarter of last year, followed by Indiana, with a 12.3 percent rise, and South Dakota, up 10.5 percent.

In **the West**, existing home sales rose 4.1 percent to a pace of 1.64 million units in the third quarter from the same period in 2004. After Utah and Washington, the strongest increase was

*The seasonally adjusted annual rate for a particular quarter represents what the total number of actual sales for a year would be if the relative sales pace for that quarter was maintained for four consecutive quarters. Seasonally adjusted rates are used in reporting quarterly data to factor out seasonal variations in resale activity. For example, sales volume normally is higher in the summer and relatively light in winter, primarily because of differences in the weather and household buying patterns.

in Oregon, where total existing-home sales rose 15.5 percent compared to a year ago; Idaho rose 12.3 percent while Alaska increased 11.7 percent.

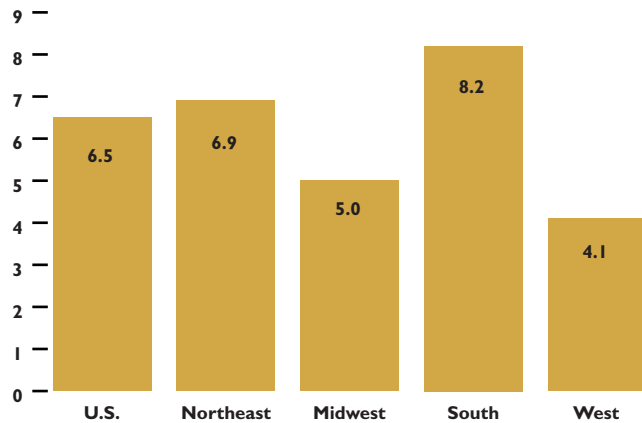
What's Ahead

The economy is growing and the labor market is firming. In addition, the nation's growing population has a fundamental need for housing. All these factors mean home sales should stay at levels that help to support the overall economy. Overall home sales are on target to hit their second highest level on record next year.

NAR's Quarterly State Existing Home Sales report is available at www.realtor.org/research. Total home sales include single family, townhomes, condominiums and co-operative housing. NAR began tracking the state sales series in 1981. The next quarterly report is scheduled to be released in February of 2006.

State Existing Home Sales

Percent change 3rd Quarter 2004 to 3rd Quarter 2005



Source: NAR Research

Forty-four states and the District of Columbia recorded higher existing home sales during the third quarter of 2005 compared to the third quarter of 2004.

Do you want more information about state home sales? Historical data is available by accessing *Real Estate Intelligence* – NAR's database that includes home sales, home prices and housing affordability index info as well as other housing-related statistics. Click [here](#) for more information.

Tax Reform – Impact on Housing and Homeownership

by NAR Staff

Homeownership was, is, and likely always will be the American Dream. Today, 74 million U.S. households own their own home. This near 70 percent homeownership rate helps drive the nation's economy through direct and indirect contributions to gross domestic product (GDP). In addition, homeownership helps households build up their net worth – household wealth – which allows for healthy consumer spending in all sectors of our economy.

Earlier this month, the President's Advisory Tax Reform panel released its recommendations. Some of their proposals could have devastating impacts on the nation's housing economy and negatively impact the nation's economy as a whole. The National Association of REALTORS® is already working to fight any threats to homeownership that could result from the recommendations included in the reform package. NAR's Research Division has made some preliminary calculations showing the financial impact on homeowners resulting from some of the Panel's recommendations.

Tax Reform Panel Proposals

There are four major components recommended by the Advisory Panel on Tax Reform that could significantly impact residential housing:

1. Convert the mortgage interest deduction from the current \$1 million mortgage loan to a 15% tax credit only up to the FHA loan limit (which ranges from \$172,000 to \$312,000 depending on locality).
2. Elimination of the mortgage interest deduction for home equity loans and mortgages on a second home.
3. Elimination of the local property tax deduction.
4. Raising the capital gains tax-free allowance to \$300,000/\$6000 from \$250,000/\$500,000 (single/married).

The impact on eliminating or changing any part of the mortgage interest deduction has been garnering a great deal of

scenario	Annual home price appreciation	Discount rate	Net present value
1 (pessimistic)	2.5 percent	10 percent	\$487 billion
2 (baseline)	4.0 percent	8 percent	\$780 billion
3 (optimistic)	5.5 percent	6 percent	\$1.47 trillion

Source: NAR Research

media coverage. And going forward, NAR will be doing more intensive research on this issue. But the elimination of the local property tax deduction could also wreak havoc on home prices, and therefore on the net household worth of homeowners, as well as housing activity and REALTOR® business.

Non-deductibility of Property Tax: Impact on Homeowning Taxpayers

It's this simple: eliminating the deductibility of property taxes will increase homeowners' tax bills. In 2003, 40.1 million U.S. homeowners claimed \$112 billion in property tax deductions for federal income tax purposes. In other words, U.S. homeowners reduced their federal tax liability by 26.5 percent of the \$112 billion in deductions -- or by \$29.7 billion in 2003. NAR estimates that in 2005 the itemized deductions for real property tax payments will rise to \$131 billion, based on the recent growth in home prices and an increase in the number of taxpayers who itemize. (This is based on the increase in the number of homeowners in the last two years and a corresponding increase in the number of filers who itemize deductions). Based on the 2003 average federal tax benefit of 26.5 percent of the itemized property tax payments, in 2005, the reduction in the homeowners' federal income tax liability is estimated to be \$34.7 billion.

Impact on Home Prices

While increasing homeowners' taxes, repealing the deduction for real property taxes would reduce home prices. The current property tax benefit applies not

only in tax year 2005, but for future years as well (assuming no changes in the tax law). Let's look at the total benefit of deducting property taxes, which includes the value calculated for future years. Over the coming years the amount of property taxes is adjusted to reflect growth in home prices (hence, growth in property tax payment) and then discounted to express it in present value terms. Under a reasonable set of alternative price growth and discount rate scenarios, the net present value of tax benefits is estimated to be \$780 billion, plus or minus \$100 billion or between \$680 billion and \$880 billion. (see table) If the property deduction is no longer permitted, aggregate-housing valuation would decline by the amount of the net present value.

Even those homeowners who do not itemize their deductions would feel the impact of the nondeductibility of property taxes. The decline in home prices (value) would affect all homeowners regardless of the individual homeowner's tax filing status. Therefore, the \$780 billion reduction in aggregate valuation will reduce home prices by an average of \$10,500 for *all of the nation's 74 million homeowners*. That is equivalent to a 5.4% decline in home price.

Impact on Market Activity and REALTORS®

The reduction in home prices will not be an instant event. But over time, incentives for existing homeowners to continue owning would likely decline. Potential homeowners would no longer be able to include the property tax

Tax Reform (continued)

deduction in their home purchase cost calculations before buying a home. Thus, it could appear to inflate the upfront purchase cost of a home. This has the potential for “scaring away” homebuyers. Therefore, a steadily declining demand will reduce home sales. Fewer sales mean less business for REALTORS®.

State Level Impact

The impact on individual states will vary given the current variations in the federal tax benefits of property tax deductions. New York claimed \$11.4 billion in deduction while Texas (a state with 2 million more residents than New York) claimed \$7.8 billion in property tax deductions. Furthermore, due to varying income distribution among states, a tax dollar benefit for each dollar of property tax deduction differs among states. For example, based on 2003 IRS data, Montana homeowners reduced their tax liability by 23 percent of the deduction claimed while Washington, D.C. residents reduced their tax liability by 29 percent of the deductible amount, compared with the average federal tax benefit of 26.5 percent.

The impact on state home prices will also vary. If the property tax is eliminated, New Jersey will likely see the largest decrease, with its average home price declining by \$28,200 (under the baseline scenario described above). New York and Connecticut would also feel the price chill, with average prices in those states declining by \$23,075 and \$22,513, respectively.

NAR – Protecting Tax Benefits of Homeownership

Real estate is a long-term investment, and 70 percent of U.S. households have

Tax Advantages of Owning

The example below shows how the mortgage interest deduction AND the property tax deduction saves homeowners money. Assume a home price of \$110,000, with a downpayment of \$10,000 and a 30-year fixed-rate mortgage at 6.5%*

Monthly mortgage and tax payments	
mortgage	\$632
property tax (@1.25% tax rate)	115
Total Monthly payment	\$747
Tax Savings per month (assume 30% income tax bracket)	
mortgage interest tax deduction	\$161
tax deduction for property tax	34
Total monthly tax savings	\$195
Total monthly cost after tax savings	\$552

**Please note that the figures here are for example only. Home prices vary depending on the market, and property tax rates vary by city and county.*

invested in housing. Eliminating just the property tax deduction – as recommended by the Tax Reform Panel – would have a measurable impact on homeowners and real estate markets. It is likely that in combination with the panel's other proposals concerning the mortgage interest deduction (eliminating or converting to a tax credit), the value of the nation's residential property could decline 10-15 percent. The panel's recommendations could impact the value of every home, whether it is financed or not.

The National Association of REALTORS® recognizes the vital role that housing-related tax benefits play in the housing market. The Association is supporting new research to determine the economic effects of the panel's recommendations, especially their impact on the value of residential and commercial real estate and their impact on home-

ownership. NAR's Research and Government Affairs Divisions will be working with members and others to insure that the U.S. tax system:

- treats homeownership as investment and not as a consumption good
- encourages savings and tax-based incentives for home purchases
- eliminates penalties for using savings for home purchases

The Association will protect the property tax and mortgage interest deductions that have played a central role in advancing homeownership in America since the federal income tax code was adopted in 1913. Updates on the latest developments on this vital issue to America's homeowners – and REALTORS® – will be posted on REALTOR.org.

For the latest developments and research on the Tax Reform Panel's recommendations, be sure to visit REALTOR.org. To read the full report from the President's Advisory Tax Reform Panel, visit <http://www.taxreformpanel.gov>.

Links to Statistical Data Series

To view the latest housing statistics from NAR, click on the links below.

Existing Home Sales – Monthly series

- [September existing home sales and median sales prices](#) – single-family and condominiums/co-ops
- [Single-family home sales and median sales prices](#)
- [Condominium/co-op sales and median sales prices](#)
- The latest EHS statistics in spreadsheet format available [here](#)

Existing Home Sales and Metropolitan Area Median Home Sales Prices – 3rd Quarter 2005

- 3rd Quarter 2005 [existing home sales by state](#)
- Existing home sales by state in [spreadsheet format](#)
- 3rd Quarter 2005 [Median Home Prices by Metropolitan Area](#)
- Metropolitan Area Home Prices in [spreadsheet format](#)

NAR's Pending Home Sales Index

- [September pending home sales index](#)
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NAR's Housing Affordability Index

- [September HAI Index](#)
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- Quarterly Housing Affordability Series
 - [3rd Quarter 2005 Affordability Index](#)
 - 3rd Quarter 2005 Affordability Index in spreadsheet format available [here](#)
 - [First-time homebuyer Affordability Index](#), 3rd Quarter 2005
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