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Hold the SALT - How has this impacted real estate? - by Albert Franke

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SALT, as you may know, is an acronym for State and Local Taxes. It was first introduced to us through An Act to Provide Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, better known as the Tax Cuts and Jobs Act of 2017 (TCJA). TCJA was signed into law nearly two years ago and its provisions applied to taxable years beginning January 1, 2018. It was the most comprehensive tax reform legislation since the Tax Reform Act of 1986.

Highlights of the TCJA included lowering corporate and individual tax rates, increasing the standard deduction and decreasing the home mortgage interest deduction to a maximum debt limit of \$750,000. Additionally, the deduction of state and local taxes is no longer unlimited and is now capped at \$10,000. This includes property taxes and either state and local income taxes and sales taxes. Also, under the new law, the standard deduction for taxpayers doubled, to \$12,000 for individuals and \$24,000 for joint filers. This increase is likely to incent taxpayers to take the standard deduction, rather than to itemize. The tax benefits of owning a home, for example, are technically reduced by not itemizing and Moody's Analytics estimated that as many as 38 million people who would have otherwise itemized, may take the standard deduction. This may have the unintended consequence of fewer people choosing to own (versus rent), solely for the tax advantages. Before TCJA, according to Zillow, 44% of U.S. homes were worth enough to justify itemizing. With TCJA, that number was expected to decrease to 14%. So how has all of this impacted real estate?

Connecticut residents took the second-highest deduction for state and local taxes and in 2014, 41% of Connecticut federal returns included a SALT deduction, averaging about \$19,000 per filer. High tax states like Connecticut, New York and New Jersey have been negatively impacted the most in terms of property values, particularly in higher-value areas of these states. When coupling this with the new maximum home interest deduction (maximum debt of \$750,000, down from \$1 million), The National Association of Realtors predicts a 10% decline in property value. Moody's Analytics has predicted a decline in these areas by as much as 11%.

Nearly two years have passed since the legislation was enacted and we are seeing its effects show up in the data. In Connecticut, median single family property prices (statewide) have increased 4.8% between 2017 and October 2019, according to statistics provided by The Warren Group. Total cumulative inflation was about 4.3% over this time period and average 30-year, mortgage interest rates were basically flat (3.99% in 2017 vs. 3.73% today). So this can best be described as treading water. However, when one drills down into more affluent communities and the higher-value market stratum, a different picture emerges. For example, consider four communities in lower Fairfield County, Connecticut (often referred to as the Gold Coast), having median residential property sale prices over \$1 million. New Canaan sale prices have dropped 8.4% between 2017 and 2019. Darien has seen a decline of 8.1% during that same period. Westport is down 9.1% and only Greenwich has fared the best, with median prices down 1.2%. The SALT provision of TCJA, when coupled with an outmigration of high net worth individuals from Connecticut to more tax-friendly states, has impacted prices of high-value residential properties by nearly 10% in most cases.

On the commercial side, the effects of SALT have been more difficult to parse. In theory, the reduction in the corporate tax rate would likely spur real estate investment in favorable markets. Real estate investment trusts (REITS) with taxable subsidiaries should realize a positive impact of the reduced corporate rates. Lower rates on pass-through business income should reduce the overall effective tax rate on REIT dividends received by individuals. Interestingly, affordable housing may be impacted if low-income housing tax credits become less useful and appealing owing to lowered corporate rates. Multifamily owners, including REITS, may be seeing a benefit from SALT and the reduction of the mortgage interest reduction, because homeownership has become less attractive.

In July 2018, four high-tax states (Maryland, New York, Connecticut and New Jersey) sued the federal government over the SALT provision in the TCJA, arguing, among other things, that the \$10,000 cap will increase the federal tax burden on taxpayers in these states, making it more difficult for the states to maintain their individual taxation and fiscal policies. They further argued that SALT would artificially depress home values in those states, resulting in the loss of tens of billions of dollars of equity. The U.S. District Court (Southern District of New York) granted the Government's motion to dismiss in September of this year and denied the States' cross-motion for summary judgment. As of this writing, the decision is on appeal.

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