

Housing advocates seek cap on Oregon's mortgage interest deduction

by Joanne Zuhl (/users/joanne-zuhl) | 12 Jan 2017

Most of the billion-dollar housing subsidy goes to top earners. Realtors will fight to preserve the popular homeowner benefit



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Oregon's biggest – and most beloved – housing subsidy is subsidizing the wrong people.

That's the perspective of a growing coalition of organizations looking to modify Oregon's mortgage interest deduction, or MID, to make it more equitable for moderate- to lower-income homeowners.

These are the homeowners who need it, they say, not the state's top 20 percent of income earners, who claim more than 60 percent of the state subsidy in terms of dollars.

“At a time when we are facing a severe housing crisis in Oregon, the biggest housing subsidy in our state is mostly giving money to the most well-off Oregonians – people who already have a home, who are in secure shelter for themselves and really do not need any help from the state to afford a

http://news.streetroots.org/sites/default/files/styles/aside_image/public/120112/ocpp20170112.jpg?itok=ucLWgAP2

home,” said Juan Carlos Ordóñez, communications director with the Oregon Center for Public Policy, or OCPP. “Reforming the MID is something that should

have been done a long time ago. But Oregon's housing crisis certainly adds urgency to this.”

The OCPP is joining the Oregon Opportunity Network, a statewide coalition of affordable housing and low-income services, in spearheading legislation for the 2017 legislative session in Salem. The two groups are joined by the Human Services Coalition of Oregon, Oregon Housing Alliance, Tax Fairness Oregon, and Habitat for Humanity of Oregon in calling for caps on the deduction and more equitable distribution of the subsidy.

Every homeowner knows about the MID, but not all reap the same benefits.

It allows homeowners who itemize their taxes to deduct from their taxable income the interest paid on mortgages up to \$1 million. Considering that payments in the early years of any 20- or 30-year loans are largely interest, the amount can be substantial.

The deduction is expected to cost the state an estimated \$1 billion in forgone income tax revenue for the 2017-19 budget.

While the details of the proposal are yet to be determined, the proposal lays out several modifications:

- Cap the amount of mortgage interest that can be deducted on state taxes at \$10,000. **(Update: At the time of this stories publication, advocates proposed the cap at \$10,000. Legislation has since been introduced at \$15,000.)**

At this level, proponents say, the majority of homeowners won't be affected. A \$300,000 mortgage, for example, under current interest rates would create \$12,652 in interest payments its first year. (The median price for homes listed in Oregon is \$319,000, but in Portland it is in excess of \$400,000, according to Zillow.)

- Eliminate use of the deduction on a second home. Proponents of the changes emphasize that this would not affect rental housing, since landlords take different deductions for rental property.
- Ultimately phase out the deduction for high-income households.

While the proposed bill cannot obligate how the revenue generated from the cap would be spent, it does call for establishing "legislative intent" to use the tax savings on affordable housing, rental housing and homelessness prevention.

Housing advocates say these modifications could generate at least \$100 million biennially for housing needs across the state.

Another option proponents say they would consider instead of the cap would be to convert the deduction into a refundable tax credit applicable to all taxpayers, not just those who itemize their taxes. It could also make higher income brackets exempt.

"Basically the policy is upside down," said Ruth Adkins, policy director with the Oregon Opportunity Network. "The Legislative Research Office has confirmed that Oregon's mortgage interest deduction costs nearly a billion each biennium. And at the same time, we know we have a housing crisis across the state, but specifically folks in low- to moderate-income families, particularly in communities of color, are shut out of homeownership. And we also have a lot of current homeowners with low incomes who are facing the possibility of losing their homes due to needing help with repairs."

Adkins said they want to see the recouped money applied to support homeownership, just at more middle- and lower-income brackets, such as starter home development and down-payment assistance for first-time homebuyers.

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On the other side of the argument is the Oregon Association of Realtors, which has said it would oppose any new cap on the deduction. From the Realtors' perspective, the \$1 billion subsidy is a good investment in homeownership, a logical link to the federal deduction, and an incentive for the second-home market, which benefits coastal and vacation-area communities.

The proposal would apply only to state income taxes, not the higher federal taxes, but from the Realtors' perspective, it's all a slippery slope. For them, and many homeowners, the mortgage interest deduction is the sacred cow of tax deductions.

The Realtors have long maintained that the deduction encourages first-time homeownership and that without it, homeownership rates would decline and could undermine the housing market.

It is also credited with keeping home prices elevated, with the market factoring the deduction as a kind of rebate on the sale price. Without it, or with it reduced, forecasters with the National Association of Realtors say, prices would decline.



Mortgage interest has been a tax deduction since 1913, when the U.S. Constitution received the 16th Amendment sanctioning income taxes. It's widely believed this was intended more as a benefit to businesses that considered interest payments as a cost of doing business, rather than for homeowners, who at the time were more likely to have paid cash outright for their homes.

That began to change after World War II, when homeownership became a pillar of the federal government. Today, homeownership rates hover around 65 percent nationally.

By the 1980s, under the tax reforms spearheaded by Oregon's own Sen. Bob Packwood, interest deductions were scaled back. You could no longer deduct your credit card interest, for example. But the mortgage deduction remained intact as a subsidy to ensure that the dream of homeownership remained accessible to the middle class. Today, at the federal level, it's a \$75 billion a year nationwide subsidy for homeowners, even on their second home.

Realtors defend the deduction, saying the majority of people who file for it make \$100,000 or less annually. In terms of actual dollars, however, the majority goes to the highest income brackets.

"One of the weird features of the MID is because it's based upon a deduction rather than a credit is that some people gain more benefit than others, based strictly upon the tax bracket that they're in," said Gerard Mildner, associate professor of real estate finance at Portland State University.

Higher-income homeowners in a higher tax bracket have a greater percentage deducted from their taxes.

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According to the Oregon Center for Public Policy, more than 60 percent of Oregon's deduction goes to the top fifth of the state's earners.

The Oregon Association of Realtors says the current policy, which echoes federal tax law, is a key incentive for homeownership at all income levels.

“We totally believe that the mortgage interest deduction is a very strong incentive for homeownership, and homeownership is the foundation for a stable financial future,” said Shawn Cleave, government affairs director with the Oregon Association of Realtors.

According to the U.S. Census, the homeownership rate was 55 percent in 1950. In 1995, it had reached 65 percent. The rate continued to climb, to 69 percent in 2004, before the housing market collapsed. The rate has declined back to 1995 levels.

Oregon's homeownership rate ended 2016 at just over 63 percent, making it the 15th lowest in the nation, Cleave said.

Over the years, there have been numerous attempts to modify the mortgage interest deduction, from the national level on down. Most of those never got off the ground against the opposition of the National Association of Realtors and its affiliates, which boasts being the nation's largest trade organization with more than 1.1 million members. In 2012, the national group successfully campaigned to amend Oregon's constitution to prohibit a real estate transfer tax to fund low-income housing assistance.

Oregon Association of Realtors wields state and national resources through its political action committee, Achieving the American Dream Coalition. The Oregon Home Builders Association, which has also come out against changes to the deduction, is fortifying its Oregonians for Affordable Housing PAC in anticipation of the upcoming session. Combined, the two groups have raised more than half a million dollars in 2016.

In 2015, a proposal to cap the mortgage interest deduction on second homes at \$125,000 in income failed to move out of the House Revenue Committee, chaired by Rep. Phil Barnhart (D-Lane and Linn counties).

Barnhart said he anticipates there will be more interest in working on this now than in previous sessions.

“I'm expecting to see several proposals for ways to improve Oregon's housing-related tax subsidies in 2017, and I think it's time we took a comprehensive look at these subsidies. We have to make sure housing subsidies in the tax code benefit the families who really need help with basic housing needs. We also need to make sure tax expenditures meant to encourage homeownership are having the intended impact at a reasonable cost given other priorities for scarce public dollars.”

He added that if members “continue to hear from their constituents that affordable housing needs to be a priority, I'm hopeful we'll be able to make progress.”



In small, coastal communities, the housing market is buoyed up by people who live elsewhere buying second homes.

These communities rely on the vacation and tourism industry as their economic base, said Cleave, of the Oregon Association of Realtors. Without the deduction, “It would be a considerable reduction in purchasing,” he said.

Jerry Johnson is an economist with Johnson Economics in Portland, which specializes in working with developers and urban planning. He said that a second home mortgage is probably somewhat of an incentive, particularly for small, vacation-oriented counties.

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Regarding a \$10,000 cap on interest, Johnson said it would probably not affect most homeowners, particularly first-time buyers.

“The impact of this on first-time homebuyers is likely negligible, as they would not typically have over \$10,000 in annual mortgage interest in the current rate environment,” Johnson said. “This likely doesn’t have a substantive impact on homeownership rates. It would seem like the proposed change would dampen some pricing at the upper end of the market, as well as second-home sales. This could be helpful for housing costs in areas such as the Oregon Coast and Central Oregon, but these economies also benefit from the construction of second homes.”

But buyers of coastal vacation homes don’t need a housing subsidy, say proponents of the change.

“Our goal is to not take it away from people for ordinary folks,” said Ordóñez, of the Oregon Center for Public Policy. “It’s only going to affect those at the very top of the income scale who don’t need a subsidy. To the industry, we would say – look, this is a poorly designed way of promoting homeownership. It’s not promoting homeownership. If your industry benefits from increased homeownership, you will do better under our plan, which will actually increase homeownership.”

Mildner, with PSU, said the change could dampen second-home purchases if second mortgages no longer qualify. However, those mortgages could qualify for the deduction if they’re absorbed in refinancing the initial home’s mortgage. That could also mean that home prices could dip.

“The supply will probably stay the same,” Mildner said. “But it will be a demand change, and it’s going to be a demand change to probably cause the price of homes to fall a little bit at the top end of the market.”



Under Oregon’s tax code, the stated purpose of the deduction is “to promote homeownership by lowering the cost of mortgages.”

“It’s not meeting the one stated goal,” Ordóñez said. “If one stops to think about it, if that’s the goal, then you’ve designed the wrong kind of policy altogether to achieve that goal. Because we have a subsidy designed to steer most of the tax benefits to those at the top. To those who already own a home. It’s structured in a way to not accomplish the goal.”

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Ordóñez was citing information from the Census’ American Communities Survey, which showed that at the close of 2015, Oregon’s homeownership rate, at 61 percent, was lower than Texas, Alaska, Washington, Florida and Wyoming, which do not have state income tax and, therefore, no state deduction.

Across Oregon, many communities are facing a housing deficit. In Portland, the housing market has not kept pace with the number of people moving here each year. In rural communities, a dire need exists for simply supplying low-income housing. The Oregon Housing and Community Services estimates that the state is short more than 100,000 units for extremely low-income Oregonians. Meanwhile, prices continue to increase. Between July 2015 to July 2016, home values in the state rose nearly 12.8 percent, according to Oregon housing bureau figures.

“We know that in communities around the state, there just are not homes at the lower end of the market,” Adkins said. “The starter homes are just not there. Our nonprofit members who do homeownership counseling have many, many qualified families who are ready to go with steady incomes and they just cannot find anything on the market, whether it’s in a rural community or in Portland.”

Cleave acknowledges the imbalance and said it’s one reason prices aren’t likely to dip even with changes to the mortgage interest deduction.

“Oregon has one of the worst supply and demand scenarios,” he said.

And that, housing advocates say, is an argument for modifying the subsidy to focus on housing options for lower- to middle-income families.

“If not now, when?” Ordóñez said. “We are facing the most severe housing crisis that this state has faced in quite a long time. And if in this type of climate you cannot take a hard long look at what is the biggest housing subsidy, then you really can’t do anything to improve public policy in this state – a policy that anybody who takes a look at it quickly recognizes that it’s a wrong-headed policy.”

“We absolutely need a lot more affordable housing,” said John Miller, a Realtors and the former executive director for the Oregon Opportunity Network.

“They’re is just a complete lack of inventory. For a Realtor who works with the entry-level market, this would be a huge help. If you’re not able to get people into their game, there’s either got to be a correction or you’ve killed your market. This would be a great benefit.”

The Oregon Association of Realtors will introduce an initiative in the upcoming legislative session for first-time homebuyers savings accounts. The initiative would be similar to programs in Colorado and Montana, Cleave said.

Regardless of that demand, Cleave maintains that the incentive is still needed to encourage first-time homebuyers in particular.

Ultimately, he said, the changes are about a money grab to plug the state's budget deficit, namely by shoring up funding for PERS – the contentious Public Employees Retirement System.

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There's no question that by the Realtors' surveys, the vast majority of homeowners love having the subsidy; however, the National Association of Realtors' 2015 report on home buyer and seller trends noted that in addition to the basic desire of people to own their own home, job-related relocation or a move were among the primary reasons for purchasing a home. Other primary reasons included affordability, financial security and a change in family situation. Tax benefits ranked 14 out of 16 reasons published in the survey, including “other.”

What is being proposed for the state would not affect the federal deduction.

At the federal level, lawmakers have boasted plans to implement major tax reforms in the coming year. According to some media reports, the nominee for secretary of the Treasury, Steven Mnuchin, has said people should expect “the largest tax change since Reagan,” including new caps on mortgage interest deductions.

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