Intergenerational Equity in Housing, February, 2008

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There's an old adage about what constitutes the perfect life, at least as I heard it years ago as a Peace Corps Volunteer in Thailand. It consisted of French (or Chinese) food, a German car, and an American Home. (Some people, I should note, added a Japanese wife.) An American home is something envied world wide, and has even become part of the advertising used by Fannie Mae -- we've all heard the ad about "fulfilling the American Dream."

The reality is that the American dream is a very remote prospect for an increasingly large proportion of our society. To be sure, some 65 percent of households, thereabouts, own their own home. But that's because an ever larger proportion of our net income is being devoted to this commitment. In New York State, the percent of mortgaged owners spending over thirty percent of their household income on selected monthly owner costs has now reached 40.9 percent. This compares to a national average estimate of 36.9 percent similarly stressed. Among the renting population, the proportion spending 30+ percent of their household income on rent and utilities is 48.1 percent, compared with an estimated 46 percent nationally. Places to live in New York are clearly expensive, even though people are willing to pay to be here.

Households, of course, also see ownership of a home as the most important means, perhaps the only means, by which to build financial equity. So people seek to own their own homes whether it makes financial sense or not. Just as

people often now make other choices for tax reasons even when it doesn't make sense otherwise, people are also often becoming homeowners for investment reasons rather than to have a place to live. Given the run-up in home values in recent years as well as government policies serving as incentives, it is easy to understand their choices.

The result is that an enormous proportion of American investment is devoted to homeownership, more than anyplace else in the world. And people don't own just a home, a sizable number now have a vacation home, a ski lodge, a pied a terre in the city, a house boat, a time share, and so on. This may have served the nation well during this era of temporary abundance, but we are increasingly aware that it was a passing moment, and that the public welfare may be better served if resources are directed more toward other purposes.

But if indeed we want to spend the inordinate amount of resources that we do on housing, policies should be such that the housing is at least equitably distributed. And we are increasingly aware that this is not now the case. There are a number of public policies in place that now skew housing resources toward certain populations, and make it difficult for others to avail themselves of them. But one that has been given too little attention is the intergenerational distribution of our housing resources at the present time.

Our housing policies are such that young families starting out in life find it extremely difficult to acquire housing, whereas many households at the other end of the age spectrum are allowed, and even encouraged, to consume far more housing than they really need. This policy should be addressed in any

review of residential property tax burdens, especially as regards homeowners pleading for special exemption from payment in their empty-nesting and final years of life. It is easy to lament the plight of the "poor widow" driven out of her home, and such stories provide the paradigmatic case for relief to "senior citizens." But there is also merit in policies that would encourage young couples and families in securing title to a home. In a world of limited resources, choices need to be made. Better that these choices be laid on the table explicitly.

Good statistics for the most recent period are lacking, but I was able to find data from the 1980 and 1990 census. Using the two most recent census decades available (1980 and 1990), we see that the proportion of homeowners nationally under 35 years of age has gone down drastically -- from 43.8 to 39.6 percent. Those over 65 years of age who are homeowners have increased from 70.1 to 75.2 percent. In 1980 homeowners under 35 were 29.9 percent and those over 65 were 49.1 percent. In 1990, by contrast, the same figures were 32.3 and 57.2 percent respectively. We know that the population is aging, and a larger proportion are in the higher age brackets than was true one and two decades ago. But not this much. According to the 2006 American Community Survey, between 14 and 15 percent of all owner-occupied housing units are by those 65 years or older even though they are only about 12 percent of the population. Anecdotal information suggests that young people are having an ever harder time in acquiring a home, while the older population brackets are holding onto

theirs. Some states, New York being one, have a disproportionately higher segment of the elderly population, as much as one percentage point higher than the national average.

There is broad sentiment in this country that people ought to be able to own their own home if they can afford it. Indeed favoring one population class over another, whether by race, sex, marital status or any other category, probably would not meet with public support. Yet favoritism by age is amply evident, and is a policy that has received little examination, attention, or debate. The greatest advantages given to older Americans in support for homeownership are in tax policy, and these need to be addressed.

With respect to federal and state income taxes, the deductibility of mortgage interest and property taxes are the pivotal influences. Although homeowners are likely to have paid off a substantial portion of their home mortgages by the time they reach senior status, they are still able to deduct their property taxes. This older station in life may put them in a higher income bracket (unless they are retired), but it is likely the case that they would also have "graduated" to more expensive homes as well. So state and national tax policy impact on home ownership decisions may be more complex than any off-the-cuff generalizations can allow. This is true with one exception: when a homeowner ultimately relinquishes title, the capital gains from the sale is exempted from taxation. This constitutes a huge windfall to titleholders (or their

heirs) that is a totally unearned transfer of community created wealth. (As noted elsewhere, rents are, by definition, socially created.)

With respect to local property taxes for the support of municipal services and schools, substantial measures have been enacted that afford senior citizen homeowners relief from full payment. Argument for such programs are based on the view that seniors have "earned" the privilege of favorable treatment by being responsible citizens in the course of their lives. It is also claimed that retirement incomes are a drop from what previous earnings typically are, and their ability to pay is therefore limited. The data in support of this second point comes mainly from analysis of income tax returns, which of course take account only of income but not of wealth. Because the property tax is a wealth tax for the most part, this compares apples and oranges, and constitutes a certain intellectual sleight-of-hand.

As I have argued elsewhere, the market value of homeownership is in good part the flow of rent through site locations and it is capitalized in the course of holding title. It is a measure of wealth and not of income, at least in so far as the collection of this rental flow is overlooked by the community. When both the windfall gain from home sales are exempt from taxation, and a good part of the property taxes are excused as well, this constitutes a huge benefit to titleholders. It is both a violation of general principles of fairness and it diverts investment decisions from more productive enterprises. In a word, it feeds real estate

speculation.

There are simple and available answers to concerns about fairness and about economic efficiency. The fairness issue is best addressed by deferral of the property taxes until such time as parcels are sold and the accrued amount due can be paid in full with interest. This puts all homeowners on a level playing field while assuring that they are not pressed unreasonably by the demands of taxation. Deferring property taxes assures the public that it will eventually receive all the revenues that it should count on. It also assures that households can remain in their homes without concern about expulsion by the tax collector.

The matter of treating real estate investments (for they are, after all, investments) with an even hand relative to other sectors of the economy is equally important. Locations are not in and of themselves productive; rather they reflect the productivity of the collective community of enterprises, it is important that investment capital not be squandered in land sites that yield no return. The lower the taxes on property, a significant portion of which is upon rent, the more sites rise in market price, thereby feeding the kind of speculative fever that we have witness for the past decade. Indeed the more community created land rent is recaptured by the public, the more it fosters rational and efficient investment decisions based on the productive factors of labor and capital. This is because rent, one way or another, flows through parcel sites, and if not recaptured in taxes it is diverted to the pursuit of

windfalls and becomes the focus of speculators.

There are two dimensions to addressing intergenerational equity in housing: The first is recapturing the economic rents that flow through real estate parcels so that the prices of property parcels is stable and not driven by speculative fever. The second is allowing the option of property tax deferral for those who may wish to do so when suitable eligibility criteria have been established. Taxing economic rents at the time of their creation assures a modicum of liquidity in the real estate market, and maintains affordability in housing for all people of all generations desirous of purchasing a home. As structures depreciate over their lifetime and land sites appreciate, a land value tax, which is a proxy for rent collection, can temper fluctuations in price and assure that market stability over the long term of a community.