Tuesday, December 11, 2012

THE DAILY RECORD

WESTERN NEW YORK'S SOURCE FOR LAW, REAL ESTATE, FINANCE AND GENERAL INTELLIGENCE SINCE 1908

TitleTRACK

The fiscal cliff and its effects on real estate

Is the economy heading for a fiscal cliff? The answer is simple — YES. Unless Congress strikes a deal, the Budget Control Act takes over in January of 2013 and will force a 9 percent reduction in federal spending almost across the board — overnight. If this comes to pass, the economy will be hit by a number of shocks happening almost simultaneously.

What will we be looking at?

- A $125 billion reduction in household wealth next year thanks to the expiration of the "payroll tax holiday," which will result in an additional 2 percent taken out of every worker's paycheck;
- The Child Tax Credit gets slashed from $1,000 to $500 per child per year;
- $40 million in unemployment benefits as temporary extensions of unemployment benefits agreed to in the budget deal of 2010 expire;
- $280 billion in increased taxes, thanks to the sunsetting of the Bush tax cut provisions, which will raise income taxes and capital gains tax across the board; and
- $98 billion in actual reductions in government spending under sequestration provisions of the Budget Control Act.

By JOHN P. NITSCHE
Daily Record Columnist

In addition, unless Congress acts, the so-called "AMT patch" will expire, which will result in the number of households paying alternative minimum tax to explode — going from 5 million to 30 million overnight. If this occurs, then a number of tax deductions important to the middle class effectively get clawed back.

On top of that, the Pease Amendment (also known as "Limitation on Itemized Deductions") kicks in, reducing most itemized tax deductions by 3 percent.

If the government does hit the brakes on spending under the so-called sequestration provisions, the Congressional Budget Office estimates that the U.S. economy would go into recession, contracting by 2.9 percent just in the first six months. The CBO also estimated that the austerity provisions could cause the economy to lose 2 million jobs, and unemployment to shoot up to over 9 percent next year.

Naturally, since unemployed workers have a hard time qualifying for mortgages, this will have a certain drag effect on the real estate market. Triggering the Pease limitation rules could have a significant effect on home prices across the board. Potential effects could be:

- Taken in isolation, the proposal to limit the value of the mortgage interest deduction to 28 percent could reduce housing values by 6.9 to 15 percent.
- The proposal to raise the 33 percent income tax rate to 36 percent could raise housing pricing by between 2.7 and 6.0 percent.
- And the proposal to increase the capital gains tax rate for upper-income taxpayers could raise housing by between 0.9 and 2.3 percent.

The net? The combined effect of all three measures could cause home prices to fall by between 4.2 and 10.2 percent.

None of the above is written in stone. It is quite possible that Congress will reach a deal at the last minute, extending many of the important tax provisions. We may lose the payroll tax holiday, but since Social Security relies on those payroll taxes, that may not be a terrible thing in the long run. The top marginal income tax rate may go up, but it is quite possible that we will see income tax rates on most taxpayers remain where they're at, and Congress will extend the AMT fix another year or two.

Should Congress fail to reach a deal and the "doomsday" scenario hits, it's going to hurt.

John P. Nitsche is president of WebTitle Agency, an authorized issuing agent for First American Title Insurance Co. of New York, Fidelity National Title Insurance Co. and Old Republic National Title Insurance Co. WebTitle Agency offices are located at 500 A Canal View Blvd., Rochester, NY 14623; and the Executive Office Building, 36 W. Main St., Suite 51, Rochester, NY 14614; phone (585) 454-4770; www.webtitle.us.