Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

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COSTLY ISAKSON HOMEBUYER TAX CREDIT AMENDMENT WOULD BE INEFFECTIVE STIMULUS

by Barbara Sard and Robert Greenstein

An amendment by Senator Isakson that the Senate added to its economic recovery legislation, providing a new $15,000 tax credit for home purchases in the 12 months after enactment,[1] has low bang for the buck as stimulus and is thus a dubious addition to the package.

Unlike the $7,500 first-time homebuyer credit that Congress adopted as part of the Housing and Economic Recovery Act in July 2008 — which the new tax credit would replace — any homebuyer purchasing a principal residence would be eligible for the credit. No income limitations would apply, and there would be no limit on the value of a home that would qualify for the tax break.

The credit could modestly increase the number of homes purchased in 2009. But the modest stimulative benefit of the credit comes at a high cost — $39 billion according to the Joint Committee on Taxation.[2] (The cost has been widely reported as $35.5 billion. In fact, the Joint Tax Committee estimated the cost at $35.5 billion *above* the $3.7 billion cost of a homebuyer credit provision that was already in the Senate bill and that the Isakson credit replaced.)

Proponents of the amendment stated that it was expected to increase home purchases by nearly 500,000 homes.[3] Yet in 2008, about *5.5 million* single-family homes were sold. (To put this figure in context, 6.4 million single-family homes were sold in 2007, and 7.5 million in 2006.) Sales were fairly level throughout 2008, and if sales in 2009 would continue at the 2008 level in the absence of the amendment, the proponents' estimate would mean the credit would increase sales by about 11

[1] Technically, the credit is $15,000 or 10 percent of the purchase price, whichever is smaller. Since few homes sell for less than $150,000, particularly to people with sufficient income to claim the credit, the usual value will be the maximum permitted.

[2] By letter to Senator Schumer dated February 5, the Joint Committee on Taxation estimated the cost of the amendment adopted by the Senate at $35.5 billion on top of the $3.7 billion cost of the homebuyer credit provision in the bill reported by the Senate Finance Committee. The amendment strikes the Finance Committee-approved provision. (Before the amendment was considered, JCT had estimated its cost, based on a previous draft, at $18.5 billion more than the Finance bill.)

[3] In an article in CongressDaily on Feb. 5, Peter Cohn stated: “Isakson and Lieberman touted a study by the National Association of Home Builders that said the amendment could, in the first year of enactment, increase home purchases by nearly 500,000 ...”

percent. In other words, *nearly 9 out of 10 of the taxpayers eligible for the credit would have bought homes without it, greatly reducing the stimulus effect per dollar spent* (i.e., the "bang for the buck").

The high cost is still more troubling because the provision is not targeted at potential homebuyers with financial need. Many of the families that would be able to claim the credit do not need an additional $15,000 to buy a home. The families most likely to benefit from the credit are among those who are suffering least from the recession, as they would need to have sufficient current income to qualify for a new mortgage. These families would, for the most part, essentially use the tax credit to increase their savings (relative to what their savings otherwise would be) by withdrawing less from their savings than they otherwise would to purchase a home (or by taking out a smaller mortgage). The tax credit thus would stimulate relatively little new spending and is likely to be one of the least effective measures in the overall recovery package per dollar of cost.

Credit Would Do Little to Spur Home Construction

Another issue is that most of the additional home sales that would occur as a result of the credit are sales of *existing* homes. A recent National Association of Home Builders' analysis of the impact of a homebuyer tax credit estimated that fewer than 1 in 5 of the homes purchased as a result of the credit would be newly constructed.[4] The $16 billion in funding for school construction that the Nelson-Collins amendment removed from the Senate recovery package would likely create many times the number of jobs that the $39 billion Isakson tax credit would.

Would Also Do Little for the Mortgage Market

Another justification advanced for the Isakson amendment is the claim that it would boost home values and stabilize housing markets. This claim is shredded in a trenchant analysis by Martin Sullivan in *Tax Notes*.[5]

Sullivan shows that even in the best-case scenario, the impact of the credit on the $20 trillion housing market would be so small as to be insignificant. He explains that the credit would do nothing to address the heart of the problem — mortgage losses and a shattered mortgage market and broken financial system.

Credit Might Even Lead to Increase in Foreclosures

Sullivan also explains that the Isakson amendment could even lead to an *increase* in foreclosures. "If a bank were trying to decide between foreclosure and working out a loan," he cautions, "the availability of the home buyer credit would tip the balance in favor of foreclosure because the bank could fetch a higher price on resale." Hence, the tax credit "will not reduce foreclosures in any measurable way — and could even increase them."

A Major Conference Issue

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[4] Paul Emrath, "Economic Effects of a Policy to Stimulate Home Buying," HousingEconomics.com, January 9, 2009.

[5] Martin A Sullivan, "Lackluster Home Buyer Credit Now in the Spotlight," *Tax Notes*, February 6, 2009.

The conference committee will weigh the Isakson amendment against a far less costly House measure that would repeal the “recapture” provision of the first-time homebuyer credit that was enacted last year and is slated to expire on July 1, 2009. The House provision would convert the existing credit from what is essentially a loan to a true tax credit, at a cost of $2.6 billion. The existing credit also could be extended for some additional months (as well as being converted to a true tax credit from a loan) at a relatively modest cost — as the $3.7 billion tax-credit provision the Senate Finance Committee had adopted would have done.