



Collapse of Housing Prices Causing Fiscal Crises at All Levels of Government

Plummeting housing prices are wreaking havoc on government revenues and budgets. The financial structure of state and local government relies on a robust and healthy housing market. Moreover, with the recent takeover of Fannie Mae and Freddie Mac, the federal government has assumed an enormous stake in a strong housing market.

By stimulating the housing market and providing support for home prices nationwide, the policies sought by the Fix Housing First Coalition will have significant positive effects on public finance at all levels of government. Moreover, these policies will also generate jobs...quickly. The National Association of Home Builders estimates that for every new single family home built, 3.05 jobs are created and \$89,216 in taxes are collected. Failing to stem the free fall in housing prices, however, will aggravate a serious fiscal crisis in government financing.

States' Fiscal Crises Are Closely Related to Housing

States are confronting a wide range of economic challenges affecting their revenue flow, but the housing crisis is clearly having the greatest impact.

- ❖ The Center for Budget and Policy Priorities reports that 41 states are facing budget shortfalls in this or next year and predicts the problem will get worse for the foreseeable future.
- ❖ According to the Nelson A. Rockefeller Institute of Government, real tax revenue at the state level declined 2.6% in the third quarter of 2008 and was down in 31 of the 42 states they surveyed.
- ❖ BusinessWeek reports that the states with the most severe fiscal problems are the states enduring the largest drop in housing prices.

"The downturn in the housing market is a big factor as to why this (the fiscal crisis) has occurred."
Arizona State Representative David Lujan

Decline in Property Tax Revenues

Property taxes have traditionally been the most stable source of revenue for local governments. Due to the collapse of the housing market, however, property tax revenues are dropping quickly and it is only the beginning. The reasons are clear. Vastly fewer homes are being built, while populations and demand for services are either stable or growing. This dynamic creates serious budget gaps for local officials. Moreover, the drop in values of existing homes results in reduced appraisals and reduced property tax revenues.

The National League of Cities reports that property taxes went from an increase of 6.3% in 2007 to a projected decline of 3.6% in 2008, a swing of almost 10%. Moreover, the League points out that, "Current property tax bills and property tax collections typically reflect values of property from 18 months ago." So this drop does not even include the steep declines in home values this year.

Decline in Income Tax Revenues

Growing unemployment is having a devastating impact on the states. Led by the drop in residential construction, the decline of construction jobs is particularly striking. According to housing industry analysts at Zellman & Associates:

- ❖ In October 2008, residential construction employment declined by an annualized rate of 11.2%.
- ❖ Since its peak, jobs related to residential construction has declined by 20% and residential contractor employment has dropped by 17%.
- ❖ If nothing is done to arrest this slide, up to 710,000 jobs could be lost in the construction industry.

As a result of these trends, the Center for Budget and Policy Priorities reports that revenues from state income taxes are down sharply. In the third quarter of 2008, state income taxes declined 3.7 percent from the previous quarter. In fact, these revenues are down in 33 of the 37 states that levy income taxes.

Decline in Sales Tax Revenues

State and local jurisdictions benefit from sales tax revenue generated on materials sold to home builders. Additionally, a home purchase generally results in increased consumer purchases, including furniture, appliances, and other large ticket items. Without an active housing market, states and local jurisdictions are losing revenue of direct and indirect sales tax.

The Rockefeller Institute reported that sales tax revenues declined in the third quarter of 2008 by 2% from the same time last year, the largest drop in 17 years.

Extending beyond the residential market, housing price declines have left consumers with less wealth, which has placed downward pressure on consumption. The evaporation of home equity has reduced Americans' aggregate wealth by roughly \$3 trillion since the housing peak in 2006. That decline has forced consumers to reduce their spending by approximately \$300 billion a year, which has yielded a major decline in tax revenues.

Decline in Building Fees

Local jurisdictions levy fees for approving building permits and extending utility services. In the states with the most severe housing crises, these fees can be a very significant source of income. In states like California, Arizona and Florida, permit fees can bring in tens of thousands of dollars per house built. However, with demand for newly-constructed homes nearly at a standstill, home builders have no need to secure building permits.

In fact, according to the U.S. Department of Housing and Urban Development, permits for new housing construction in November sunk to the lowest level in history.

These building fees are generally used as a base for budget projections. Many cities may now be facing a dramatic drop in revenues due to budgets based on estimated activity set many months ago. Without the impact fees, many local infrastructure and community improvement projects will be underfunded, forcing additional downward pressure of employment and sales tax revenues as projects are set aside until needed funding is collected.

Unemployment Insurance System is Heading Toward Insolvency

Massive job losses are putting an extraordinary strain on state budgets. For many states, their unemployment trust funds, already stretched by a general economic slowdown, are facing insolvency. Media reports indicate that several states – including California, Michigan, Missouri, New York, Ohio, South Carolina, Wisconsin,

Indiana, Kentucky and Arkansas – have less than six months' worth of unemployment trust fund reserves, putting these funds at high risk of insolvency.

However, just as job losses in the housing market have aggravated the burden on unemployment benefits, revitalization of the housing market is among the most effective means of creating new jobs *quickly*.

Case Study: California

According to the Sacramento Regional Research Institute, California's homebuilding industry contributed nearly \$40 billion to the state economy and created 266,000 jobs per year in 2007. And every dollar spent on new housing construction in California generated nearly another dollar in total economic activity.

Construction of a new house provides a one-time benefit to the state of nearly \$16,000 and an ongoing benefit of \$3,500 per year – cash directly to the state treasury.

Locally, the benefits are equally compelling. Construction of a new house provides a one-time benefit to local governments of \$3,000 and an ongoing, annual benefit of \$771.

In this current economic climate, the state of California as well as many if not most localities are facing severe declines in revenue.

The Federal Government Is Affected as Never Before

Of course, the housing crisis is not limited to state and local governments. As a result of the collapse of Freddie Mac and Fannie Mae, the Federal government is now backing trillions of dollars in mortgage debt. This debt is collateralized with houses whose prices are declining precipitously all across the country. A program designed specifically to raise housing prices will directly reduce the liability that American taxpayers face in this newly acquired obligation.