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Fitch Ratings: If Home Prices Drop, Will U.S. Local Government Revenues Follow?

Fitch Ratings-New York/Chicago-13 February 2019: Despite recent investor concern, Fitch Ratings does not expect that local governments will be exposed to large revenue declines if home prices drop, according to a new report.

Property tax revenues barely declined in aggregate after the housing bust of the mid-2000s. And the housing market of today is very different with far less speculative construction and much more sustainable home price growth. However, not all local governments were immune to the precipitous home price declines during the last economic downturn.

"Weak housing market trends did create fiscal stress for some local governments during the last downturn so it's reasonable to expect that this stress could return," said Managing Director Amy Laskey.

A state to watch is California, where property tax revenues should be well protected if home prices were to fall again despite recent frothiness in some parts of the state. Offsetting a lack of tax rate flexibility, most areas have built up substantial cushion under Prop 13. This means assessed values would likely decline only mildly in the next downturn. Conversely, home prices in parts of Michigan, which has similar assessment and taxation restrictions, have not recovered from the last downturn. As such, some Michigan local governments are more susceptible to large revenue declines over time.

Recent caps on SALT deductions and mortgage interest deductibility are not likely to precipitate large, en masse home prices declines. "Employment, wage growth, consumer confidence, affordability and life events play a bigger role in home buying decisions than tax incentives," said Director Robert Rulla. The ripple effect of housing disincentives, however, would be felt more acutely in housing markets with high home prices and/or high taxes.

A longer-term demographic worth keeping a close eye on over time will be millennials as they will represent a higher proportion of homebuyers. In fact, most homebuilders are already repositioning communities to target these first-time homebuyers by offering more affordable homes. This likely means median prices for new homes would decline while existing entry level homes would become more expensive. "The large number and high homeownership rate of baby boomers may put downward pressure on prices as this group ages and millennials and Generation Z do not pick up the slack," said Rulla.

'What Investors Want to Know: Housing Market Trends' is available at 'www.fitchratings.com'

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