First Time Underwater: The Impact of the First-time Homebuyer Tax Credit

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Abstract

One of the items that Congress added to the American Recovery and Reinvestment Act of 2009, President Obama's stimulus package, was a first-time homebuyer tax credit. The tax credit gave people buying their first home, or who had not been homeowners for at least three years, a tax credit equal to 10 percent of the purchase price of the home, up to $8,000. The intention was to spur home buying and put an end to the plunge in home prices, which were dropping at an annual rate of close to 20 percent at the time. According to the Government Accountability Office, 2.3 million people took advantage of the credit, at a cost to the government of $16.2 billion. This delayed the deflation of the bubble, but did not stop it. By the end of 2011, nationwide home prices had fallen by 8.4 percent since the credit-induced peak reached in the second quarter of 2010. They are continuing to fall into 2012. The temporary boost to the market from the credit allowed many homeowners to sell their homes at prices that were still partially inflated by the bubble. This was good for these homeowners, as well as their creditors, who might have otherwise been forced to accept short sales. However, it was bad news for homebuyers who were persuaded to buy homes at prices that were often still above trend values This paper briefly outlines the impact of the homebuyer credit. The first part produces a set of calculations of the amount of wealth transferred to sellers and creditors as a result of the credit. These calculations are intended to determine the additional amount that homebuyers paid for homes as a result of the credit, as opposed to a situation in which the housing market had been allowed to continue its decline unchecked. The second part of the paper focuses on some of the cities where the credit appears to have had the greatest impact. It looks at the extent to which buyers of less expensive homes – the segment of the market most influenced by the credit – experienced losses as a result of buying homes at bubble-inflated prices.

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