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HOUSING: On second thought ...

Curbs on mortgage tax deduction would hit LV market hard, experts say

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A tax-reform group will today discuss changing the mortgage-interest deduction for second homes. Some of the second homes a change in the rules would affect include units in condominium-hotels, such as the Residences at MGM Grand, pictured here Monday.

Any move to trim the federal tax deduction on mortgages could force a second look at the Las Vegas Valley's reliance on the second-home market.

When the President's Advisory Panel on Federal Tax Reform meets today, its members will consider changing what properties and loans qualify for the mortgage-interest deduction homeowners take on their tax returns each year.

Real-estate watchers say the panel could discuss cutting the deduction for interest on vacation

Photo by Clint Karlsen.

homes, investment properties and home-equity loans. Such a move could have a major effect on the Las Vegas market, where nearly 50,000 luxury condominiums in 175 towers -- many of them targeted at second-home buyers and investors -- are in planning, according to local economic research firm Applied Analysis. The city's biggest developments, from MGM Mirage's $5 billion Project CityCenter on the Strip to the Related Cos.' $3.5 billion Las Ramblas on Harmon Avenue, will rely heavily on vacation-home buyers.

"Removing the deduction on second homes, coupled with rising interest rates and somewhat of a cooling housing market, would have a profound effect on Las Vegas, at least in the short term," said Bruce Hiatt, a high-rise sales specialist and broker-owner of Luxury Realty Group in Las Vegas. "The stock market is less and less a place where people want to put their money. People would rather put their money in real estate. If that deduction is taken away, where will they invest?"

Rick Piette, manager of Premier Mortgage Lending Group in Las Vegas, said removing the mortgage-interest deduction from secondary homes would have a "serious effect on the local and national economies."

"People would buy homes anyway, but the deductibility of mortgage interest is a primary consideration in purchasing a home," Piette said.

Removing mortgage-interest deductions from vacation properties won't affect just the local high-rise condominium market. In the third quarter, 21.2 percent of new homes sold in the Las Vegas Valley were bought as vacation homes or investments, said Steve Bottfeld, an analyst with real estate research company Marketing Solutions. That percentage doesn't include any high-rise sales, which have yet to hit the market's closing data.

But how much would the loss of a tax deduction really affect second-home buyers and investors? Buyers of vacation homes tend to have high net worth, and Hiatt said about 60 percent of the high-rise buyers he works with can pay cash for their properties. Still, the wealthy often make decisions based on tax burdens, he said.

"For many of these buyers, their tax advisers are typically looking at property as part of the big picture in terms of advising them where to invest their money," Hiatt said.

High-rises that operate as condo-hotels, through which owners rent out their unoccupied units through a hotel rental pool, are especially vulnerable, Hiatt said.

"That market is almost all investor-driven," Hiatt said. "That's what their product is aimed at."

Condo-hotel projects on and around the Strip include The Residences at MGM Grand, Trump International and the Cosmopolitan.

Towers targeted at residents could fare better, since two-thirds of their buyers would claim the homes as primary residences, Bottfeld said. Residential towers planned on or near the Strip include Icon, Sky Las Vegas and Allure.

However, analysts agree that any effect on local home sales would be temporary.

"There will be the sudden intake of breath at first, but buyers will then turn around and say, 'It's still the best value around -- the heck with it, I'm going to buy,'" Bottfeld said. "We are looking at a market that has simply branded itself so well as a resort destination that people probably will absorb it and move on."

Hiatt pointed to the European real estate market as an example. In Europe, he said, homeowners can't deduct their mortgage interest, and overall home prices are much higher than prices in the United States. Yet, Europeans continue to buy and sell luxury homes, he said.

"In the long term, people will get used to it. Real estate will always be the king of investments. It's still a tangible asset you own at the end of the day," Hiatt said.

Removing the mortgage-interest deduction on second homes could even spur more residents to eventually move here permanently, Bottfeld said.

Many second-home buyers who already own in Las Vegas claim their local vacation properties as their primary residences so they can enjoy the state's lack of personal income tax. Eliminating the tax benefits of having a vacation-home mortgage could encourage owners to move to low-tax states like Nevada in search of other tax advantages.

Taking away the interest deduction on home-equity loans could also affect how consumers free capital from their homes, Piette said.

Rather than home equity mortgages or lines of credit, more homeowners would simply refinance their properties, which would allow them to lower their monthly payments and still write off their loan's interest.

That greater interest in refinancing should keep the lending industry healthy even if the interest deduction no longer applies to equity loans, Piette said.

President Bush appointed the tax reform panel in January to make recommendations on changing the tax code to make it "simpler, fairer and more pro-growth," a White House statement said.

But local experts don't put high odds on any near-term alterations in who qualifies for mortgage-interest deductions.

"These deductions are so sacred to the U.S. public that it would be difficult to change them," Piette said.

Bottfeld agreed: "The bottom line is, I don't think this is going to happen. Any law (changing the deductions) will be defeated because it's an economic stupidity. The second-home market comprises 15 to 20 percent of the shelter industry in the United States. If you knock down that much of the shelter industry -- which is basically keeping this economy afloat -- you're taking away a lot of consumer spending."