CoEqual

METHODOLOGY FOR ESTIMATING THE IMPACT OF THE TAX CUT AND JOBS ACT ON LOCAL HOMEOWNERS WITH HOME EQUITY LOANS

The Tax Cut and Jobs Act of 2017 repeals the deduction for interest paid on home equity loans that are used for purposes other than home improvement or home purchase. Co-Equal has developed a methodology for estimating the number of homeowners in a local area that are adversely affected by this provision.

The data sources used in the methodology are publicly available. They are:

- The *2017 American Community Survey* conducted by the U.S. Census Bureau, which provides data on the number of homeowners in local areas and on the types of home equity borrowing they have;

- The *2017 Survey of Consumer Expectations* conducted by the Federal Reserve Bank of New York and the *2016 Survey of Consumer Finances* conducted by the Federal Reserve Board of Governors, which provide data for estimating the proportion of home equity borrowing used for purposes other than home improvement; and

- The *2016 American Housing Survey* conducted by the U.S. Census Bureau, which provides data on use of cash extracted from primary mortgages in refinancing.

Home equity loans can take three primary forms: (1) home equity lines of credit, sometimes referred to as HELOCs, which allow homeowners to borrow against the equity in their home up to a credit limit; (2) a second or "junior lien" mortgage; and (3) a "cash-out" refinancing in which homeowners increase the size of their borrowing during the refinance to extract cash. In this methodology, a homeowner with of one of these types of home equity loans is considered adversely affected by the new law if the law prevents the homeowner from deducting the full interest on the loan. In this methodology, a home equity loan that is used for either home improvement or home purchase is referred to as a home equity loan used for home improvement.

The *2016 Survey of Consumer Finances* provides national data on the proportion of primary mortgages that include cash-out refinancing in Table 14. According to this survey, 13.9% of mortgage holders have refinanced to take cash out. Because there is no publicly available data on the local proportion of primary mortgages that include cash-out refinancing, this methodology applies the national proportion to the local data on the number of homeowners with primary mortgages to estimate the number of local homeowners with cash-out refinancing.

The sum of the number of local homeowners with a HELOC, second mortgage, and cash-out refinancing provides an estimate of the number of local homeowners with existing home equity loans. To determine the number of local homeowners adversely affected by the new tax law, this number needs to be adjusted to (1) to remove the homeowners who used their HELOC or second mortgage exclusively for home improvement, (2) to remove the homeowners who used their cash-out refinancing exclusively for home improvement, and (3) to prevent double-counting of homeowners with both a HELOC or second mortgage and a cash-out refinancing.

Because local data on these adjustment factors is not available, the methodology uses national data from the *2017 Survey of Consumer Expectations* (Housing Survey) to derive the adjustment factors. The survey results show that 33.6% of homeowners with HELOCs or second mortgages use them exclusively for home improvement; 25.9% of homeowners with cash-out refinancing use them exclusively for home improvement; and 7.4% of homeowners with a HELOC or second mortgage also have a cash-out refinancing.

The formula used to determine the number of adversely affected homeowners in a local area is:

$$\text{Homeowners affected} = 0.926\ (0.664\ (\text{HEL})) + .741\ (\text{COR})$$

In this formula, HEL stands for the number of homeowners with a second mortgage or HELOC, and COR stands for the number of homeowners with cash-out refinancing.