



Thoughts on Tax Reform -- Strategy and the Mortgage Interest Deduction

Summary

Senate Majority Leader McConnell is backing away from the Trump administration's timeline for passing tax reform and we explain why we think that is a good thing. Also, it is clear that a limit on the mortgage interest deduction is part of negotiations. The headlines might be a negative for mortgage originators but we expect a limited fundamental impact.

□ **Tax reform timing and strategy** -- Senate Majority Leader Mitch McConnell (R-KY) made some comments on Tuesday that received media attention because they were perceived as a rebuke of President Trump. He also made comments on the timeline for tax reform that received less attention but are probably more important than his other comments -- at least for investors. In his Tuesday appearance in Kentucky, McConnell separated himself from the Trump administration's ambitious timeline for passing tax reform and refused to say when tax reform might be finished. We think this is a smart political move. McConnell knows the Senate moves at its own pace and that the Senate's schedule might not line-up with the White House's expectations, so there is nothing to be gained by over-promising when the Senate can pass a tax bill. In fact, setting artificial and unrealistic timelines can backfire because these timelines will not be met and it generates the illusion of failure. This was the case with health care.

□ **Tax reform details** -- It is difficult to get an accurate read on how deep tax rates might be cut and what the offsets might be (i.e. the elimination or reduction of deductions and other tax treatments). Most lawmakers are back in their constituencies and not in Washington and much of the current work on tax reform is being done by staffers, so very few of the details have been worked out. That being said, once the border-adjustment tax was dropped, lawmakers were forced to turn to a 2014 tax reform plan authored by former Rep. Dave Camp (R-MI) in order to find ways to make tax legislation as close to deficit neutral as possible. Recent reports in *Bloomberg* and other publications suggest a cap of the mortgage interest deduction is on the table and we think chances are better than 50/50 that some limit (perhaps at \$500,000 in mortgage debt) is likely. A cap could have an impact on a specific slice of the market -- home sales in upper middle class and lower upper class areas. Home sales in cheaper areas will probably experience a smaller impact since many borrowers in those areas do not itemize their deductions and instead rely on the standard deduction. Furthermore, an increase

in the standard deduction will further reduce the number of taxpayers who itemize their taxes. The largest homes in the wealthiest areas will probably see minimal impact from a limit on the mortgage interest deduction since taxpayers in those areas are already subject to phase-outs of deductions. **Bottom-line: We think a cap on the mortgage interest deduction is certainly on the table in negotiations for a tax bill and will probably be included in the proposal released by lawmakers later this year. The related headlines might be a slight negative for the mortgage originators. However, we think the fundamental impact will be limited.**

□ Please feel free to contact us to discuss these or other matters.

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Macro Policy

McConnell won't put a timeline on tax reform - Politico Pro (Subscription Required)

"Senate Majority Leader Mitch McConnell said he would not join the expectations game for when Congress will pass tax reform, departing from the aggressive timeline laid out by the White House. 'I'm not going to tell you when we are going to finish tax reform, but we'll finish it. That's the way we begin to change America,' McConnell told the Florence, Ky., Rotary Club on Tuesday, according to the Northern Kentucky Tribune. Last month, White House legislative director Marc Short said markups would begin in September, legislation would move through the House in October, and it would clear the Senate in November. That followed earlier predictions by Treasury Secretary Steven Mnuchin that tax reform would be done by August."

Trump administration weighs slashing mortgage deduction - Politico

"A tax break popular with homeowners and the real estate industry could take a hit as Republicans look for ways to pay for their tax reform plan. Despite promises from the Trump administration in April that it would 'protect the homeownership...deductions,' multiple sources tracking tax reform said that the cap on the mortgage interest deduction - currently set at the interest on up to \$1 million of mortgage debt - could be lowered in tax reform. That would be a slap in the face to an industry that strongly supported President Donald Trump during his presidential bid...The topic came up during a White House roundtable with real estate industry representatives [July 31]. National Economic Council Director Gary Cohn, a key decision-maker on tax reform, and his lead deputy on tax reform, Shahira Knight, led the meeting. Cohn previously told members of Congress that almost everything, including changes to the mortgage interest deduction, would be on the table."

White House pitches deal for wall money - and no shutdown - Politico

"The White House is pushing a deal on Capitol Hill to head off a government shutdown that would lift strict spending caps long opposed by Democrat in exchange for money for President Donald Trump's border wall with Mexico, multiple sources said. March Short, the White House's director of legislative affairs, met with top staffers from both parties on the Senate Appropriations Committee last week to make a hard sell for the proposal, the sources said. Short - who said the border funding would be used for a 'double fence' stressed that the White House is insisting on a down payment for construction this fall. Short also lobbied for a big budget increase for the Pentagon, another priority for Trump. The government runs out of money after Sept. 30. Without a spending deal, federal agencies will be forced to close until an agreement is reached. Democrats have vowed to oppose funding for a border wall, making it probably the biggest threat to an early October closure."



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The recommendations contained in this report were produced at 10 August 2017 08:45 EDT and disseminated at 10 August 2017 08:45 EDT

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