A Redesign of the California Renter's Credit

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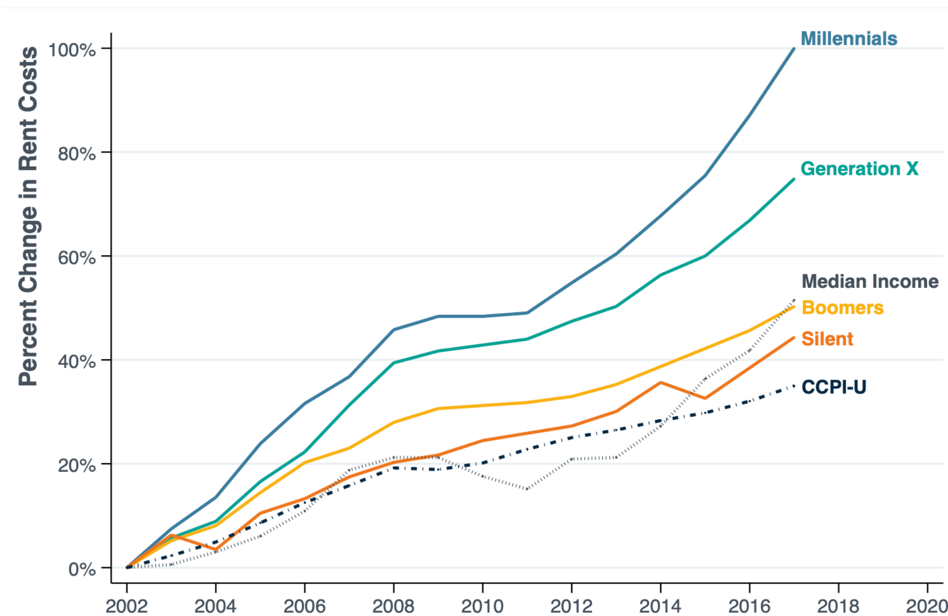
Young Renters in California are Extremely Rent-Burdened

Rising rents in California have exacerbated financial challenges for a broad segment of the population. Across the state, 46% of renters are rent-burdened with annual rents exceeding 40% of their post-tax income.[1] The picture is bleaker for people on the lower end of the income spectrum; among renters earning less than $25,000 after taxes, more than 3.3 million people, or 70%, are rent-burdened. The trend of rising rents and tightening rental markets is not new. For the past several decades, population growth, limited construction, and low vacancy rates have played a role in driving up rental costs. Today, California cities dominate the upper ranks of the nation's most expensive rental markets; cities in the top eleven include San Francisco, San Jose, Oakland, Orange County, San Diego, and Los Angeles.[2]

Figure 1: How Quickly Have Rents Increased by Generation?



Source: Author's calculations based on IPUMS USA, University of Minnesota, www.ipums.org
Note: CCPI-U is California Consumer Price Index, All Urban Consumers. Median Income is median income among renters only.

The problem of rising rents is particularly pronounced for young people in the state. With a rapid decline in homeownership among millennials,[3] California's population of young renters has grown significantly. Currently, millennials make up the largest proportion of burdened renters, with more than 1.7 million millennial tax filers spending more than 40% of their post-tax income on rent.[4] As shown in Figure 1, millennials have also seen the greatest increase in rent costs since 2002. From 2002 until 2008, rent prices increased at a faster rate than median income among renters. When incomes fell during the Great Recession, rent costs for young renters only plateaued and have continued to grow faster than income throughout the recovery.

The Tax Code Overwhelmingly Favors Homeowners

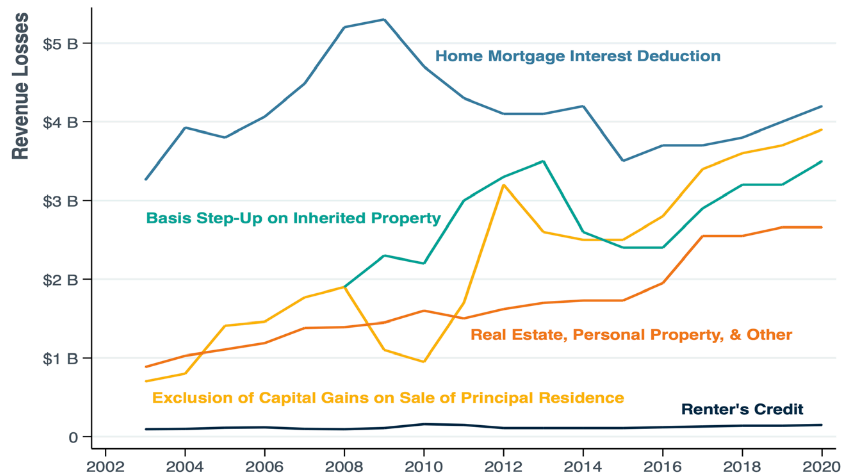
State spending through the tax code on renters pales in comparison to support for homeowners. While the Renter's Credit has seen little growth since 2003, benefits accrued to property owners have increased by almost 200% during the same period (Figure 2). In 2019-2020, $4.3 billion will be spent on the state Home Mortgage Interest Deduction alone, while only $140 million will be spent on the Renter's Credit. Although homeownership is an important policy goal,[5] tax expenditures for housing and property owners primarily benefit those who are older and wealthier.[6] For a state where 45% of people are renters, the tax code reflects little parity between homeowners and renters.

The following analysis aims to answer the question: If California were to support renters through the tax code on the same scale it does homeowners, what would that look like, and how many renters could the state help?

The Current Renter's Credit Does Not Move the Needle on Rent Burden

The Renter's Credit is a California state tax credit that reduces tax liability for qualified renters. In 2019, single filers (or married/registered domestic partners filing separately) with incomes under $49,932 were eligible for a non-refundable $60 credit. Heads of household, widowers, and joint filers with incomes under $85,864 were eligible for a non-refundable $120 credit. The credit is applied to a tax filer's liability, reducing the amount owed if the liability is greater than zero and having no impact otherwise.

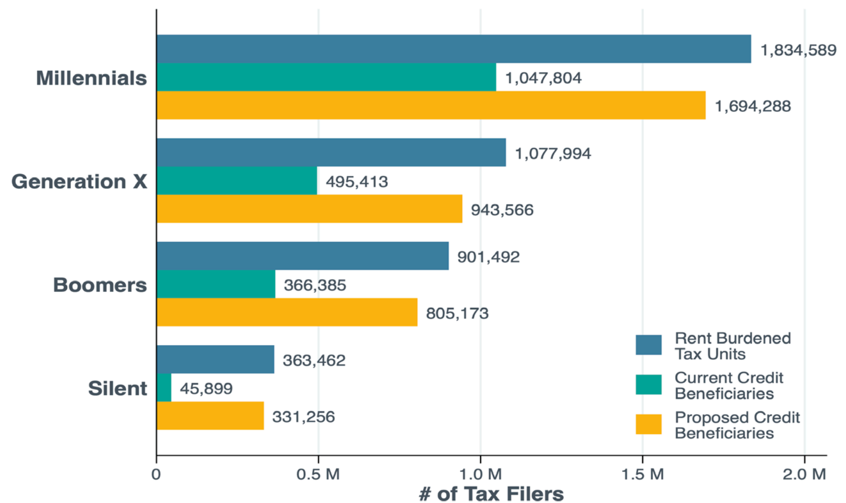
Figure 2: Spending on Tax Expenditures Related to Housing and Property Ownership



Source: Author's calculations based on IPUMS USA, University of Minnesota, www.ipums.org

Renter's Credit beneficiaries tend to be younger because the likelihood of being a renter in California decreases across the life cycle. Among taxpayers receiving the Renter's Credit, 1 million are millennials (53%), 0.5 million are Generation X (35%), 0.4 million are baby boomers (19%), and the remainder are other generations. Millennials have the highest level of Renter's Credit eligibility because they are the largest group of renters and tend to have lower incomes than older generations (Figure 3).

Figure 3: What Share of Rent-Burdened Tax Filers Qualify for the Renter's Credit?



Source: Author's calculations based on IPUMS USA, University of Minnesota, www.ipums.org

The current Renter's Credit has almost no impact on rent burden, defined here as the ratio of annual gross rent to income after taxes and transfers. By using after-tax income for the analysis, this proposal builds a clearer picture of the cash-on-hand Californians have to pay rent. In 2018, the state spent $125 million on the Renter's Credit for 1.8 million taxpayers.[7] However, at an average $70 per person, the credit only reduced the number of rent-burdened taxpayers by approximately 2,900. Moreover, many rent-burdened Californians are ineligible for the credit because it is non-refundable. This means that in order to receive any benefit, taxpayers must have a positive tax liability (in other words, they must owe taxes). While more than 1.9 million tax filers claimed the credit in 2016, another 5 million tax filers with zero or negative tax liability would have received the credit if it were refundable.

A Targeted Credit Design Could Help Millions of Californians

A Renter's Credit redesign would more directly target the credit toward those most in need of rent support. Rather than a modest, uniform credit, this design would seek to subsidize housing for those paying above 40% of post-tax income on rent. This analysis builds on a 2018 proposal by Sara Kimberlin, Laura Tach, and Christopher Wimer,[8] but makes modifications to include low-income beneficiaries and sets a maximum credit amount.

A note on our methods: To create tax filing units, we used American Community Survey (ACS) 1-year data from 2016. We calculated liabilities using Taxsim 27, a National Bureau of Economic Research tax simulator, and our estimates of overall liability and Renter's Credit eligibility are within 10% of administrative data published by the California Franchise Tax Board.

Figure 4: Maximum Credit Available for Different Renters Under the Proposed Renter's Credit

Source: Author's calculations based on IPUMS USA, University of Minnesota, www.ipums.org
Note: This benefit schedule assumes that renters are paying below Fair Market Rent for their unit size. If they were paying above Fair Market Rent for their unit size, then the credit based on FMR would supersede all other credit calculations.

The proposed Renter's Credit design has four components: a phase-in, a maximum credit amount, a phase-out, and a cap based on annual rent paid. As shown in Figure 4, the phase-in range starts at $0 of income and extends to $7,500; over that range, the annual credit rises from $2,400 to $3,000. This design ensures that low-income taxpayers, who on average owe more than $7,000 in rent,[9] receive substantial relief while offsetting potential work disincentives. From $7,500 to $30,000 in income, the credit remains at its $3,000 maximum, an amount that ensures that most people receive the credit they need to cover rental costs when they are paying above 40% of post-tax income on rent; this plateau also avoids regressive and expensive payouts to higher income groups. In this model, the credit begins to phase out at $30,000 at a rate of six cents for every dollar of income up to an eligibility threshold of $80,000, at which point potential recipients are no longer eligible (i.e. the credit is worth $0). This wide income range is intended to capture people with a variety of needs, from a restaurant worker earning just above minimum wage to a single working parent.

Unlike the current Renter's Credit, which does not respond to differential needs, this proposal includes a cap based on annual rent paid or Fair Market Rent (FMR), as suggested by Kimberlin, Tach, and Wimer. This cap ensures that the credit directly accounts for rent costs, and it discourages opportunistic behavior, such as renting otherwise unaffordable apartments. When the capped credit amount falls lower than the phase-in, maximum credit amount, or phase-out, it supersedes those amounts. The capped amount is calculated as follows:

$$\textit{Capped Credit Amount} = \min(\textit{Annual Gross Rent}, \textit{FMR}) - 0.4 * \textit{Post Tax Income}$$

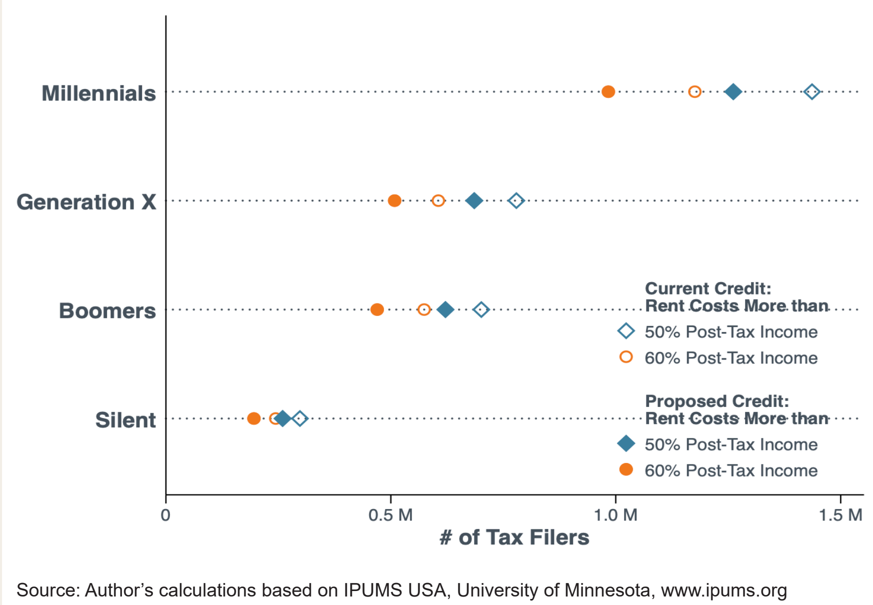
Figure 4 illustrates the maximum available credit depending on income for three different renters. If a renter paying $10,000 in annual rent earned $15,000, they would be eligible for a $3,000 credit. However, if that same renter earned $20,000, they would only receive a $2,000 credit because the credit based on their annual gross rent would override the default credit. At $20,000 in annual rent costs, a renter earning $35,000 would be eligible for a $2,700 credit while someone earning $45,000 would receive $2,000. A renter paying $30,000 in annual rent with a yearly salary of $60,000 would be eligible for a $1,200 credit. This figure assumes that all renters are paying below Fair Market Rent for their unit size. If they were paying above Fair Market Rent for their unit size, then the credit based on FMR would supersede all other credit calculations.

This proposal would provide meaningful rent support to those who need it the most. The average proposed credit would be $2,250 and would benefit almost 1.9 million more people than the current credit. At the 50% of post-tax income rent burden level, the proposed credit design would reduce the overall quantity of rent-burdened tax filers from 3.3 million to 2.9 million, an 11.9% decrease. Millennials would be the largest beneficiaries of the credit, with more than 1.7 million millennial taxpayers receiving rent support (Figure 5). Nevertheless, this redesign would tackle rent burden for Californians across the age spectrum and,

compared to the ineffectual credit available today, would provide meaningful rent support for a substantial number of Californians.

This proposed Renter's Credit would cost the state of California an estimated $8.7 billion in foregone tax revenue. While this significantly exceeds spending on the current Renter's Credit, the cost should be evaluated in the context of what the state already spends on tax credits for homeowners and other property owners. As articulated previously, state spending through the tax code on renters pales in comparison to support for homeowners (Figure 2). In 2019 alone, the state spent $14 billion in foregone tax revenue on benefits provided to homeowners, including the Home Mortgage Interest Deduction (MID).[10]

Figure 5: Fewer Californians are Rent-Burdened Under the Proposed Renter's Credit



Source: Author's calculations based on IPUMS USA, University of Minnesota, www.ipums.org

The MID, like many of the state's tax expenditures, does not include a sunset clause and is rarely reviewed for cost-effectiveness. But given the current fiscal crisis brought on by the coronavirus pandemic, as well as the ongoing housing crisis now exacerbated by that pandemic, the state should reevaluate all of its housing-related tax expenditures. In doing so, the state could take the opportunity to spread tax benefits (and burdens) more equally between homeowners and renters.

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Notes and References

[1] The unit of analysis is the tax filing unit rather than the household because the Renter's Credit is administered at the tax unit level (unless otherwise noted, all references to people, beneficiaries, or other similar terms are synonymous with the tax unit or tax filer).

[2] Public Policy Institute of California. (January 2018). California's Future: Housing. San Francisco, CA: Hans Johnson & Marisol Cuellar Mejia.

[3] Council of Economic Advisors (July 2014). America's Millennials in Recovery. Washington, DC.

[4] Rent burden is often defined as spending more than 30% of pre-tax income on rent. However, for this analysis, rent burden was defined as greater than 40% of post-tax income. Because effective tax rates vary significantly, using a post-tax measure of income provides a clearer picture of the resources available to pay rent. For background on the 30% measure, see: https://www.census.gov/housing/census/publications/who-can-afford.pdf.

[5] Research on the Home Mortgage Interest Deduction finds that it actually reduces homeownership. For more information, see: https://www.stlouisfed.org/open-vault/2018/may/why-economists-dont-like-mortgage-interest-deduction.

[6] Sommer, K. & Sullivan, P. (2018). Implications of US Tax Policy for House Prices, Rents, and Homeownership. American Economic Review, 108 (2), 241-74.

[7] California Franchise Tax Board (2019). B-4A, Adjusted Gross Income Class Comparison, All Filing Statuses. Retrieved from https://data.ftb.ca.gov/California-Personal-Income-Tax/B-4A-Adjusted-Gross-Income-Class-Comparison-All-Fi/hepm-s2cf

[8] Kimberlin, S., Tach, L., & Wimer, C. (2018). A Renter's Tax Credit to Curtail the Affordable Housing Crisis. RSF: The Russell Sage Foundation Journal of the Social Sciences 4(2), 131-160. https://www.muse.jhu.edu/article/687579.

[9] Author's calculation based on American Community Survey (ACS) 1-year data from 2016.

[10] California Department of Finance. Tax Expenditure Reports. Retrieved from http://www.dof.ca.gov/Forecasting/Economics/Tax_Expenditure_Reports/index.html