



Public policy effects on real estate - by John Rynne

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Much of the health of the real estate industry is due to government policy. It makes perfect sense that the real estate industry and the appraisal industry go hand in hand. If the real estate industry is booming or sinking, so is the appraisal industry and vice versa. With the relatively high interest rates of the past two years and the oversupply of certain segments like the office market, real estate services have been in less demand. This was certainly the case for many real estate appraisal and sales offices in upstate New York. It's hard to decipher how much is due to New York state high tax policies. However, interest rates and loan availability is generally attributed to federal policies which will be my focus in this article.

On Monday March 30th, 1981 an appraisal office was opened up in Rochester. That office was mine. It was a very significant time. Mortgage interest rates were hovering around 15.5% and later in the year peaked at 18.5%. The economy was in shambles. On that same day President Reagan who was in office for just over two months was almost assassinated. Fortunately, the President survived and his policies turned around the economy dramatically within his first term. The key was the dramatic Economic Recovery Act of 1981 (ERTA). This legislation was based upon "Supply Side" economics which was the theory that by reducing taxes in the private sector the result would be more tax revenue because the more efficient private sector would flourish. In the previous administrations, the focus was on Keynesian economics which depended on inefficient government to directly stimulate the economy on a "trickle down" basis.

One of President Reagan's chief advisors was economist Arthur Laffer, who was a big proponent of supply side economics. He was the author of the infamous Laffer Curve. The key to supply side economics was to find the "sweet spot" of tax rates which would maximize the supply of goods and services. Besides large decreases in income tax rates, ERTA also put forth tax credits, accelerated depreciation and other vehicles to move resources away from the inefficient government sector. At the same time tax revenue would increase substantially because of the rise in the Gross Domestic Product (GDP) by the more efficient private sector. It was a smashing success throughout Reagan's first term. However, certain parts of the economy, namely real estate, became oversupplied. This created serious defaults of mortgages, because many types of space couldn't be rented or sold due to oversupply. This was applied to most sectors including, but not limited to, office, multifamily, retail, residential, and industrial real estate. Fortunately, it didn't have much of a detrimental effect on the non real estate sectors of the economy.

To counteract this oversupply in the real estate sector, the Tax Reform Act (TRA) of 1986 was enacted. This increased capital gains taxes, put limits on accelerated depreciation, tax credits, etc. The appraisal industry during Reagan's first term benefited greatly and there was a real estate boom. However, this soon changed in his second term where thousands of projects throughout the country went into default due to the oversupply. This created a crisis in the lending industry because the loan principals and interest revenue were reduced. This created lender failures especially in the savings and loan sector. The government had to step in with the creation of the Resolute Trust Corp. (RTC) which took control of the real estate portfolios of failing lenders and kept watch of even the healthy lenders. They began a program to have all commercial and subdivision loans to have

current appraisals. This created a boom especially in the appraisal industry through, not only in George H. W. Bush's four year term which ended in January, 1993, but also in the early part Bill Clinton's first term. So the appraisal industry had a golden 10 year period, due to both feast and famine of the real estate industry. However, for most of the Clinton presidency the real estate appraisal industry struggled, except for the early parts of his administration. Although part of this struggle was the hangover of the oversupply of general real estate which occurred due to ERTA of the Reagan administration a decade earlier.

As a former Democrat now independent it may be anecdotal or an anomaly that my experience in upstate New York since 1981 is that we had our best years under Republican administrations due to their embrace of supply side economics. Based upon this trend the real estate industry should be optimistic about the incoming Washington, DC administration.

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