An Analysis of Extending New Jersey's Sales and Use Tax to Seasonal Home Rentals

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INTRODUCTION

Through its predecessor companies, Wharton Econometrics (WEFA), and Data Resources (DRI), Global Insight founded the modern economic forecasting industry more than 40 years ago. Always a leader in modeling and forecasting, Global Insight has combined its analytical capabilities with the deep experience of industry professionals to provide unparalleled coverage in autos, energy, agriculture, steel, telecommunications, trade, tourism, healthcare, construction, and many others. Our 325+ professional analysts, researchers, and economists on our staff of 600 employees bring expertise spanning approximately 170 industries and over 200 countries. We collect and monitor data, provide forecasts and analysis, and offer consulting advice to our clients in business, financial, and government organizations around the world.

In this report we analyze the market for seasonal rental properties in New Jersey. We describe how seasonal rental units contribute to local economies and the overall state economy. We further analyze the potential economic impact of an extension of the state sales tax to seasonal rentals, presenting our findings of the impacts seasonal rentals, and the local and state economy.

THE SURVEY

Global Insight surveyed REALTORS® in the state of New Jersey regarding various aspects of seasonal rental units they have listed in five specific counties: Atlantic, Cape May, Monmouth, Ocean, and Sussex. The respondents were asked questions about the renters of the seasonal units: whether or not they had a permanent residence in New Jersey, and if they did, in which county did they reside; how long the typical renter stayed; and whether or not they were repeat renters. They were also asked questions about the seasonal rental units themselves: how many they had listed in each county; and what the rental and vacancy rates were for the listed units over several years.

Renters

The survey response rate was 10%, and based on the responses received, nearly 43% of the seasonal renters have a permanent residence in the state of New Jersey. A large portion of the renters that live in New Jersey, nearly 42%, reside in five counties: Bergen, Burlington, Camden, Hudson, and Middlesex. Pennsylvania is the largest supplier of seasonal renters coming from outside of the state, representing 31% of seasonal renters. Nearly all of these seasonal renters come to the shore for one week and they come with their families. More than half of the seasonal renters are repeat customers who have been returning to the shore for between 2-5 years.

Rental Units

The number of units reported by the survey respondents, 7,840, represents approximately 7.2% of the 109,075 total seasonal rental units, which Global Insight's Travel and Tourism Service estimates are in the state. The seasonal rental units in the sample were concentrated in two counties: Cape May (5,714), and Ocean (1,897). This is a close representation of the overall seasonal rental unit market in the state, where nearly 70% of total seasonal rental units are located in the two counties. The number of seasonal rental units in the sample for the two counties represents approximately 10% of the total units in those two counties. We restrict our analysis of the survey results to those two counties, the only two for which the response rate was statistically significant.

Table 1 below summarizes the survey findings regarding rental and vacancy rates in Cape May and Ocean counties.

TABLE 1

		2002	2003	2004	2005	2006
Cape May	Peak Weekly Rental Rate	$2,501	$2,597	$2,737	$2,758	$2,768
	Y/Y Percent Change (%)		*3.8*	*5.4*	*0.8*	*0.4*
	Peak Vacancy Rate (%)	11.2	11.0	10.8	11.1	13.0
	Off-Peak Weekly Rental Rate	$1,249	$1,240	$1,342	$1,403	$1,318
	Y/Y Percent Change (%)		*-0.7*	*8.2*	*4.5*	*-6.1*
Ocean	Peak Weekly Rental Rate	$1,695	$1,746	$1,792	$1,833	$1,902
	Y/Y Percent Change (%)		*3.0*	*2.6*	*2.3*	*3.8*
	Peak Vacancy Rate (%)	9.5	13.4	13.0	13.5	15.8
	Off-Peak Weekly Rental Rate	$1,258	$1,254	$1,289	$1,268	$1,345
	Y/Y Percent Change (%)		*-0.3*	*2.8*	*-1.6*	*6.1*

In both counties, weekly rental rates during the peak season, which is June through August, have been increasing in the years since 2002, although in Cape May the rate of increase has slowed in 2005 and 2006. The peak season vacancy increased by nearly two percentage points in both counties in 2006. One possible economic reason for this increase in vacancy rates was the large increase in gasoline costs that was seen across the nation. This increase in gasoline costs meant both increased driving costs to the shore, and that there was less disposable income available to be spent on other "luxury" items, such as vacations, and therefore lower rental demand. In previous work Global Insight has computed that the average increase in annual gasoline costs during this period was approximately $465.

Other economic conditions may have also played a role in the slower rental market in 2006. The two largest providers of seasonal renters, New Jersey and Pennsylvania, have seen continued improvements in employment since 2002, and in 2002 and 2003 each had growth that was above the national level. Beginning in 2004, though, job growth, especially in New Jersey, fell below that seen in the nation, and remains well below national levels. This slowing of growth in these states may also have contributed to lower rental demand in Cape May and Ocean counties. Moreover, employment growth in 2006 slowed significantly in those New Jersey counties that have the highest proportion (based on survey results) of seasonal renters.

A slowing housing market may also have contributed to a slower rental market in 2006. In the housing boom years, many people were using the built up equity in their homes as a means of financing consumer spending. As the housing market slowed, people began to curtail some of this spending, resulting in less income available for vacations. In New Jersey especially, but also in Pennsylvania, home price appreciation slowed considerably between 2005 and 2006, mirroring a nationwide trend.

THE ECONOMIC CONTRIBUTION OF THE SEASONAL RENTAL INDUSTRY

The seasonal rental industry in New Jersey makes a significant economic contribution to the New Jersey economy. Here "economic contribution" refers to the amount of jobs, earnings and output that are generated via the seasonal rental industry. The first segment of the economic contribution comes from the direct spending of renters on rental units and the associated local spending of the visiting renters. The direct spending upon rental units flows through the New Jersey economy through the property owner's income as well as the cost components such as construction, maintenance, and upkeep expenditures. The visitor's spending flows through the local economy through transportation expenditures, and local spending on food, dining, shopping, and entertainment. These expenditures then ripple through the economy to generate jobs, output, and earnings.

The economic contribution measures the impact of seasonal rental units on the New Jersey economy, and the local economies of Cape May and Ocean counties. Visitor spending on rental units and otherwise contributes to the demand for goods and services produced by the local and regional economy. Our economic models estimate the total impact on economic activity in all sectors produced by these expenditures. These models recognize that some fraction of the incomes generated is sent out-of-state to non-resident property owners, to out-of-state suppliers, or as other out-of-state spending. The contributions of seasonal renters, via rental expenditures and visitor spending, to regional economic activity levels are presented for employment, output, and total earnings. The direct impacts (e.g., renters' spending on seasonal rental units), indirect impacts (e.g., purchases of inputs by the local businesses who supply the seasonal rental industry), induced impacts (e.g., local spending of workers and other earnings generated by the direct and indirect activity), and total impacts are presented for each of these measures.

Cape May, 43,124 units, and Ocean County, 33,200 units, make up 70 percent of all seasonal homes in New Jersey. Leisure and hospitality employment in Cape May exceeded 10,200 workers in 2005, while Ocean County employed over 17,000 workers in the sector. The state's leisure and hospitality services sector employs over 338,000 workers and contributes $15.4 billion to the state's output. According to our survey, Cape May County and Ocean County have average weekly rental rates of $2,767 and $1,902, respectively, during peak rental season. Tables 2, 3, and 4 indicate the impact of seasonal rental units upon New Jersey, Cape May and Ocean counties.

Seasonal rental expenditures were calculated using data from our survey in conjunction with existing Global Insight data. Rental expenditures were calculated by multiplying the average peak weekly rental rate for a given area (i.e. Cape May County) times the number of peak rental properties. That number is then multiplied times 12 weeks (the peak season) and one minus the peak vacancy rate from our survey. The rental expenditures number is then broken down into maintenance expenditures and landlord income. Those numbers are inputted into the economic impact model which calculates the final impacts. Visitor spending data was computed by multiplying the peak visitor stay times the average peak spending per stay for several categories (food, transportation, shopping and entertainment). The expenditures for the categories were also inputted into the economic impact software in order to obtain the final impacts.

TABLE 2

Seasonal Rental Impacts On New Jersey (2006$)	
Employment	
Direct	37,215
Indirect	6,960
Induced	9,090
Total	53,265
Labor Income	
Employee Comp.	$ 1,715,020,413
Proprietor's Income	$ 277,496,697
Total Earnings	$ 1,992,517,110
Output	
Direct	$ 5,195,728,626
Indirect	$ 996,789,455
Induced	$ 1,218,466,624
Total	$ 7,410,984,705

Table 2 shows the total impact of seasonal rental units (both rental expenditures and visitor spending) upon the New Jersey economy. Seasonal tourism infuses a direct expenditure of $5.1 billion into the New Jersey economy. This impact results directly in 37,215 jobs, with and additional 16,050 positions being indirect and induced. Total earnings are calculated at nearly $2.0 billion. In addition, seasonal rental units contribute $7.4 billion in output to New Jersey.

An examination of the components (rental expenditures and visitor spending) tells a more complete story. Expenditures on rental units totaled $2.7 billion in 2006. This direct expenditure and, with its indirect and induced impacts on the New Jersey economy, generated 12,052 total jobs. Indirect and induced jobs totaled 3,929 positions. The resulting total earnings were $509.3 million dollars. The bulk of total earnings came from employee compensation, which totaled $433.9 million.

In addition, in 2006 visitor spending of $2.4 billion accounted for an impact of 41,213 total jobs. Approximately 25 percent (10,386 jobs) of the total employment impact is located in the food and beverage sector. Entertainment (amusement, gambling and other recreation) accounted for the next largest impact of 7,278 positions. Shopping (general merchandise stores) and gas stations result in the final two significant impacts, producing 6,552 jobs and 5,525 jobs, respectively. Of the total job impact, 12,121 jobs were indirect and induced. The visitor spending job impact represents 8.6% of New Jersey's total employment impact that is attributed to the state's tourism industry. Total earning was $1.8 billion. The corresponding output was $4.0 billion, with $1.7 billion coming from indirect and induced output.

TABLE 3

Seasonal Rental Impacts On Cape May County (2006$)	
Employment	
Direct	17,517
Indirect	2,379
Induced	2,638
Total	22,534
Labor Income	
Employee Comp.	$ 548,255,368
Proprietor's Income	$ 113,681,156
Total Earnings	$ 661,936,524
Output	
Direct	$2,247,800,845
Indirect	$ 259,786,043
Induced	$ 279,842,236
Total	$2,787,429,123

Table 3 shows the total impact of seasonal rental units (both rental expenditures and visitor spending) upon the Cape May County economy. The total direct expenditures of $2.2 billion is injected into the Cape May County economy. This impact results directly in 17,517 jobs, with an additional 5,017 positions being indirect and induced. Total earnings are calculated at $661.9 million, with $548.3 million coming via employee compensation. Finally, seasonal rental units contribute $2.8 billion in output to Cape May County. The rental expenditure and visitor spending impacts are distinguished in the paragraphs below.

In Cape May County, the direct seasonal rental expenditure of $1.2 billion accounted for 5,622 total jobs, with 1,424 jobs stemming from indirect and induced activities. Total earning totaled $189.8 million. Total output in Cape May was $1.46 billion. Indirect and induced output in Cape May summed to $142.6 million in 2006.

In addition, in Cape May County visitor spending totaled $949.2 million, contributing 16,912 jobs to the economy. Similar to the state, 26 percent (4,487 jobs) of the total employment impact is located in the food and beverage sector. Shopping (general merchandise stores) produced the next largest impact and contributed 3,229 jobs. Gas stations and entertainment (amusement, gambling and other recreation) added 2,671 jobs and 3,147 jobs, respectively. Visitor's spending was also responsible for $472.2 million in total earning in Cape May County. The associated output totaled $1.3 billion.

TABLE 4

Seasonal Rental Impacts On Ocean County (2006$)		
Employment		
Direct		12,393
Indirect		1,658
Induced		1,833
Total		15,884
Labor Income		
Employee Comp.	$	383,332,640
Proprietor's Income	$	76,935,793
Total Earnings	$	460,268,433
Output		
Direct	$	1,389,652,251
Indirect	$	183,822,520
Induced	$	194,499,851
Total	$	1,767,974,622

Table 4 shows the total impact of seasonal rental units (both rental expenditures and visitor spending) upon the Ocean County economy. The total direct expenditures of $1.4 billion is injected into the Ocean County economy. This impact results directly in 12,393 jobs, with an additional 3,491 positions being indirect and induced. Total earnings are calculated at $460.3 million, with $383.3 million coming via employee compensation. Finally, seasonal rental units contribute $1.8 billion in output to Ocean County. The rental expenditure and visitor spending impacts are discussed below.

Ocean County's direct seasonal rental expenditures of $637.8 million accounted for an impact of 2,876 total jobs. Of that total, 728 jobs were indirect and induced. Total earning was $97.1 million. The corresponding output was $747.3 million, with $72.9 million coming from indirect and induced output.

In addition, in Ocean County visitor spending of $730.8 million in 2006 contributed 13,008 jobs to the economy. Over 26 percent (3,448 jobs) of the total employment impact is located in the food and beverage sector. Shopping (general merchandise stores) produced the next largest impact and contributed 2,486 jobs. Gas stations and entertainment (amusement, gambling and other recreation) added 2,047 jobs and 2,423 jobs, respectively. Visitor's spending was also responsible for $363.1 million in total earning in Ocean County. The associated output totaled $1.0 billion.

ECONOMIC IMPACT OF A SALES TAX ON RENTALS

There has been some interest in New Jersey in extending the 7% state sales tax to seasonal rental units. In this section we consider the impacts of such an imposition, and extensively examine two scenarios: one in which the property owner shoulders the full tax increase and there is no increase in rental rates; and one in which the sales tax is fully passed on to renters, increasing their true cost for the seasonal unit by 7%.

The economic theory of sales tax incidence is well established, and governed by the well known principles of supply and demand. An imposed tax reduces the demand for a good or service (in this case, rentals), by the same amount that would result from a 7% rent increase. In order to continue to sell the same amount of the product (here to maintain rental occupancy) owners would have to reduce their rents by 7%. On the other hand, if sellers owners are unwilling to accept that they can keep rents higher by accepting higher vacancy rates. The resulting outcome, or equilibrium, of supply and demand, in any such market will be determined by the relative elasticities of supply and demand. At the other extreme, rental demand may be inelastic so that renters are willing to pay the additional 7% tax and continue to rent the properties.

These are the two scenarios we present economic impact results for. The actual case is somewhere in between, but we find the resulting range of economic impacts to be instructive. The survey results do hint of the likely magnitude of the reaction. A 7% increase in weekly rental rates would result in an increased cost to renters of $180, on average. This rental rate increase is 39% of the 2006 gasoline cost increase we noted in 2005-2006. Thus the impact of the rental increase on consumers is not as large of a factor as the increase in gasoline costs. During that period rental rate increases slowed and vacancy rates increased. If we assume that the gas increase alone led to the two percentage point increase in vacancy, then a rental increase alone would lead to an increase in vacancy rate of 0.8 percentage points, and a decline in rents of 2.4%.

When the owner is assumed to bear the entire burden of the tax, not passing any of it on to the renter, this will reduce their income from the rental units. This, by itself, should have little impact on vacancy rates in the short run. Ultimately as the income generating capacity of rental properties is reduced, investment in property would be expected to decline. This would also immediately reduce overall spending in the state to the extent that the property owners are New Jersey residents. They would have less income to spend, and lower spending could have an effect on the overall state economy. That impact is detailed below.

If the full, tax included, rental rates do increase, there is then the potential for renters to venture to other "shore" locations in Delaware or elsewhere. This movement away from the New Jersey market would reduce spending and lower economic activity in the state and shore counties. We also detail that impact below.

ECONOMIC IMPACT RESULTS

The first tax scenario (Owner Incidence) shows the impact of seasonal rental units on the same areas, assuming that the owners of the rental properties bore the entire burden of the proposed sales tax. That is, rents were unaffected so renters saw no increase in costs including taxes. Tables 5 and 6 indicate the results for the state and the two counties.

TABLE 5

Owner Incidence Impact On New Jersey	
Employment	
Direct	(117)
Indirect	(33)
Induced	(41)
Total	(191)
Labor Income	
Employee Comp.	$(7,926,011)
Proprietor's Income	$(1,056,867)
Total Earnings	$(8,982,878)
Output	
Direct	$(165,987,112)
Indirect	$(5,085,355)
Induced	$(5,482,950)
Total	$(176,555,417)

Direct rental expenditures are reduced to $2.5 billion. This is projected to reduce employment by 191 jobs in the state. In this case, total earnings would fall by $9.0 million and output would fall by $176.6 million.

TABLE 6

Owner Incidence Impacts On Cape May And Ocean County: (2006$)			
Cape May County Impacts			
Cape May County		**Ocean County**	
Employment		**Employment**	
Direct	(65)	Direct	(33)
Indirect	(11)	Indirect	(5)
Induced	(11)	Induced	(5)
Total	(87)	Total	(43)
Labor Income		**Labor Income**	
Employee Comp.	$(2,485,035)	Employee Comp.	$(1,271,788)
Proprietor's Income	$(432,653)	Proprietor's Income	$(221,422)
Total Earnings	$(2,917,688)	Total Earnings	$(1,493,210)
Output		**Output**	
Direct	$ (76,857,198)	Direct	$(39,333,713)
Indirect	$(1,225,353)	Indirect	$(627,115)
Induced	$(1,230,751)	Induced	$(629,870)
Total	$(79,313,302)	Total	$(40,590,698)

In the Owner Incidence scenario for Cape May County, the direct seasonal rental expenditures would be reduced to $1.1 billion. This would result in a loss of employment totaling 87 workers. Total earnings will be reduced by $2.9 million and the county's output is projected to fall by $79.3 million.

In Ocean County the direct seasonal rental expenditure would decrease to $600.6 million. This would result in the loss of 43 jobs produced. In addition, total earnings would fall by $1.5 million (with $1.3 million of the decrease coming from employee compensation). The county's output will shrink by $40.6 million.

TABLE 7

Renter Incidence Impact On New Jersey (2006)	
Employment	
Direct	(2,283)
Indirect	(421)
Induced	(531)
Total	(3,235)
Labor Income	
Employee Comp.	$(100,528,411)
Proprietor's Income	$(15,861,214)
Total Earnings	$(116,389,625)
Output	
Direct	$(184,429,910)
Indirect	$(60,710,822)
Induced	$(71,156,292)
Total	$(316,297,025)

The Renter Incidence scenario for New Jersey (Table 7) shows that the declines in visitor spending would result in 3,235 fewer jobs after a tax imposition. Total earnings would be $116.4 million lower than in the baseline.

The reduction in total output for the state of $316.3 million has the potential to reduce purchasing power in the areas where those renters permanently reside. Nearly 43% of seasonal renters live in the state of New Jersey, and they mainly come from five counties: Bergen, Burlington, Camden, Hudson, and Middlesex. These counties would see reduced local spending as a result of a decline in other disposable income following higher shore rental rates. The five main counties will see the following declines in purchasing power, for a total of $56.6 million:

Bergen: $14.1 million
Burlington: $12.5 million
Hudson: $11.6 million
Middlesex: $10.5 million
Camden: $7.9 million

TABLE 8

Renter Incidence Impacts On Cape May And Ocean County: (2006)			
Cape May County		**Ocean County**	
Employment		**Employment**	
Direct	(943)	Direct	(717)
Indirect	(122)	Indirect	(92)
Induced	(134)	Induced	(101)
Total	(1,199)	Total	(910)
Labor Income		**Labor Income**	
Employee Comp.	$(28,227,741)	Employee Comp.	$(21,487,937)
Proprietor's Income	$(5,252,868)	Proprietor's Income	$(3,931,946)
Total Earnings	$(33,480,610)	Total Earnings	$(25,419,882)
Output		**Output**	
Direct		Direct	$(50,075,191)
Indirect	$(66,100,677)	Indirect	$(10,644,540)
Induced	$(14,039,240)	Induced	$(10,729,201)
Total	$(14,134,443)	Total	$(71,448,932)

Under the Renter Incident scenario in Table 8, Cape May employment would fall by 1,199 positions. The decreased visitor spending would also reduce total earnings by $33.5 million and total output by $94.3 million. In Ocean county, employment would fall by 910 positions. The decreased visitor spending would also reduce total earnings by $25.4 million and total output by $71.4 million.

CONCLUSION

The seasonal rental industry contributes $7.4 billion to the NJ economy. A proposed 7% tax on seasonal rental units would have varying impacts depending on how the tax is distributed between property owners and renters. There is a lower bound, which is described by the scenario of the property owner bearing the full burden of the rental tax. The impact is relatively low under this scenario because only the owners are affected by the tax. It is their rental profit that is directly impacted. And, profits tend to have lower multipliers than other expenditures. The upper bound occurs if renters bear the full burden of the tax by way of a 7% increase in their full rental cost. In this case, visitor spending in the state of New Jersey on food, transportation, shopping and entertainment will be affected to a much larger degree.

The effects of the tax on the state of New Jersey will fall within these two bounds depending on how the tax is distributed between the property owners and the renters. In terms of employment, jobs lost due to the imposition of the tax will range up to 3,235 jobs. Total earnings will decline by up to $116.4 million as employment declines because spending is reduced to accommodate the tax increase.