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FISCAL IMPACT REPORT

ORIGINAL DATE 1/26/15

SPONSOR Egolf LAST UPDATED _____ HB 113

SHORT TITLE Tax Credit for Energy-Efficient Homes SB _____

ANALYST Graeser

REVENUE (dollars in thousands)

Housing Exhibit

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
	(\$6,400.0)	(\$6,400.0)	(\$6,400.0)	(\$6,400.0)	Recurring	General Fund

(Parenthesis () indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		\$70.0	\$70.0	\$140.0	R*	General Fund

(Parenthesis () indicate expenditure decreases

[*] The Sustainable Building Credit expires in FY 2016. This proposed credit is effective July 1, 2015. During the overlap period, EMNRD will need an additional FTE. However, when the Sustainable Building Credit expires, this new credit will have approximately double the applications of the predecessor credit.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Energy Minerals and Natural Resources Department (EMNRD)

SUMMARY

Synopsis of Bill

House Bill 113 creates a new “Energy Efficient Home Tax Credit.” The purpose is to encourage New Mexico taxpayers to build energy efficient homes and to purchase foreclosed homes renovated to high-efficiency standards. The tax credit ranges from \$4 to \$8 thousand, with the higher amounts awarded to homes with a HERS index of zero, or 100 percent energy reduction attributed to the renovation of a foreclosed home. A certified Home Energy Rating System index rater tests the new building after construction and the renovated home before and after renovation. EMNRD is required to issue a certificate, similar to the solar photovoltaic certificate. The homeowner/taxpayer submits this certificate to the Taxation and Revenue Department

(TRD) with the annual Personal Income Tax filing. The credit is refundable, in case it exceeds a taxpayer's liability for the year. The credit is not transferable, nor can it be carried forward. Only homes with a HERS rating of 60 are eligible for this credit. (This means that the new home must be 40 percent more efficient than the average new home built in the US. The minimum improvement for a renovated foreclosed home is 40 percent reduction, but the renovated home is not required to achieve any particular level of HERS rating after renovation.)

The effective date of the act is July 1, 2015. There is a sunset date of June 30, 2018. Single family homes that begin construction before June 30, 2018 are eligible for the credit even if the construction is not completed by the sunset date.

FISCAL IMPLICATIONS

This bill may be counter to the LFC tax policy principles of adequacy, efficiency, accountability and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations. Estimating the cost of tax expenditures is difficult. This bill contains an implied consent provision. Accepting the credit (section 1K) is authorization for TRD to reveal to the legislature sufficient information to allow a determination of the effectiveness of the credit.

EMNRD points out that a similar credit – the sustainable building tax credit – is capped at \$4 million for residential buildings each year; this residential credit is currently fully subscribed through its expiration at the end of 2016. This credit is not capped, and it is refundable, so will likely exceed the sustainable building tax credit. The \$6 million estimated annual general fund impact in the table expects that refundability and absence of a cap will cost the general fund 150 percent of the sustainable building tax credit amount. EMNRD has experienced applications for the non-refundable credit in excess of \$6 million for several years.

According to CoreLogic¹, 2.3 percent of New Mexico homes were in foreclosure at the end of CY 2013. 2,747 New Mexico homes were foreclosed in the 12 months of CY 2013. This rate has fallen somewhat, but the foreclosure inventory is still in the vicinity of 2 percent of the total owned homes in the State.

The US Census Bureau² estimates approximately 476,000 single family detached homes in the state in 2000 and 388,000 in 1990. Single family attached townhomes total about 36,000. For the purposes of estimating, assume about 13,000 homes are in the foreclosure inventory. Further assume about 10 percent of these homes will be purchased by “flippers” who will elect to renovate to the HERS 40 percent reduction level. Reducing the inventory to zero will take a number of years. Assume, therefore, that 250 homes per year are eligible for the renovation credit at the \$4,000 level.

In addition, there will be an additional 1,000 new homes per year built to the HERS 60 rating standard, 200 to the HERS 30 standard, and 20 to the HERS 0 standard.

The increase of up to 1,500 in the number of certifications demanded of EMNRD may require and additional FTE. EMNRD expects to add one FTE.

¹ <http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-january-2014.pdf>

² <https://www.census.gov/hhes/www/housing/census/historic/units.html>

SIGNIFICANT ISSUES

This credit bears no relationship to the actual additional cost to achieve a HERS 60, 30 or 0 rating for new construction or a reduction of 40 percent, 70 percent or 100 percent in energy consumption for renovation. With the popular solar credits (30 percent federal and 10 percent state), the credit is directly related to the cost of the installation. This makes the calculation of return on investment known (or at least accurately estimated) at the time the decision to utilize the credit is made. The experience with the solar credit is that some homeowners will install solar when the pay-off period is around 10 or 11 years or less, but will not install if the return period is greater. Since this proposed credit is not tied to the cost of the renovations or additional cost of the new construction, it will be difficult to calculate the economic benefits of this credit to either purchasers of renovated homes or homeowners building a new home.

We can estimate the economics for a typical new home or a renovated home. The average new energy-efficient home built to a HERS 60 standard will save \$95 per month compared to an average 1,500 square foot home. In ten years, this is a total energy savings of \$11,400. This is a greater return than the \$4,000 proposed credit. The total additional costs to achieve this HERS rating could be a 20 percent increase in cost for more efficient doors and windows and additional wall and ceiling insulation. These costs might add \$10 per square foot to the typical \$140/square foot to \$180/square foot custom construction or \$120/square foot tract developer home. Thus, this calculation implies that the payoff period is on the same order of the payoff period for solar photovoltaics.

While this credit will reduce a homeowner's state personal income tax, it will increase that person's federal tax liability if the homeowner itemizes deductions. Because New Mexico no longer allows a deduction for state income taxes paid, this feedback will not affect the homeowner's Personal Income Tax liability in addition to the energy credit.

The level of energy reduction for renovated foreclosed homes may not be an efficient use of scarce State resources. The US Department of Energy estimates that the average existing home scores 130 on the HERS index. A 40 percent reduction in HERS index yields an after-renovation HERS of 90. Compared to a minimum reduction from the typical construction standard of 60 for the same \$4,000 credit, this renovation credit costs the state \$4,000 for a 10% reduction from typical new construction. <http://www.resnet.us/hers-index>

The U.S. Department of Energy has determined that a typical resale home scores 130 on the HERS Index while a standard new home is awarded a rating of 100.

- A home with a HERS Index Score of 70 is 30 percent more energy efficient than a standard new home
- A home with a HERS Index Score of 130 is 30 percent less energy efficient than a standard new home

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met since TRD is permitted and required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

See above. One additional FTE at EMNRD will be required to process the additional applications for credit.

TECHNICAL ISSUES

EMNRD suggests replacing the reference to the 2004 International Energy Conservation Code with the 2009 or with the version adopted in State regulation at 14.7.6 NMAC.

On page 5, line4, the bill should read “Married individuals” instead of “A husband and wife.”

OTHER SUBSTANTIVE ISSUES

This bill, as with virtually all tax credit bills, fails the essential LFC tax policy principles, as listed below.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy:** Revenue should be adequate to fund needed government services.
2. **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity:** Different taxpayers should be treated fairly.
4. **Simplicity:** Collection should be simple and easily understood.
5. **Accountability:** Preferences should be easy to monitor and evaluate

This bill does have an innovative feature. Accepting the credit is an implied consent to waive confidentiality and allow TRD to provide aggregate data to the legislature regarding the utilization and cost of the credit.

EMNRD has moved into the arena of determining the effectiveness of the renewable energy production credit by putting a request for proposal on the street to study the energy and economic impacts of this commercial credit. Although a draft report has been delivered pursuant to the contract, it is, apparently, not ready for release.

LFC staff suggest that EMNRD study the energy and economic impacts of the sustainable building tax credit before the legislature enacts this successor credit. Such a study could also be modified to embrace the provisions of this proposed credit. Because of the heavy oversubscription of the sustainable building tax credit, it is not unlikely that a proper study will show that the economics of building energy-efficient buildings are sufficiently attractive that the tax credit will have only marginal impact on the number of buildings built to at least a HERS 60 standard. This study should quantify the payback period for typical insulation, fenestration and highly efficient heating and cooling systems. If this period is around 10 years without the credit, then the additional stimulus from the proposed credit will be minimal.

ALTERNATIVES

The LFC staff strongly advises that a cap be placed on this credit. There are substantial uncertainties in the estimate of take-up for this credit. This uncertainty should be addressed in a similar manner to some of the other energy credits enacted over the last few years.

The standard for renovated foreclosed homes could be expressed in the same terms as for new construction. This would put the efficiency of the credit for foreclosed homes on the same basis as for new construction.

Comparison of HERS Rating to Utility Costs

A HERS Rating is a measure of energy use in a home. This chart reflects the typical monthly utility bill on an 1800 sq. ft. home with a full basement compared to that home's HERS Rating. The lower the HERS Rating, the more energy efficient the home. The savings really add up!

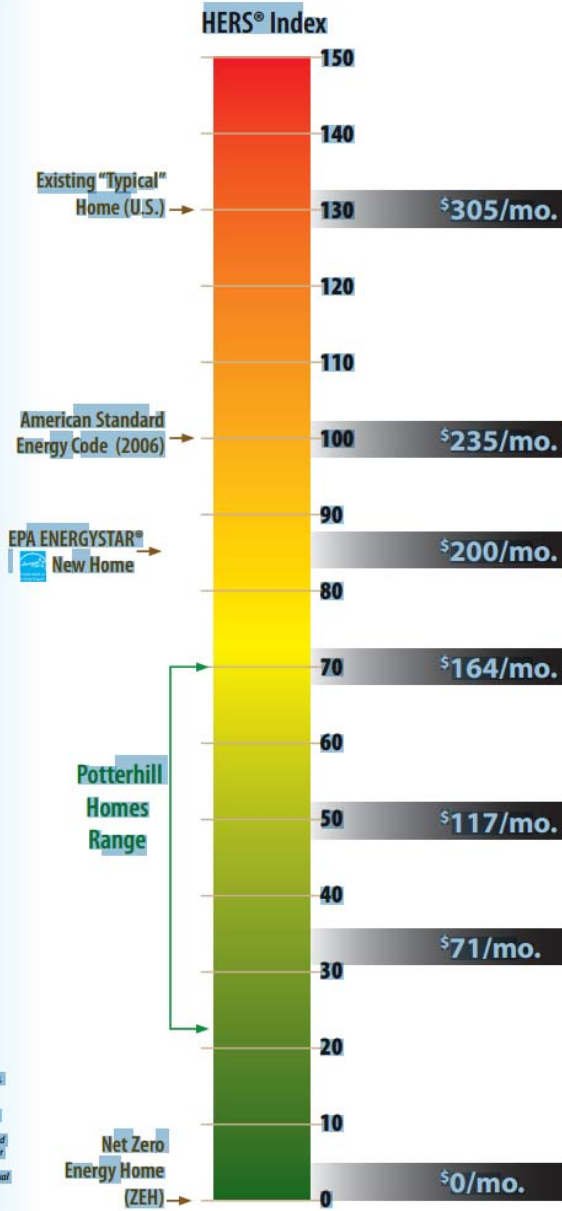


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*Utility costs and HERS Ratings can and will be managed separately.

The information provided in this brochure is based upon assumptions and information provided by reputable sources, including the National Weather Service, the US Energy Information Service (annual electric utility data) as well as private entities such as RESNET (HERS rating methodology) which are not affiliated with Potterhill Homes. The estimated energy costs and savings take into account typical usage and costs at a given point in time for a specific model of home in a specific location. Actual energy costs will vary and will depend on many variable factors and a change in any of these variables or assumptions could result in reduced savings or higher energy costs. Such variables include, but are not limited to, homeowner behavior, actual utility usage and consumption, the fluctuating cost of energy, actual weather conditions, and home and equipment maintenance over time. Potterhill Homes does not guarantee or warrant actual energy costs or cost savings.



<http://www.hersindex.com/wp-content/uploads/HERS-vs-UTILITY-COSTS.pdf>

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