F I S C A L   I M P A C T   R E P O R T

SPONSOR SFC **ORIGINAL DATE** 3/12/15 **LAST UPDATED** 3/17/15 **HB**

SHORT TITLE Sustainable Building Tax Credits **SB** 279/SFCS

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recur. or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18**	**FY19**		
	($0.0)	($0.0)	($5,000.0)	($5,000.0)	Recurring	General Fund – PIT and CIT

(Parenthesis ( ) indicate revenue decreases

Note: although the revenue impact is shown above at its statutory maximum (capped) amount, it may be claimed over a period of years because the credits are not refundable and some amounts are payout limited (the 25% rule). However, since the provisions of the new law are very similar to those of the current law, the rollovers and limitations of current law coupled with the current proposal will have the effect as shown.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	0.0	0.0	80.0	80.0	Recurring	EMNRD Operating

Parenthesis ( ) indicate expenditure decreases

EMNRD estimates 1 FTE to revise the qualification rules and to approve applications. The bill replaces the existing credit with a new, but very similar one effective January 1, 2017. EMNRD's workload is likely to remain relatively static. TRD also reports an administrative impact – primarily to change forms and instructions. See Administrative Impacts below.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
Energy, Minerals and Natural Resources Department (EMNRD)

Response not Received from
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Finance Committee Substitute for Senate Bill 279 proposes extensive changes to the Sustainable Building Tax Credit, first enacted in 2007, and significantly amended in Laws 2013, Ch. 92.

- Allows the current sunset to take effect. Projects must have been completed by the end of CY 2016 and certified within 2016's $5,000,000 cap.
- The existing 7-2-18.19 NMSA 1978 is not repealed. Projects certified under the provisions of current law will continue to be claimed pursuant to existing provisions. Thus projects whose payouts conform to the 25% rule will continue as current law. Because the provisions of the new sustainable building tax credit are sufficiently similar to the old provisions, most projects built prior to December 31, 2016, but not certified because of the 2016 cap will be eligible for certification pursuant to the new provisions.
- These credits will be based (as the current credits) on the Leadership in Energy Development (LEED) or Build Green New Mexico classifications and certification levels. The tax credits per square foot for commercial projects are the same as in current law and range from as much as $6.25 per square foot for the first 10,000 square feet of a project rated LEED-NC Platinum to a minimum of $.30 per square foot for LEED-CI Silver projects of 50,000 to 500,000 square feet.
- Tax credits per square foot for residential projects are reduced by about 40% from current law and range from as much as $6.50 per square foot for LEED H Platinum or Build Green NM Emerald to a minimum of $3.00 per square foot for LEED-H Silver or Build-Green NM Silver. In all cases, the maximum creditable square footage has been reduced from 3,000 square feet to 2,000 square feet:

	Qualified Occupied Square Footage Tax Credit per Square Foot	7-2-18.19 NMSA 1978	CS/SB-279
Residential Credit			
LEED-H Silver or Build Green NM Silver			
	First 2,000 square feet	$5.00	$3.00
	Next 1,000 square feet	$2.50	$0.00
LEED-H Gold or Build Green NM Gold			
	First 2,000 square feet	$6.85	$4.50
	Next 1,000 square feet	$3.40	$0.00
LEED-H Platinum or Build Green NM Emerald			
	First 2,000 square feet	$9.00	$6.50
	Next 1,000 square feet	$4.45	$0.00
Manufactured Housing			
	First 2,000 square feet	$3.00	$3.00
	Next 1,000 square feet	$3.00	$0.00

- Requires a three-part test for certification: (1) LEED or BuildGreen NM silver, gold, platinum or emerald specifications; (2) a HERS (Home Energy Reduction Standard) rating of 60 or less; and (3) low-flow internal water fixtures and some drip irrigation if appropriate.
- The credit is similarly limited to $25,000 per year or 25 percent of the approved credit,

whichever is more. The credit is not refundable, but may be carried forward for 7 years.

- The bill retains the total $5,000,000 cap, but reallocates this total among residential, commercial and manufactured homes. The commercial cap increases from $1 million to $1.25 million; the manufactured housing cap decreases from a maximum $1.25 million to a fixed $375,000; the residential cap increases from a minimum of $2.25 million to a fixed $3.375 million. EMNRD is allowed to shift any unused credit among the three categories.
- Credits for a single individual or corporation who completes multiple projects in the course of a year will be applied and limited based on each project, not on the total credits approved for all projects. (This reverses a provision of Laws 2013, ch. 92, § 1).
- Retains the provision that a project eligible for a solar market development tax credit (7-2-18.14 NMSA 1978) is not eligible for this credit unless the solar market development credit has not been claimed and will not be claimed.
- Retains requirement for eligibility for manufactured housing to be EPA Energy Star compliance and to have been constructed to current HUD Zone 2 and New Mexico construction codes.
- Requires a renovation project to have reduced energy consumption by 60% compared to DOE and EPA averages and that the building has achieved a HERS rating of 60.
- Adds a water conservation requirement for the indoor plumbing fixtures and requires any landscaping to have included the provision of drip irrigation.
- TRD is required to report to the legislature beginning in 2019 and every three years on the annual aggregate amount of credits in the various categories with other data necessary for the legislature to determine whether the credit is effective in performing the purpose for which it was created.
- This bill establishes a sunset date for the new provisions of December 31, 2026.

FISCAL IMPLICATIONS

The provision allowing certification for separate projects constructed by a single taxpayer will not affect the amount of claims, but may affect the rapidity with which claims are paid. For example, if a single developer completed three projects in a year with earned credits of $20,000, $60,000 and $140,000 for a total of $220,000, the original bill would limit the credits to $55,000 in the year of completion and $55,000 in each of the following three years. Pursuant to the provisions of the amendment, the credits would be paid $80,000, $60,000, $45,000 and $35,000 for the year of completion and the three following years.

EMNRD notes “The revenue impact for CS/SB 279 could be up to $5 million annually in sustainable building tax credits, the same level as in current law.” However, LFC staff note that the new provisions take effect immediately as the current provisions expire. The transition should be seamless.

TRD reports that, except for FY 2012, the applications of approved credits to PIT or CIT returns have been far short of the statutory cap, which is applied to certifications.

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Expenditures	$1,095.5	$1,036.7	$2,325.2	$4,710.4	$2,230.7
Claims	73	202	304	425	297

Prior to 2013, the residential cap was $5 million, including up to $1.25 million for manufactured housing and an additional amount of $5 million for commercial properties. However, currently, EMNRD reports that the full $4 million annually in residential project credits have been allocated through FY 2016. Assuming that the full $5 million annually were approved for FY 2013 through FY 2016, there is a total of $12.8 million in deferred claims outstanding as of June 2016. There are two potential reasons why the general fund cost is somewhat difficult to determine. First, approved credits applications are limited to tax liability. Amounts in excess of current-year liabilities may be carried forward for up to seven years. Secondly, credit approvals for any one taxpayer in any one taxable year are limited to a maximum of $25,000 per year, unless total credits earned exceed $100,000, in which case the annual credit is limited to 25 percent of the total for the current year and three subsequent years. It is unknown the proportion of current approvals that have been limited by this 25 percent rule.

EMNRD notes a staffing and budgetary impact of this bill. "A fiscal impact to EMNRD's operating budget is estimated to be $80,000 as it requires the equivalent of 1.0 FTE to administer the tax credit program and staff support to make changes to the existing database to account for changes to the SBTC. EMNRD reviews the documentation that shows that program requirements have been met." LFC staff note that the transition between the existing program and the credit proposed in this bill should be seamless. The same number of applications should be received in the future as in the past and additional staff may not be required.

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. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures. This bill explicitly requires TRD to collect data and report to the legislature beginning in 2019 and every three years thereafter. TRD will undoubtedly require assistance from EMNRD in assembling all of the relevant data, including an estimate of energy or water savings.

SIGNIFICANT ISSUES

Based on previous comments [adjusted by LFC staff to conform to the provisions of this substitute bill] EMNRD notes the following:

> "SBTC credits have been completely allocated for the residential portion of the program through FY2016 under current law. Beginning January 1, 2017, applicants who were denied certification as of the sunset date of the current law could reapply for certification pursuant to the provisions of the new law. However, the credits would be at the reduced rates and the applicants would have to meet the new water requirements."
>
> "From FY2009 through FY2016, 2,983 homes have been certified as eligible for the SBTC - saving 116 million BTU's in energy compared to homes built to meet existing code requirements. Over 1,000 multifamily units and 15 commercial buildings, each rep-

> resenting approximately one million square feet, also received tax credits during the same time period, along with 354 manufactured homes."

The effective date of the act is not stated – assume 90 days after adjournment or June 19, 2015. The provisions of the bill are applicable for tax years beginning January 1 2017 (with first fiscal impact late in FY 17 and significant impact for FY 18).

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met since TRD is required in the bill to report to an interim legislative committee regarding the data compiled from the reports from taxpayers claiming the credit and other information to determine whether the credit is meeting its purpose. TRD will require assistance and cooperation from EMNRD.

ADMINISTRATIVE IMPLICATIONS

EMNRD notes that this program will require one FTE at a cost of 80.0. This is probably already in the budget and budget request since the program is similar form has been in place since 2007.

> "EMNRD reviews the documentation that shows that program requirements have been met. EMNRD is authorized to issue rules on procedures for administering the provisions of the bill. Additional staff support will be needed for amendments to the current rules. Homebuilders may need training on how to meet the water conservation requirement of SB279."

In another similar bill, EMNRD indicates that their current budget is not adequate to handle more energy tax credit applications. However, the provisions of this bill will provide the same level of incentives and therefore the same level of applications as the current law. The table of Additional Operating Budget Impact is shown as $0 for all years.

TRD may experience some administrative impact, but not in FY 2016. The new credit is almost identical to the current one from the standpoint of TRD.

RELATIONSHIP

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 credit is not capped.

House Bill 64 creates a "home energy and water efficiency income tax credit". The tax credit's purpose is to increase the efficiency of energy and indoor water use of existing residences in the state. This credit is not capped.

TECHNICAL ISSUES

While not an issue of the bill draft, which is technically impeccable, LFC staff have identified an issue related to the regulations promulgated regarding the Sustainable Building Tax Credit.

EMNRD has promulgated regulations regarding the Sustainable Building Tax Credit. These rules are at NMAC 3.3.29.1 et seq. These regulations, however, only restate 7 -2-18.19 NMSA 1978 and do not provide additional guidelines for troublesome cases. TRD has not further promulgated regulations for this credit.

The vast majority of buildings eligible for this credit are owned and the taxpayers claiming the credits are high-income taxpayers for which the credit amounts will be claimed on the first tax return filed after the construction expenses are incurred. Note: maximum credits for a single project that would be earned by a project built to the LEED Platinum standard ($6.50 per square foot and 2,000 square feet maximum) is $13,000, which is under the $25,000 floor requiring the delayed payout. Based on historical data on claims processed, many claimants may not have the New Mexico liability to cover the full amount of the approval and the claims must be rolled forward.

On page 9 of the bill, Paragraph M provides that, "if the sum of all new sustainable building tax credits… exceed the taxpayer's income tax liability for <u>that</u> taxable year, the excess may be carried forward for a period of up to seven years

The regulation at 3.3.29.13B lacks the single word, "that"…

> **B.** If the amount of the sustainable building tax credit the applicant claims exceeds the applicant's income tax liability [ed. no identification of which tax year is meant], the applicant may carry the excess forward for up to seven consecutive taxable years.

Pursuant to the regulation, apparently the approval and application is a multistep process: the applicant fills out a form and provides the required certification documents to EMNRD for staff review the application and providing a certification document to the applicant. Within 30 days, the taxpayer submits the certification document to TRD with a RPD-41327 SUSTAINABLE BUILDING TAX CREDIT APPROVAL form. After some period of time, TRD provides an approval document to the taxpayer applicant who can then undertake to claim the credit. Some credits are limited by the 25% rule, and that limitation, presumably, would be made clear in TRD's approval document. However, it is not clear on the RPD 41329 Claim form that previous tax years are closed for application of the credit.

Since the regulation does not contain the important restriction "that taxable year," a sophisticated taxpayer might be tempted to apply the approved credits to the oldest open year first, and roll any excess forward to the second oldest, next oldest and then current year. This same strategy could be used in case the total credit was limited by the 25% rule. This would only be a problem for a commercial project in excess of 50,000 square feet. A LEED-EB or CS Gold 50,000 square foot building would be eligible for SBTC of $89,500. This is in excess of $25,000 and the 25% rule would kick in.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The sustainable buildings tax credit will expire at the end of 2016.

OTHER SUBSTANTIVE ISSUES

(Note: 1 acre = 43,560 square feet, so that a 500,000 square foot building represents almost 11 ½ acres under roof.) The tallest building in New Mexico is the Albuquerque Plaza. This building is 351 feet tall and has 22 floors. It probably has around 380,000 square feet of total area.

Note: the largest buildings in the state may have been built by the state or federal governments. These buildings would not be eligible for the credit, even though they might have a major impact on the overall level of energy consumption and greenhouse gas emissions.

From TRD's 2014 Tax Expenditure Report:

> "According to EMNRD, the credit has reached its cap in FY15 and FY16. In the 12-month period through October 2013, EMNRD received, reviewed, and processed 1,078 applications comprising 2.7 million square feet of floor area: six commercial buildings of 663,970 square feet; 216 multifamily housing units of 201,763 square feet; 67 manufactured homes of 111,082 square feet; and 795 single-family homes of 1,787,047 square feet. The construction of these new homes and commercial buildings that meet ENERGY STAR, LEED, or Build Green New Mexico standards, have provided jobs in 22 counties."

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