FISCAL IMPACT REPORT

SPONSOR Gurrola/Cates/Herrera/Chavez **LAST UPDATED** 2/6/24 **ORIGINAL DATE** 1/31/24

SHORT TITLE Allow Water Reuse Requirements **BILL NUMBER** House Bill 291

ANALYST Graeser

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
TRD/PIT		($2,000.0)	($2,000.0)	($2,000.0)	($2,000.0)	Recurring	General Fund

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
CID/RLD	$183.9	$183.9		$367.8	Nonrecurring	Other state funds
NMED		$349.5	$349.5	$698.0	Recurring	General Fund
TRD		No fiscal impact**				

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.
**Note: TRD will include the new credit as part of its annual forms and systems updates.

Sources of Information

LFC Files

Agency Analysis Received From
New Mexico Environment Department (NMED)
Taxation and Revenue Department (TRD)
Office of the State Engineer (OSE)
Regulation and Licensing Department/Construction Industries Division (RLD/CID)

SUMMARY

Synopsis of House Bill 291

House Bill 291 provides four areas of impact:

1. Pursuant to newly developed rules promulgated by the state engineer, counties, and municipalities may adopt ordinances requiring water harvesting and storage or water

recycling and reuse.

2. Proposes a water harvesting personal income tax credit of 20 percent of the cost of installing a permitted rainwater or storm water catchment system. Each credit is limited to $5,000 representing an expenditure of $25 thousand. The maximum credits allowed each year is $2 million. Credits that exceed the claimant's tax liability may be carried forward for 10 years. Credit certificates may be transferred or sold. Claims are to be processed on a first-come, first-served basis, with no rollover provisions. Construction Industries Division of the Regulation and Licensing Department (CID/RLD) is required to develop and maintain rules on technical aspects of the water harvesting systems. Claims for the tax credit will be processed by the Taxation and Revenue Department (TRD). TRD is required to include utilization data in the annual Tax Expenditure Report.
3. CID/RLD is required by January 1, 2025, to develop rules for the installation of water harvesting systems and collateral rules regarding certification of installers and inspectors of water harvesting systems. Additionally, the division will require water harvesting systems to be permitted, similar to the permitting system for construction. To be eligible for the personal income tax credit, a water harvesting system must be permitted by CID. Other duties are assigned to CID in this regard.
4. The environmental improvement act is amended to allow governmental entities to apply for matching funds for installation of rainwater or stormwater harvesting equipment and structures on government-owned properties. The bill requires the New Mexico Environment Department (NMED) to set up a process to review applications and award matching funds. Wage and apprenticeship requirements are provided. No appropriation is made in the bill to any fund from which the matching funds would be allocated. There may be a special appropriation in HB2 or HB junior for catchment systems at public buildings for rainwater, storm water, or untreated water that has not been in contact with toilet waste.

This bill does not contain an effective date and, as a result, would go into effect 90 days after the Legislature adjourns, or May 15, 2024, if enacted. The personal income tax credit is applicable for tax years beginning January 1, 2024. The tax credit sunsets for installations after January 1, 2034.

FISCAL IMPLICATIONS

This bill creates or expands a tax expenditure. LFC has serious concerns about the substantial risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or action be postponed until the implications can be more fully studied.

The bill establishes an annual cap amount of $2 million. There is no provision in the case that applications exceed the cap in any year. For this reason, the fiscal impact is shown at the cap amount for the exhibit period and beyond.

Homeguide indicates a range of costs for water harvesting systems[1]:

Rainwater harvesting system costs $200 to $2,500 installed for an above ground, 50- to 200-

[1] https://homeguide.com/costs/rainwater-system-cost#:~:text=A%20rainwater%20harvesting%20system%20costs,tank%2C%20depending%20on%20the%20size.

gallon rain barrel system. Installing a residential cistern or rainwater collection system costs $2,000 to $12 thousand on average for an above ground cistern or $6,500 to $24 thousand for an underground tank, depending on the size.

Assuming the average installation is $2,500, the 20 percent tax credit results in a $500 tax credit claim. Four-hundred systems statewide could qualify annually for the tax credit and 4,000 could qualify over the 10-year life of the credit. Several municipalities and counties, including Santa Fe, now require water harvesting installations on new homes and on permitted remodels. Over the last five years, new home sales in the Santa Fe area have average about 200, with several times that number of remodels[2]. Therefore, residents of Santa Fe County alone would consume the full amount of the tax credit.

Section 4 requires NMED to set up a process to review applications and award matching funds for catchment systems at public buildings. However, the bill does not provide or identify a funding source for such matching funds. The bill also does not provide any funding for administrative support for such a process, which would require 3 new FTE at an estimated cost of $349.5 thousand, including salaries, benefits, and other costs.

TRD expects the credit to grow over time.

Cost of setting up rainwater catchment systems:

The cost associated with different types of rainwater catchment systems can vary depending on several factors, including the system size, complexity, materials used, and installation requirements. Here are some general cost considerations for various types of rainwater catchment systems:

1. Rain Barrels: Rain barrels are one of the simplest and most affordable rainwater catchment systems. They typically range in size from 50 to 100 gallons and can be connected to downspouts to collect rainwater from rooftops. The cost of a rain barrel can vary between $50 and $200, depending on the material (plastic or wood), design, and additional features such as spigots or diverters.

2. Above-Ground Cisterns: Above-ground cisterns are larger storage containers that can hold several hundred to thousands of gallons of rainwater. These cisterns are often made of plastic, concrete, or metal. The cost of an above-ground cistern can range from a few hundred dollars for smaller capacities (e.g., 250-500 gallons) to several thousand dollars for larger capacities (e.g., 2,000- 10,000 gallons). Additional expenses may include installation, plumbing connections, and accessories like filters and pumps.

3. Underground Cisterns: Underground cisterns are installed below the ground surface, providing a discreet and space-saving water storage option. These cisterns are typically made of durable materials like concrete or plastic. Underground cisterns are more expensive due to excavation and installation costs. The cost can range from a few thousand dollars for smaller capacities to tens of thousands of dollars for larger capacities.
4. Rainwater Harvesting Systems with Treatment: Some rainwater catchment systems include water treatment components to ensure the collected rainwater is suitable for

[2] https://www.huduser.gov/portal/periodicals/USHMC/reg/SantaFeNM-HMP-Aug23.pdf

potable use. These systems may incorporate filters, UV disinfection, or other treatment methods. The cost of these systems can vary significantly depending on the complexity of the treatment setup and water quality requirements. It may range from a few thousand to tens of thousands of dollars.

Note: the costs provided above are general estimates and can vary depending on local market conditions, labor costs, and specific installation requirements. Additionally, expenses related to permits, site preparation, plumbing connections, and maintenance should be considered when budgeting for a rainwater catchment system.

TRD cannot provide a more precise estimation due to the lack of data on current investment in rainwater capture in New Mexico. The fiscal impact could vary between $100 thousand to $2 million.

OSE is charged with developing and promulgating rules.

A rule making required by Sections 1 and 2 will require at least one FTE the first year, and one-half FTE thereafter for consultation and field visits on foreseen complaints.

RLD notes that there does not seem to be a source in the bill or other requests to fund Section 4 of the bill:

The RLD further notes that it is unclear from the text of HB291 how the Environment Department is expected to fund the "matching funds" requirement under Section 4 of the bill in light of the fact that HB291 does not contain a provision for any appropriation of funds.

SIGNIFICANT ISSUES

Note that OSE points out conflicts between the provisions of this bill regarding stormwater catchment and current law:

Section 2, subsection A creates a new section of the Income Tax Act to offer tax credits for individuals and businesses for up to 20 percentof the purchase and installation of a system. As rainwater is only permitted to be captured from rooftops, this bill should be amended to state this clarification. Allowing stormwater catchment could interfere with existing state water law and negatively impact other water right owners.

Section 2, subsection E should clarify this is only for rooftop rainwater capture systems to avoid conflict with existing water law.

Section 2, subsection M defines rainwater or storm water catchment system to also include untreated wastewater that has not come into contact with toilet water waste for potable or non- potable water. Untreated wastewater must never be commingled into rainwater capture due to bacterial growth and possible PFAS contamination from soaps, shampoos, and other sources. It is recommended that "untreated wastewater" be stricken from the definition and rules be made specific to the reuse of gray water. Including untreated wastewater would be contrary to NMED rules.

The four disparate provisions of this bill form a strategy to require and incentivize rainwater and stormwater harvesting and recycling. It is a carrot and stick approach, with a modest PIT credit the carrot and granting authority to counties and municipalities to require water harvesting pursuant to rules developed by the state engineer and CID the stick.

With many other credits, an executive agency is assigned the duties of certifying conformance to rules promulgated by that agency and providing certificates which claimants may present to TRD with their annual PIT filings. Sometimes this multiple step process results in installations that expect to be certified being denied that certification because of the cap. Because there is no provision here for a procedure that would allow a claimant denied because of the cap to refile or roll the claim to a following tax year, some or many applicants may be disappointed.

The sale or transfer of the credits would permit a developer or contractor to include the permitted water harvesting credit in the contract terms or new home sales price and not allow the homeowner to benefit from the PIT credit.

NMED notes:

HB291 calls for the Office of State Engineer to develop regulations in conjunction with Construction Industries Division to facilitate a water harvesting program for residential and commercial applications including rainwater, stormwater runoff, and other wastewater sources not in contact with sewage. It allows for use of the harvested water for both potable and non-potable uses. HB291 does not address the need for filtration and disinfection of harvested water to make it safe for potable uses. Harvested water and stormwater runoff carry significant risks of contaminants.

OSE notes:

Section 1 adds a new section of Chapter 3 NMSA 1978. Subsection A allows a county or municipality to adopt an ordinance to require water reuse and recycling. Water reuse and recycling is not defined nor mentioned anywhere else in the bill.

Section 2, subsection A creates a new section of the Income Tax Act to offer tax credits for individuals and businesses for up to 20 percent of the purchase and installation of a system. As rainwater is only permitted to be captured from rooftops, this bill should be amended to state this clarification. Allowing stormwater catchment could interfere with existing state water law and negatively impact other water right owners.

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TRD also comments on the policies involved in the provisions of this bill:

New Mexico has a challenging water situation due to its arid and semi-arid climate. As a result, rainwater harvesting plays a crucial role in water conservation efforts and supplementing water supplies. Rainwater harvesting in New Mexico involves collecting and storing rainwater that falls on rooftops, paved surfaces, or other catchment areas. This

practice helps capture and utilize rainwater for various purposes, such as irrigation, gardening, livestock, and even indoor non-potable uses.

The state of New Mexico recognizes the importance of rainwater harvesting and has implemented policies to encourage its adoption. In 2007, the state passed a law that allows for the residential collection and use of rainwater. This law permits individuals to collect rainwater from rooftops for outdoor watering and other non-potable uses without obtaining a water right.

Many homeowners and businesses in New Mexico have embraced rainwater harvesting techniques to conserve water and reduce reliance on traditional water sources. Various methods are employed, including the use of rain barrels, cisterns, and underground storage tanks to collect and store rainwater.

However, the effectiveness of rainwater harvesting in New Mexico is influenced by the region's limited rainfall and the sporadic nature of precipitation. Annual rainfall varies across the state, with some areas receiving fewer than 10 inches (250 mm) annually. This means that the amount of rainwater that can be harvested may be relatively low compared to regions with higher rainfall.

To maximize the benefits of rainwater harvesting, it is important to employ effective water management practices, such as proper system design, rainwater filtration, and efficient water use techniques. Tax credits for rainwater catchment could be supported for the following reasons:

1. Water Conservation: Rainwater catchment helps conserve potable water resources by reducing reliance on traditional water sources such as groundwater or surface water. By capturing and utilizing rainwater, individuals and communities can reduce their demand for water from these sources, especially in regions with limited water availability or during drought conditions.

2. Sustainable Water Management: Rainwater catchment promotes sustainable water management practices. Instead of letting rainwater runoff and potentially contribute to erosion or flooding, capturing, and storing rainwater allows for its controlled use for various purposes like irrigation, gardening, or non-potable indoor uses. This can help reduce the strain on municipal water supplies and promote a more resilient water infrastructure.

3. Cost Savings: Utilizing rainwater can lead to cost savings for individuals and businesses. By using harvested rainwater for activities like landscape irrigation or livestock watering, users can reduce their reliance on treated water sources, which often come with associated costs such as water bills. Over time, the investment in rainwater catchment systems can pay off through reduced water expenses.

4. Environmental Benefits: Rainwater catchment systems contribute to environmental sustainability. By reducing the demand for water from traditional sources, it helps alleviate the pressure on ecosystems, rivers, and aquifers. Additionally, using rainwater for outdoor irrigation can reduce the need for chemical fertilizers and detergents, which can have harmful effects on water quality and aquatic life.

Homeowners and businesses in New Mexico have embraced rainwater harvesting techniques. For conservation and cost savings alone, homeowners and businesses will strive to maintain their own personal and business interests. It is reasonable to assume that they would continue to do so even without the presence of this tax credit if investment in water catchment systems deliver a significant return on investment. The credit may unnecessary distort economic activity in New Mexico by incentivizing economic activity that would occur even in the absence of the incentive and by providing state subsidies to a mature and profitable business sector. The credit will shorten the time period for an individual's savings to pay for the investment.

While tax incentives may support particular industries or encourage specific social and economic behaviors, the proliferation of such incentives complicates the tax code. Adding more tax incentives: (1) creates special treatment and exceptions to the code, growing tax expenditures or narrowing the tax base, with a negative impact on the General Fund; and, (2) increases the burden of compliance on both taxpayers and TRD. Adding complexity and exceptions to the tax code does not comport generally with the best tax policy.

Section 1 allows counties and municipalities to adopt ordinances requiring water harvesting and storage. The credit would defray some or all of the cost for residents of counties and municipalities that adopt such mandates. However, the bill does not restrict the type of water harvesting or storage system that the local government may require, and so the credit may offset only a small part of the cost. An additional unknown affecting the cost estimate is how many local governments may choose to adopt the mandate.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the credit and other information to determine whether the credit is meeting its purpose.

NMED notes the following:

HB291, like any unfunded mandate, risks reducing NMED's service levels by increasing demands on the Department and its workforce without providing additional resources.

ADMINISTRATIVE IMPLICATIONS

TRD is assigned all the administrative responsibilities for the personal income tax credit. NMED and CID bear a significant administrative burden. In its agency analysis, NMED estimates needing 3 FTE at a recurring cost of $349.5.

RLD/CID expresses concern about time frames and funding:

Recognizing the very short timeline provided by Section 2, subsection (J) of the bill for the RLD to develop and adopt the very detailed and specific rules establishing procedures to provide certification of water harvesting systems for the purposes of obtaining a water harvesting tax credit (July 2, 2024) and further recognizing that the RLD currently does not have staff with the training or experience necessary to carry out those tasks, the only viable alternative for the RLD to be able to perform this duty by the required time-frame would be for the RLD to enter into what would likely be multiple contracts for professional services

with qualified experts and/or professional associations. Assuming the RLD is able to locate such properly qualified experts and convince them to take on these duties under the proscribed timeframe, that still means that the RLD would require significant funding in the current fiscal year (FY24) in order to have rules ready for promulgation in less than five (5) months. The RLD's best estimate is that at least three contracts for professional services would have to be extended, with each contract being for the amount of up to sixty thousand dollars ($60,000.00), for a total necessary appropriation for this single part of HB291's requirements of not less than one hundred eighty thousand dollars ($180,000.00) in FY24. Additionally, the RLD would be required to conduct a public rulemaking hearing process before June 30, 2024, which, in light of the complexity of the rules contemplated, would necessitate the hiring of a professional hearing officer and a court reporter, which would carry an anticipated cost of three thousand five hundred dollars ($3,500.00) also necessary to be appropriated in FY24.

FISCAL IMPACT to the RLD in FY25:

Similar to the fiscal impact to the RLD for FY24, Section 3 of HB291, beginning at subsection (A), continues to impose highly involved and complicated rulemaking responsibilities on the CID that must be completed not later than January 1, 2025. Again, recognizing the RLD/CID's lack of staff with expertise on the matters assigned to the CID by the bill, the only reasonable method by which the RLD would be able to obtain the resources necessary to accomplish the required rulemaking tasks would be to contract with outside experts or organizations under professional services contracts. Here again, the RLD's best estimate is that at least three (3) contracts for professional services would have to be extended, with each contract being for the amount of up to sixty thousand dollars ($60,000.00), for a total necessary appropriation for this single part of HB291's requirements of not less than one hundred eighty thousand dollars ($180,000.00) in FY25. Additionally, the RLD would be required to conduct a public rulemaking hearing process before December 31, 2024, which, in light of the complexity of the rules contemplated, would again necessitate the hiring of a professional hearing officer and a court reporter, which would carry an anticipated cost of three thousand five hundred dollars ($3,500.00) also necessary to be appropriated in FY25.

ADDITIONAL FISCAL IMPACT of Note:

The RLD further notes that it is unclear from the text of HB291 how the Environment Department is expected to fund the "matching funds" requirement under Section 4 of the bill in light of the fact that HB291 does not contain a provision for any appropriation of funds.

TECHNICAL ISSUES

Allowing the PIT credit to be sold or transferred may obviate the incentive, with the benefit realized by the contractor or developer, not the homeowner. LFC recommends that the credit not be transferable.

OSE has suggested several mandatory amendments to avoid conflicts with current law and regulation.

Section 2, subsection A creates a new section of the Income Tax Act to offer tax credits for individuals and businesses for up to 20% of the purchase and installation of a system. As rainwater is only permitted to be captured from rooftops, this bill should be amended to state this clarification. Allowing stormwater catchment could interfere with existing state water law and negatively impact other water right owners.

Section 2, subsection E should clarify this is only for rooftop rainwater capture systems to avoid conflict with existing water law.

Section 2, subsection M defines rainwater or storm water catchment system to also include untreated wastewater that has not come into contact with toilet water waste for potable or non-potable water. Untreated wastewater must never be commingled into rainwater capture due to bacterial growth and possible PFAS contamination from soaps, shampoos, and other sources. It is recommended that "untreated wastewater" be stricken from the definition and rules be made specific to the reuse of gray water. Including untreated wastewater would be contrary to NMED rules.

Because of the environmental contamination risks associated with harvested water for potable and non-potable uses, NMED should be consulted by CID and OSE in the process of developing rules.

NMED further notes:

HB291 may conflict with the Groundwater and Surface Water protection regulations (20.6.2 NMAC) regarding reuse and with Liquid Waste Regulations, in addition to Safe Drinking Water regulations.

NMED has communicated with the Regulation and Licensing Department (RLD) and shares RLD's concerns regarding new requirements that HB291 would put in place, the interaction with existing laws and rules regarding the construction industry, and how the bill's requirements would impact the authority and responsibilities of the Construction Industries Commission and RLD's Construction Industries Division.

Neither the Office of the State Engineer nor the Construction Industries Division have the technical staff and expertise to address the water quality issues associated with the use of harvested water for potable use.

NMED recommends, at minimum, that the sponsor adopt the following amendments:

NMED recommends that HB291 clarify that rainwater, storm water or untreated wastewater is considered "gray water" and that water that has come into contact with toilet waste is considered "black water." Additionally, the bill should be clear that water may only be used as a potable or non-potable water source after it has been properly treated for a certain type of use.

On page 5, in subsection M:

M. As used in this section, "rainwater or storm water catchment system" means a system that is designed provide for the collection of rainwater, storm water or untreated wastewater <u>(gray water)</u> that has not come into contact with toilet waste <u>(black water)</u> for use as a potable or non-potable water source <u>after treatment to meet water quality standards for a proposed use</u>."

TRD also has several suggested amendments to propose to improve the administration of the tax credits in Section 2 of the bill.

This bill calls for RLD to adopt rules establishing procedures to provide certification of water harvesting systems on page 4, Subsection J. However, on page 3, Subsection C, TRD is tasked with the application process and management of the tax credit cap in Subsection D. It

is suggested to avoid multiple certification and application points that RLD be the application, certification, and managers of the $2 million dollar cap that is based on the application process. This would be similar in function to credits that have an application process with the Energy, Minerals, and Natural Resources Department. This can be accomplished by adding "regulations and licensing" before department on page 3 line 2; on page 3 line 6 before department; and page 3 line 10 before department.

TRD would also prefer that the following language be added on page 5, inserted as Subsection K "The regulations and licensing department shall determine whether an eligible taxpayer's purchase, and installation costs qualifies for the water harvesting income tax credit, and shall issue a certificate to each qualifying taxpayer. The certificate shall include the taxpayer's name, the amount of the credit allowed, and a unique identification number. The regulation and licensing department shall provide the taxation and revenue department appropriate information for all eligible taxpayers to whom certificates are issued. The regulation and licensing department shall provide the department with the certificates of eligibility issued pursuant to this subsection in an electronic format at regularly agreed upon intervals."

If the above changes are made, on page 3, lines13 after the period through line 17 can be stricken. Page 5, Subsection K already includes this information, and the language aligns further with TRD being the department the credit is claimed with on a tax return.

OTHER SUBSTANTIVE ISSUES

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

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

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy Principle	Met?	Comments
Vetted: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.	?	Some aspects of this proposal have been previously debated, but other aspects are new
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. Clearly stated purpose Long-term goals Measurable targets	 ✓ ✗ ✗	
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	✓	

Accountable: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date. Public analysis Expiration date	 ✓	
Effective: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure. Fulfills stated purpose Passes "but for" test	 ? ✗	The tax credit is unlikely to incentivize any more installations than ***requiring*** permitted installations
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	✗	
Key: ✓ Met ✗ Not Met ? Unclear		

LG/rl/ne/ss/al/rl/ne