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

ORIGINAL DATE 2/1/2020
SPONSOR Romero, A **LAST UPDATED** 2/9/2020 **HB** 179

SHORT TITLE Low-Income Housing Gross Receipts **SB**

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22	FY23	FY24		
-	($4,500.0)	($4,800.0)	($5,000.0)	($5,300.0)	Recurring	General Fund
-	($2,900.0)	($3,100.0)	($3,200.0)	($3,400.0)	Recurring	Local Governments

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Mortgage Finance Authority (MFA)

SUMMARY

Synopsis of Bill

House Bill 179 expands the existing gross receipts tax (GRT) deduction for sales to nonprofit organizations to include the sale of construction material to nonprofit organizations providing low- and moderate-income housing opportunities. The effective date of this bill is July 1, 2020.

FISCAL IMPLICATIONS

The existing tax deduction (Section 7-9-60 NMSA 1978) already applies to the sale of construction materials to nonprofit organizations providing low-income homeownership opportunities. In addition to expanding the deduction to opportunities for moderate-income families, this bill changes “homeownership” to “housing”, which appears to expand the deduction to apply to nonprofit organizations that lease property to low- and moderate-income residents, such as apartment buildings.

This bill lacks definitions for “low-income” and “moderate-income”, making it unclear the threshold for which housing opportunities the expanded deduction would apply (see *Technical Issues*).

According to the Mortgage Finance Authority (MFA):

> "The affordable housing rental projects awarded funding by MFA in 2019 will have an estimated $47,912,826 in expenditures on construction materials (excluding labor). MFA does not have data on affordable homeownership construction materials (excluding labor). However, MFA believes an equal annual amount of $47,912,826 would be sufficient given the high need for affordable housing. Thus, the total annual recommended amount [to estimate the cost of the deduction for construction] is $95,825,652.
>
> MFA has seen the cost of construction materials rising between 5% and 7% annually, which should be considered when calculating an escalation rate for any cap that may be considered with this bill."

Using the construction materials estimates and growth rates provided by MFA, the expansion of this deduction is estimated to cost the general fund $4.5 million and local governments about $2.9 million in FY21.

Notably, this estimate uses only data provided by MFA. While it is likely that affordable housing projects qualifying for this deduction would seek out financing from agencies like MFA, the bill does not limit claims for this deduction to those projects awarded funding by MFA. Therefore, it is possible for the bill to have a higher fiscal impact than the estimate.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, 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 creates a tax expenditure with a cost that is difficult to determine but could be significant. LFC has serious concerns about the significant 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 be held for future consideration.

SIGNIFICANT ISSUES

Notably, the deduction modified by this bill applies only to construction <u>materials</u> sold to a nonprofit organization providing low- and moderate-income housing opportunities. However, by regulation, the existing deduction does <u>not</u> apply to receipts from performing a construction project for a nonprofit organization, including the construction services and the value of all property used in the construction project, as these are receipts from performing a service and are therefore considered to be fully taxable. This appears to limit the deduction only to nonprofit organizations that build affordable homes and rental projects (for example, organizations like Habitat for Humanity).

The Mortgage Finance Authority's (MFA) Housing Development Department provides funding for developers who are creating or rehabilitating housing for low-income families, both rental and for-sale homes. Most of the housing units created with MFA funding are set aside for families earning between 30 percent to 60 percent of the area median income, or about $25,000 for a family of four in the Albuquerque area.

New Mexico has an Affordable Housing Tax Credit program to encourage private investment in affordable housing by providing donors to qualified housing developments with a credit on their state taxes. To use this tax incentive the donation must be made to an affordable housing development that has been approved by the MFA. Once a project is approved and donations secured, investment vouchers are issued to the donors. Donors receive investment vouchers for up to 50 percent of the value of the donation. Donations can be made up to $1 million. Eligible donations may include land, buildings, cash, or services that support the development of an approved affordable housing project.

A 2015 report by the U.S. Government Accountability Office (GAO) found widespread challenges in rising construction costs making it more difficult to build moderately-priced housing.[1] The NCHSA 2018 report found that apartments financed by the federal Low Income Housing Tax Credit on average cost roughly the same to develop as the typical apartment, even as the housing credit properties must by law meet many requirements that typical apartment buildings do not. This bill's proposed amendment to the deduction may result in an increase of availability of affordable housing for low- and moderate-income families provided by nonprofit organizations.

This bill narrows the gross receipts tax (GRT) base. Many of the efforts over the last few years to reform New Mexico's taxes focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound tax pyramiding issues and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> 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.

TECHNICAL ISSUES

This bill does not provide a definition for "moderate-income" and the existing deduction provides no definition for "low-income". The U.S. Department of Housing and Urban Development defines "low-income" as 80 percent of the median family income for the area but has no definition for "moderate-income". However, the U.S. Census Bureau has started defining moderate income as 80 percent of the median family income for a given metropolitan area, low income at 50 percent, and very low income at 30 percent. Other agencies tie definitions of income to some percentage of the federal poverty level.

[1] https://www.gao.gov/assets/700/694541.pdf

Without definition, TRD would need to promulgate the meaning by rule or regulation, which may or may not be in line with the bill's intent. Additionally, lack of statutory definitions may lead to tax protest claims or litigation on whether the low- and moderate-income thresholds are met. The bill should be amended to include a definition for moderate-income or to identify a state or federal agency's definition of the term.

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

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

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

1. **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 (RTSP), to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **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.
5. **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.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	**Met?**	**Comments**
Vetted	✘	Not reviewed by LFC or RSTP
Targeted		
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✘	No reporting required for existing deduction.
Accountable		
Public analysis	✘	
Expiration date	✘	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✘ Not Met ? Unclear		

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