Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the Legislature. LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

FISCAL IMPACT REPORT

SPONSOR	Armstrong/Duncan/Murphy/Dow/ Hernandez	**LAST UPDATED**	
		ORIGINAL DATE	2/13/2025
SHORT TITLE	Housing Construction Tax Credit	**BILL NUMBER**	House Bill 325
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Type	FY25	FY26	FY27	FY28	FY29	Recurring or Nonrecurring	Fund Affected
GRT	**$0.0**	**($148,324.0)**	**($153,367.0)**	**($157,815.0)**	**($163,338.0)**	Recurring	General Fund
Hold Harmless	**$0.0**	**($151,589.0)**	**($156,743.0)**	**($161,289.0)**	**($166,934.0)**	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	FY25	FY26	FY27	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD	**No fiscal impact**	**Indeterminate but minimal**	**No fiscal impact**	**Indeterminate but minimal**	Nonrecurring	**General Fund**

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

Sources of Information

LFC Files

Agency Analysis Received From
Governor's Office on Housing
NM Mortgage Finance Authority (NMFA)

Agency Analysis was Solicited but Not Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 325

House Bill 325 allows for gross receipts tax (GRT) deductions on labor costs incurred during the construction of new residential housing and for the sale of new residential housing. "Residential housing" is a single-family residence, a town house, a condominium, or an apartment building. Up to $125,000 in gross receipts can be deducted per twelve-month period for the sale of new residential housing, and up to $75,000 for housing intended for lease. The bill also establishes a "hold harmless" provision, ensuring that municipalities and counties receive distributions from the state to offset potential revenue losses from these deductions.

The effective date of this bill is July 1, 2025.

FISCAL IMPLICATIONS

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. 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.

Industry estimates suggest that labor costs typically constitute up to 40 percent of residential project expenses, while materials account for approximately 40 to 50 percent. The remaining 10 to 20 percent is attributed to permits, fees, overhead, and other related expenses. These percentages can fluctuate based on factors such as regional labor rates, material availability, and specific project requirements. To estimate the impact of this bill, LFC used TRD's GRT RP-80 report, which reports taxable gross receipts by industry NAICs code. LFC used detailed fiscal year 2024 NAICs data to estimate that up to 65 percent of total taxable receipts in the construction industry could be for residential construction. LFC then applied that share and the estimated share of labor costs to state, county, and municipal construction GRT receipts from TRD's RP-500 GRT report. This estimates approximately 25 percent of all construction receipts would become deductible. The 2024 revenue loss estimate is grown by the consensus revenue estimating group GRT forecast growth each year. Because of the hold harmless provision, the revenue loss to locals is repaid by the state.

The Taxation and Revenue Department would incur minor costs for systems updates to comply with the provisions of HB325.

SIGNIFICANT ISSUES

The proposed gross receipts tax deduction for home sales is unnecessary because Section 7-9-53 NMSA 1978 already exempts the sale of real property, including homes, from GRT. Under current law, receipts from the sale of real estate are not subject to GRT, meaning there is no taxable amount to deduct. This makes the new deduction redundant, as it does not provide any additional tax relief beyond what is already in place.

The Governor's Office on Housing notes that in the past few years, New Mexico has experienced a precipitous rise in the cost of construction, and this coupled with dramatic increases in interest rates, mean that the hard cost to build a new housing unit has increased as much as 50 percent in some communities. This is reflected in the prices of newly built homes which, according to the National Association of Homebuilders *Priced Out* study, have increased over $115,000 (36 percent) in just five years. The current median new home in New Mexico is now estimated at $442,000, a price which is deemed unaffordable to nearly 82 percent of New Mexican households. By providing a discount on the overall hard cost to construct a housing unit, this could move some projects that are currently on the edge of financial feasibility into feasible

territory.
The Governor's Office on Housing also notes that, because this would apply to all new housing, including luxury housing, the deduction could be interpreted as subsidizing housing construction, which does not need financial support from the public sector. Similarly, with no income- or price-targeting associated with the policy, there is no guarantee this will create more entry-level or affordable housing, nor that those benefits provided by the deduction will be passed on to buyers, although eventually market competition pressures could incentivize this.

The proposed GRT deduction for construction labor raises important questions regarding its effectiveness and necessity, particularly through the lens of the "but for" concept in tax policy. The "but for" test is often used to evaluate whether a tax incentive influences behavior or if the desired activity would have occurred regardless of the tax break. In this case, the key question is whether homebuilders would increase new residential construction "but for" the tax deduction on labor costs, or if these projects would proceed at the same rate without the incentive.

If the deduction truly encourages additional home construction, it could be justified as a means to boost housing supply, particularly in areas experiencing shortages. By lowering labor costs, the policy could make projects more financially feasible, leading to increased investment in new housing developments. This could be especially beneficial in markets where high construction costs serve as a barrier to entry for developers. If the deduction leads to new construction that would not have otherwise occurred, then it would be fulfilling its intended purpose.

However, if most homebuilders would have undertaken these projects regardless of the deduction, then the policy fails the "but for" test, making it an inefficient tax incentive. In this scenario, the deduction would function primarily as a windfall for developers, reducing their tax liabilities without actually influencing their decision to build. This is a common critique of tax incentives—if they do not result in additional economic activity beyond what would have happened anyway, they may serve as an unnecessary expenditure of state resources.

Additionally, there is the question of who ultimately benefits from the tax savings. While builders and contractors may see lower tax liabilities, it is unclear whether these savings will be passed down to homebuyers in the form of lower housing costs. If market conditions allow developers to retain the financial benefit rather than adjusting home prices downward, the deduction may do little to address housing affordability. In that case, the policy would serve primarily as a subsidy to the construction industry rather than as a meaningful intervention in the housing market.

In tax policy, effective incentives must be targeted and designed to encourage behavior that would not otherwise occur. If the GRT deduction for construction labor fails to meaningfully increase housing production, it may not be an efficient use of tax incentives. A better approach could involve direct housing affordability initiatives, such as subsidies for first-time homebuyers, incentives for affordable housing developments, or programs that address construction labor shortages through workforce development.

The hold harmless provision ensures that municipalities and counties do not lose GRT revenue due to the newly proposed deductions for construction labor and home sales. It does so by requiring the state to reimburse local governments for the lost tax revenue based on the amount of deductions claimed within their jurisdictions. While this mechanism prevents immediate funding shortfalls for cities and counties, it shifts the fiscal burden to the state government, which must allocate funds to cover these distributions. This creates a long-term risk, as the state would bear the financial cost of a tax incentive that primarily benefits private developers and homebuilders, without a guaranteed return in the form of increased housing affordability or economic growth.

This bill narrows the GRT base. Many New Mexico tax reform efforts over the last few years have 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 met with the bill's requirement to report annually in the tax expenditure budget the data compiled from the reports from taxpayers taking the deduction.

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.	✗	No record of an interim committee hearing can be found.
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	✗	There are no stated purposes, goals, or targets.
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	✓	The deduction must be reported publicly in the TER.
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	✗	The deduction does not have an expiration date.
Effective: The tax expenditure fulfills the stated purpose. If the tax	?	There are no stated

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		purposes, goals, or targets with which to measure effectiveness or efficiency.
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✓ Met ✗ Not Met ? Unclear		

ALTERNATIVES

The Governor's Office on Housing noted several alternatives to this proposal that could increase affordable housing in the state:

> One way to increase the effectiveness of this legislation would be to have it only apply to entry-level housing. This would provide a benefit to market actors to explicitly target the type of housing most needed: that which serves entry-level buyers and New Mexico's workforce. A simple price threshold under which the deduction applied, such as $450,000 (roughly equivalent to the current new median home sales price), would decrease the fiscal impact to the state and incentivize the market to work in those lower price points, without providing costly financial benefits to the development of higher end housing. For instance, the median new home price in Santa Fe County now exceeds $900,000, reflecting the large percentage of new luxury and custom homes being developed, an activity that does not warrant any sort of public sector benefits.
>
> There are many other opportunities for lowering the cost to develop housing in New Mexico which have not been utilized yet, and this proposed model is unproven for increasing units or decreasing the overall cost of housing for consumers. A sunset date could make any negative financial impact short-term and create time to evaluate the initiative to assess its impact on housing markets. It would also create time to enact other best practice approaches to lowering development costs in the state.
>
> There are a large number of state and local regulatory, land use, and building code reforms that can have a significant impact on housing development costs. For instance, Santa Fe County's Affordable Housing Plan identified that it now takes between 3-4 years to win approval for a large-scale housing development. Decreasing that time to 12-18 months through expedited approval processes could save up to $80,000 per housing unit in holding, overhead, and legal costs. A recent effort in Virginia to "right size" building codes, removing costly compliance with little impact on life safety, netted an average decrease in hard development cost of $24,000 per unit, more than double the tax benefit proposed for a single-family home.

JF/SL2/rl