Statement on behalf of the National Association of Home Builders

1201 15th St NW

Washington, DC 20010

House Ways and Means Subcommittee on Select Revenue Measures

Hearing on Member Proposals related to Certain Tax Provisions that either Expired in 2011 or will expire in 2012 (also known as "tax extenders")

April 26, 2012

On behalf of the 140,000 members of the National Association of Home Builders (NAHB), we respectfully submit this statement discussing the significance and impact of several expired and expiring tax extenders.

In 2005, Congress passed the Energy Policy Act (P.L. 109-58) and established a number of important tax incentives to promote greater energy efficiency in the built environment – single family, multifamily and commercial homes and buildings. These incentives acted as the only federal-level programs to address energy efficiency in new and existing homes and buildings with the intent of moving the market towards greater efficiency and the delivery of innovation and technology transfer in building design and practice.

Two of these tax credits expired at the end of 2011: the credits for tax code Section 45L and Section 25C. While Congress has allowed the incentives to lapse before and has extended them retroactively, for consumers and businesses this uncertainty is extremely disruptive.

Retroactive extensions are particularly problematic for the consumer and small business-oriented tax provisions. In general, these taxpayers are more sensitive to tax uncertainty. Middle-class taxpayers, who are the primary beneficiaries for energy tax incentives, are particularly unlikely to purchase a more expensive, energy efficient product on the expectation that Congress will extend a tax credit retroactively. Likewise, manufacturers are unable to market those products as tax-credit eligible. As a result, when these types of credits are extended retroactively, the “winners” are more likely to have purchased the qualifying product anyway, while middle-class consumers will miss out.
Section 25C – Qualified Energy Efficiency Improvements Tax Credit

The 25C tax credit began as a modest incentive for the purchase of qualified energy efficiency improvements for existing homes, such as windows, doors, roofs, and HVAC equipment. Originally, the 25C credit provided 10% of the cost of the product (not including installation and labor costs) not to exceed $500 but imposed various lower caps on specific energy efficient property, such as a maximum of $200 for window purchases. At the outset, the credit offered little appeal to existing homeowners because the specifications for the qualified improvements had price tags that far exceeded the tax credit. Further, the various caps caused confusion and added complexity. In 2009, the American Reinvestment and Recovery Act (ARRA) expanded the original 25C program and increased the credit to 30% with a $1,500 cap and included some labor and installation costs. All qualifying products now had the same cap, providing much needed simplicity. As a result, the appeal and popularity of this incentive soared and many retailers, manufacturers, and contractors advertised the newly-enhanced credit which encouraged business and fostered job growth in remodeling activity at the end of 2009 and 2010.

The success of the credit in those two years is unquestionable. IRS data for tax year 2009 also indicates that 25C was heavily used by middle-class homeowners. Of taxpayers claiming the credit, two-thirds had an adjusted gross income of $100,000 or less; 93% of taxpayers claiming the credit earned less than $200,000. Taxpayers in these income classes tend to be very price sensitive, and 25C arguably tipped the scales in favor of energy efficient equipment. Consider a simple window replacement: most homes have an average of twelve windows. Just installing basic windows is a substantial investment. As a result, middle-class homeowners undergoing window replacement today are less likely to install energy efficient windows based on a hope and prayer that Congress will retroactively extend the 25C tax credit later this year.

The lapse in the 25C tax credit will also impact overall economic activity in the remodeling sector. For example, for tax year 2009, over $5 billion of 25C tax credits were claimed. NAHB estimates that these tax credits were claimed in connection with over $25 billion in remodeling expenditures. Remodelers often leverage this tax credit when working with clients. These tax credits helped support the remodeling industry (see graph below) during a period in which new home sales experienced dramatic declines. NAHB estimates that the remodeling activity generated by this tax credit in 2009 was associated with over 278,000 full-time jobs. NAHB estimates that every $100,000 in remodeling expenditures creates enough work for 1.11 full-time equivalent jobs.¹ The programs supported approximately $13.2 billion in wages for these workers and $7.5 billion in net business income.

¹ THE DIRECT IMPACT OF HOME BUILDING AND REMODELING ON THE U.S. ECONOMY (HTTP://WWW.NAHB.ORG/GENERIC.ASPX?SECTIONID=734&GENERICCONTENTID=103543&CHANNELID=311), NAHB ECONOMICS PAPER.
NAHB strongly supports an extension of the Section 25C tax credit. To make it an effective incentive for 2012, action needs to be taken in the very near term. Long-term, NAHB would also urge Congress to simplify and modernize the new credit by increasing the $500 cap to $1,000; allow homeowners to claim installation costs for all eligible products; and remove the confusing lower caps. Adopting this 10% tax credit with a $1,000 cap will greatly simplify the current tax credit and provide an incentive that middle-class homeowners will continue to utilize to improve the efficiency of their homes. Ideally, NAHB believes this credit would be most effective as a permanent provision of the tax code.

**Section 45L – New Energy Efficient Home Tax Credit**

Also expired as of January 1, 2012, the Section 45L tax credit provided a $2,000 credit to builders of new homes that exceed a minimum energy code specification (2003 International Energy Conservation Code plus the 2004 supplement) by at least 50% in both heating and cooling efficiency. The efficiency performance must be independently verified by an authorized energy rater, and the credit is subject to both a basis adjustment and may not be claimed against alternative minimum tax (AMT) liability. Eligible homes include residences, single-family and multifamily, that are sold to owner-occupants or leased for rental purposes.

Although this credit has suffered from start-and-stop issues of short-term and retroactive extensions over the last five years, and has again expire at the end of 2011, the 45L program has managed to deliver the market transformation results that Congress intended to encourage. The chart below shows that from enactment the Section 45L credit went from 0.7% of the market in 2006 to 11% of the market for new homes in 2011.
<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Homes Verified</th>
<th>% of New Homes Sold</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>7,110</td>
<td>0.7%</td>
</tr>
<tr>
<td>2007</td>
<td>23,000</td>
<td>3%</td>
</tr>
<tr>
<td>2008</td>
<td>22,000</td>
<td>5%</td>
</tr>
<tr>
<td>2009</td>
<td>37,000</td>
<td>10%</td>
</tr>
<tr>
<td>2010</td>
<td>21,000</td>
<td>7%</td>
</tr>
<tr>
<td>2011</td>
<td>32,000</td>
<td>11%</td>
</tr>
</tbody>
</table>

Data provided by Residential Energy Services Network (www.natresnet.org)²

In 2011, 11% of all the new homes sold met the energy thresholds of the Section 45L credit and were 50% or more energy efficient, with a nearly five-fold increase in total certified homes.

With the current lapse of this credit, builders who utilize this tax credit face the difficult decision of whether to continue to offer the benefits of this credit to their customers without knowing if the credit will be extended. This decision is made more difficult due to the ongoing housing depression and incredibility small margins most builders currently operate on. In fact, the impact of a retroactive extension can likely be linked in part to the drop in qualifying homes seen in 2010. In that tax year, all of the tax extenders, including 45L, lapsed for 11 ½ months before Congress extended them retroactively.

Home building is an industry driven by small, often family-owned businesses. According to NAHB’s membership survey, 79% of home builders have fewer than 10 employees. Small business owners cannot afford to gamble on whether a tax credit will be extended retroactively. If a builder assumes the credit will not be extended, they may well lose a sale to another builder who assumes it will be and therefore quotes a lower price. The uncertainty created by the recent history of extending these tax provisions retroactively unfairly places small business owners between a rock and hard place. NAHB believes that Congress should not be placing businesses and consumers in the position of guessing the direction of tax policy. Congress has an obligation to create a degree of tax certainty rather than the current situation that leaves businesses to predict the future.

---

² This represents the actual number of homes certified by RESNET, which is the largest certifier. Some additional homes may have qualified through other eligible certifiers.
Role of the Tax Code in Energy Policy

Although some of these incentives would benefit from updates, nearly all of these tax incentives are performing exactly as Congress intended when establishing them back in 2005. Despite the unprecedented downturn in housing and the resultant recession, the increased amount of economic activity associated with retrofit incentives under 25C, coupled with the stellar market penetration of new energy-efficient homes under 45L confirm that federal policies promoting building efficiency are effective, necessary, and accomplish broad conservation goals.

Some have argued for elimination of all energy and efficiency tax incentives in an effort to let the market determine the direction of costs and savings for consumers. Unfortunately, families that do not have the economic resources to undertake a meaningful energy upgrade will be sidelined in this process—as the data shows for Section 25C, taxpayers who used the credit are overwhelmingly middle-class families. And with or without these incentives, the Department of Energy is on a mission to federalize and mandate aggressive energy code requirements for new homes and buildings that will further deteriorate housing affordability. Some of these new and proposed requirements will prove to be very expensive to the consumer and will take decades to recover the investment, a payoff few homeowners will see as the average homeowner remains in their home for about ten years while the average home remains in the housing stock for 60 years or more. Further exacerbating the situation, appraisals often inappropriately or inaccurately value energy efficiency and energy-efficient features in homes, creating a regulatory disincentive for optional energy efficiency upgrades.

With an aging infrastructure and building stock, more American families are going to be relegated to living and working in less-efficient homes and buildings.\(^3\) New construction is just now increasing from historic lows, and as the housing market begins to return to normal levels, consumers will be facing dramatically different mortgage qualification requirements and financing issues than before the downturn. The reality is that the oldest, least-efficient homes are the most affordable to families with lower and moderate incomes. Unfortunately, these families also bear the largest burden in energy costs, as a percentage of income.

Utilization of the tax code to promote energy efficiency and consumer savings is the most effective opportunity to truly shape an efficiency policy that is not punitive to the housing market as a whole, and creates jobs as a result. The use of the tax code to incentivize energy efficiency in buildings has a long history of bipartisan support. Much like other environmental rules and regulations, efficiency requirements are expensive, and ultimately the consumer bears the brunt of those costs. New home builders cannot absorb costly new mandates, and these costs will be passed onto new homebuyers. But to really improve home energy efficiency, we must look at the over 95 million rental and owner-occupied homes that were built before modern energy codes in 1991. Without effective tax incentives, those homes will continue to waste energy and cost the consumer money.

\(^3\) The average age of an owner-occupied home in the U.S. is now 35 years and climbing. See the following NAHB analysis for more detail ("An Aging Housing Stock," Eye on Housing blog, [http://eyeonhousing.wordpress.com/2012/01/31/an-aging-housing-stock/](http://eyeonhousing.wordpress.com/2012/01/31/an-aging-housing-stock/) )
Low Income Housing Tax Credit—Expiration of the Fixed Credit Rate

While not a traditional tax extender, under a provision enacted in 2008 as part of the Housing and Economic Recovery Act (HERA), Congress temporarily fixed the 9% LIHTC credit at a full 9% for buildings placed in service before December 31, 2013. Although this provision does not technically expire until the end of 2013, for all practical purposes, it has already expired.

Although the temporary fix of the 9% credit does not expire until the end of 2013, projects will only qualify for the fixed credit rate if the building is placed in service before the deadline. A building is considered placed in service when it is constructed and fully leased. According to the Census Bureau’s Survey of Construction, in 2010 the average permit-to-completion time for all multifamily building was 16.7 months. As a result, for credits that are being allocated now, investors and project underwriters cannot be certain that projects will be completed and placed in service before the deadline. Therefore, prudent underwriting requires that today’s projects be financed based on the much lower floating credit. This will reduce the amount of equity going into projects receiving allocations this year, although the deadline is 2013.

If the fixed rate is not extended, the amount of equity properties could receive would be reduced by more than 15%, making it more difficult to do LIHTC developments, particularly as state and federal governments cut back on direct spending that is used to fill financing gaps for LIHTC properties. The “floating rate” system also creates uncertainty for owners and investors and complicates state administration of the program.

Under the Low Income Housing Tax Credit (LIHTC) program, affordable housing developments receive tax credits which are used to attract equity capital. There are two types of tax credits: one credit provides 70% of the financing cost and is used for new construction and substantial rehabilitation; and a second credit that provides 30% of the financing cost which is used to acquire an existing property which is rehabilitated. These are often referred to as the 9% and 4% credits respectively because that was the original credit amount when the program was created in 1986.

LIHTC credits are provided over a ten year period and without this legislation, the credit rates are adjusted monthly. The IRS calculates the monthly values of the credits based on the cost of borrowing by the federal government. As a result, today’s low federal borrowing costs produce very low credit rates, which reduces the amount of private equity invested in LIHTC development. In March 2012, the 9% credit was only worth 7.43%; the 4% credit was worth 3.18%.

Legislation has been introduced in the House by Chairman Tiberi and Ranking Member Neal to make the fixed credit rate permanent (H.R. 3661). The legislation would also apply to a 4% tax credit used to acquire an existing property which is rehabilitated for affordable use. NAHB urges Congress to pass H.R. 3611 as soon as possible due to the uncertainty created by the looming expiration date.
Mortgage Insurance Premiums

Another important tax extender for the housing sector is the deduction for mortgage insurance premiums. From 2008 through the end of 2011, certain mortgage insurance premiums were allowed as an itemized mortgage interest deduction. Qualified mortgage insurance consisted of premiums paid for insurance provided by the Veterans Administration, Federal Housing Administration, Rural Housing Administration and private mortgage insurance. The deduction is subject to an income phaseout, with only partial deductions permitted for those taxpayers with more than $100,000 of adjusted gross income (AGI), and no deduction permitted for taxpayers with AGI in excess of $110,000.

The deduction is particularly critical for reducing the debt cost of homeownership for first-time homebuyers, who are more likely to require mortgage insurance due to having smaller downpayments for the purchase of a home. According to NAHB estimates, there are approximately 2.1 million households that should have formed but did not as a result of the Great Recession. These potential households constitute pent-up housing demand, and as the labor market improves, this unlocked housing demand will help add momentum to the building recovery in the housing markets.

According to 2009 IRS (the most recent available), 3.6 million taxpayers benefited from the mortgage insurance deduction, with $5.5 billion in total deductions. Given the income phaseout, the deduction’s final tax benefit is entirely collected by middle class homebuyers.
J.P. DELMORE
Assistant Vice President
Government Affairs
202 266 8412
jdelmore@nahb.org

National Association of Home Builders
1201 15th Street, NW
Washington, DC 20005