

Statement on Behalf of the National Association of Home Builders

“Energy Tax Incentives Driving the Green Job Economy”

House Committee on Ways and Means

April 14, 2010

Introduction

The National Association of Home Builders (NAHB) appreciates the opportunity to submit testimony on the issue of “*Energy Tax Incentives Driving the Green Job Economy.*” NAHB represents 175,000 members who work in the residential construction industry and are overwhelmingly comprised of small businesses. For example, NAHB’s average single-family builder has 11 employees, constructs fewer than 20 homes per year, and has a dollar volume of business revenues of approximately \$1 million. The energy efficiency tax incentives established by Congress have had a positive impact on all segments of the housing market and ultimately provide a benefit in delivering housing that achieves energy efficiency benchmarks that exceed standard, code-built homes and buildings.

NAHB urges Congress to pass legislation to extend the Internal Revenue Code Section 45L New Energy Efficient Home credit (Section 45L), which expired at the end of 2009. The Section 45L program encourages the construction of homes that are 50% above code and it is the *only* federal tax incentive for energy efficiency in new home construction. NAHB also recommends extending and expanding other building efficiency tax incentives to further improve the nation’s housing stock and create jobs in the battered construction sector. Policies that promote energy-efficient housing provide a short-run benefit in terms of job creation and a long-term benefits in the form of reduced energy bills for American families and protection of our natural resources.

State of the Residential Construction Sector

The home building sector has been severely challenged as result of the Great Recession. Housing starts have fallen from their peak in 2005 of more than 2 million on an annual basis to approximately 575,000 housing starts as of February 2010. This dramatic decline in construction activity has resulted in lost economic activity and jobs. Since early 2006, the residential construction sector has lost 1.3 million jobs, a disproportionate share of the more than 8 million jobs that have been lost during the Recession.

While the longer term outlook for housing remains positive, it will take some time for the housing sector to return as a vehicle for job creation and opportunity for economic benefits. For example, NAHB forecasts that housing starts will not rise to the nearly 1.2 million mark until the end of 2011, although general demand for housing – based on population growth and the need to replace older stock – still remains at 1.5 to 1.8 million units per year.

As history foretells, the home building sector must recover for any economic recovery to truly take effect. In fact, for six recessions prior to the current one, residential fixed investment (RFI) – a broad measure of home building activity’s contribution to Gross Domestic Product (GDP) – led GDP growth out of the downturn. However, with the current levels of housing inventory and the ongoing foreclosure crisis, housing is not currently poised to lead the economy to a robust recovery in 2010.

A weakened housing sector means a weak economy. Historically, home building activity has accounted for about 5% of GDP growth, while services provided by existing homes account for about 13% of GDP. This makes housing’s share of the economy approximately 18%. As of the last quarter of 2009, however, home building represented only 2.8% of the economy. And the declines in home building and home improvement routinely subtracted a full percentage point from GDP in recent quarters. These declines mean lost jobs, taxes and income.

NAHB has estimated the positive impacts from home building. Using Bureau of Economic Analysis data, NAHB economists have found:

- Construction of an average single-family home generates:
 - 3.05 full time jobs
 - \$145,400 in wage income
 - \$40,600 in small business income
 - \$45,300 in corporate income
 - \$66,500 in federal tax receipts
 - \$22,800 in state and local tax revenue

- Construction of an average multifamily housing unit generates:
 - 1.16 full time jobs
 - \$54,900 in wage income
 - \$14,900 in small business income
 - \$16,800 in corporate income
 - \$24,900 in federal tax receipts
 - \$8,600 in state and local tax revenue

- \$100,000 in remodeling expenditure generates:
 - 1.11 full time jobs
 - \$52,700 in wage income
 - \$13,800 in small business income
 - \$16,100 in corporate income
 - \$23,700 in federal tax receipts
 - \$6,600 in state and local tax revenue

The current depressed level of home building activity means that these economic benefits are lost to all stakeholders in the housing sector. However, one efficient method of providing stimulus to this sector is through the use of energy efficiency-related tax credits.

Section 45L – New Energy Efficient Home Credit

NAHB members currently build about 80 percent of all new units in the United States. Thus, the nation's home builders can profoundly affect sustainability, conservation of natural resources and protection our environment. One important avenue for achieving these goals is through the nation's tax code. The 45L credit, enacted as part of the *Energy Policy Act of 2005*, is a key market incentive that shifts builders towards significant energy savings in new home construction. The program allows a \$2,000 tax credit to a home builder who constructs a qualified new energy-efficient home (for sale or for lease [in homes of three stories or less], certified to achieve at least a 50 percent reduction in energy usage relative to the 2004 Internal Energy Conservation Code, thereby adding to the nation's housing stock a highly efficient home for 60 years or more. Because energy-efficient homes hold a higher value on the market, adding Section 45L homes to a local community's housing stock is also beneficial for state and local governments, as these homes increase the value of the area's property tax base for decades to come.

Programs like Section 45L are effective at promoting energy efficiency because they combine a tax incentive with market-determined supply and demand for home construction. Other approaches, such as an artificially-imposed mandates, require officials to establish enforcement procedures and verify compliance, absorbing scarce resources and time for state and local governments that are already suffering budgetary constraints. Meanwhile, a tax incentive simply reduces the cost of construction above minimum code requirements, i.e building highly energy-efficient homes, thereby encouraging that behavior. Further, with a tax credit, important production decisions are still reserved for builders, buyers and home owners. Consequently, a tax credit program costs little to operate and does not require expensive or expansive administrative oversight that is usually required with a mandate.

NAHB members report that the Section 45L credit is particularly beneficial to small home builders, who in many cases have the flexibility to react to marketplace preferences, such as the demand for highly-efficient homes. The credit can help develop this maturing market, which would yield long term benefits with respect to our nation's energy consumption. Increasingly, large, production home builders are also incorporating higher levels of energy efficiency into the construction of their homes. This emerging trend is due in large part to the Section 45L credit. Indeed, from a slow start in 2006, for which only about 10,000 new homes qualified for the tax credit, if the credit is extended NAHB estimates that nearly 50,000 homes would be constructed to tax credit standards.

Despite the significant downturn, data from the Residential Energy Services Network (RESNET), the primary energy rating organization for certifying Section 45L homes, shows that the market penetration percentages have grown for Section 45L homes, even though fewer homes have been built over the last three years. In the absence of data from the IRS which may capture the entire universe of claims for Section 45L, the RESNET data shows market trends that are important and significant indicators of the incentives have performed as Congress intended upon passage.

Year	New Homes Sold (US Census)	45L Certified Homes (RESNET)	% of Homes Sold
2006	105,2000	7,110	0.6
2007	77,6000	23,702	3
2008	48,5000	21,939	4.5

NOTE: While RESNET certifications capture a large percentage of homes certified to 45L, it does not capture all Section 45L homes.

Unfortunately, the 45L credit expired at the end of 2009. Extending the credit is good public policy, and the longer the extension, the more effective the program will be at delivering highly-efficient new homes. Because home building is a lengthy process, builders are unlikely to participate in a tax program that may end before the construction process is completed. Fortunately, the credit is extended for one year by H.R. 4213, the *American Workers, State and Business Relief Act of 2010*, which is now before the House of Representatives. The loss of this credit would be not only a loss for builders striving to meet market demand while preserving housing affordability, but a loss for the Congressional effort to increase energy efficiency in new homes.

In addition to extension, NAHB also recommends several modifications that will improve the overall reach of the Section 45L program. Achieving the 50-percent threshold required for the 45L credit can be an expensive, especially for smaller builders. Home builders report that the increased construction costs required to meet the 45L thresholds can far exceed the \$2,000 tax credit. In conjunction with the required basis adjustment (which reduces the value of the credit to approximately \$1300), the credit value is often incompatible with the incremental costs necessary to achieve its requirements. In today's market, these costs cannot be transferred to homebuyers; therefore Congress should provide a way to help builders ameliorate the expenses associated with achieving higher levels of energy efficiency by increasing the credit amount.

The home building industry is dominated by small businesses, typically organized as pass-thru entities (approximately 80% of NAHB's membership – 47% were organized as S Corps alone). As such, the Alternative Minimum Tax (AMT) is a real problem for claiming some tax credits. Allowing the Section 45L credit to be claimed against AMT liability would be a significant help for the program.

Finally, providing parity for conventional housing with manufactured housing would increase the scale of the benefits of the tax incentive. Under prior law, a partial tax credit for homes achieving a 30 percent improvement exists, but only for manufactured homes. Expanding the 30 percent credit program to conventional housing would increase the nation's stock of energy efficient homes.

NAHB supports H.R. 4226, the *Enhanced Energy Efficiency Building Incentives Act of 2009*, which improves the operation and extends the life of these meaningful incentives. H.R. 4226 allows for a higher-tier (\$5,000) incentive for Section 45L based on improvements in the whole-house approach, instead of just focusing on the building envelope. Additionally, H.R. 4226 allows the credit to be claimed against AMT and extends the credit until 2015. The bill

also enhances the 179D program to allow for construction of energy-efficient condos (4 stories or more above grade), and increases the credit to \$3.00 per square foot for 50% improvement over the relevant ASHRAE energy code.

Sections 25C and 25D – Residential Energy Property Credits

Two other tax incentives programs are key players in the effort to improve the nation's housing stock are Section 25C and Section 25D. Section 25C of the tax code allows homeowners who make qualified improvements, such as windows and hot water heaters, a tax credit of 30% of the cost of the improvement, up to a total of \$1,500 for 2009 and 2010 combined. The credit only applies to improvements installed in principal residences and installation costs cannot be used to determine the credit amount for building envelope materials, e.g., windows, doors, roofing materials and installation.

Section 25D allows a 30% tax credit, which is uncapped, for installation of advanced renewable energy production property in a home, such a solar panels, geothermal heat pumps, fuels cells, and small (residential) wind turbines. The credit applies to the installation of qualified property through the end of 2016. The 25D credit can be used in new or existing housing.

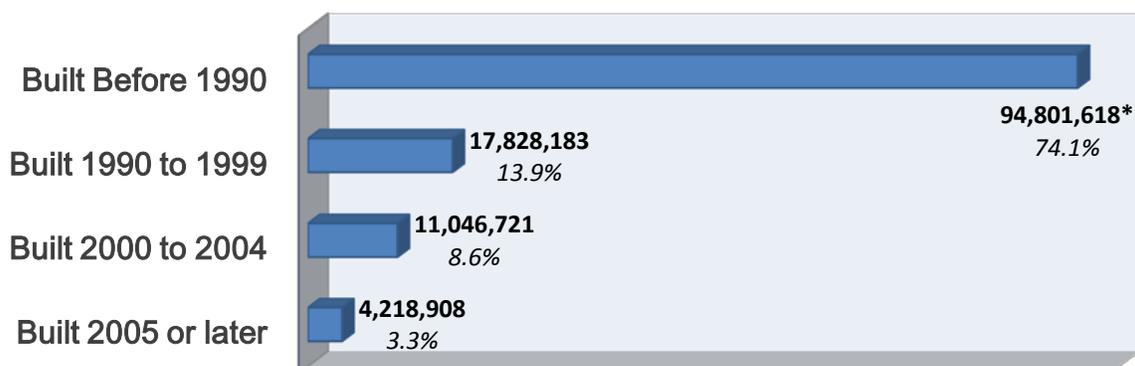
Taken together, the two credits provide a significant tax incentive for the energy efficiency initiatives in homes. IRS Statistics of Income data for 2007, albeit a year in which different rules applied, reveal the benefits of the credit to be widespread. For that tax year, 4.3 million taxpayers claimed at least one of these credits (via Form 5695), for a tax savings of \$942 million. Of these homeowners, 94% had an income of less than \$200,000.

Given the impending expiration of the section 25C tax credit and its value to the remodeling market, NAHB recommends a multiple year extension. Given the higher level of energy efficiency of newly-constructed housing, incentivizing the improvement of the nation's existing housing stock represents a powerful way to improve energy use in the residential sector. According to the Census Bureau's American Housing Survey (AHS), there are 99 million housing units that are at least 10 years old, including 71 million that are at least 30 years old. Of the 130 million existing homes in the U.S., 74% were constructed before 1990 when energy codes largely did not exist. Addressing the inefficiency of this lion's share of the residential market – i.e., older, less-efficient homes – will produce substantially more energy and financial savings for American consumers.

Age of Structure Demographics

Total Housing Units, U.S. - 127,895,430

2007 American Community Survey, U.S. Census Bureau



* Modern energy codes were primarily unsued prior to 1992.

Congress could also make several improvements to the 25C program to maximize its impact. First, Congress should increase the cap from \$1,500 to \$3,000. AHS data show that 97% of energy-related remodeling projects involve a total expenditure of \$10,000 or less. With a 30% credit, a cap of \$3,000 would allow the vast majority of these projects to qualify for a tax credit when using energy efficient products. Second, Congress should permit installation costs to be included for the installation of building envelope materials. Proper installation by a trained professional, such as a NAHB Certified Graduate Remodeler or Certified Green Professional, is important to ensuring the home is properly retrofitted, and such costs should count for the purposes of the credit.

Sections 179D – Energy Efficient Commercial Buildings Deduction

Section 179D of the tax code permits a deduction for a portion of the costs of installing energy-efficient systems into commercial buildings, including multifamily rental buildings that are four stories or more above grade. The maximum deduction is generally \$1.80 per square foot. The provision applies to improvements made before the end of 2013. Qualified improvements must achieve a 50% level of improvement above the ASHRAE Standard 90.1-2001, and partial deductions are available for more limited improvements.

The 179D deduction is targeted to commercial properties. For this reason, NAHB recommends moving multifamily rental properties from this application of this section and into the Section 45L program. Moreover, because the 179D deduction does not apply to for-sale condo units located in buildings of four stories or more above grade, NAHB suggests expanding the multifamily application of this incentive to such housing units within the 45L credit.

Similarly, a significant share of multifamily construction is completed under the section 42 Low-Income Housing Credit program (LIHTC). To make this program operate effectively with the Section 45L program, it would be necessary to provide a waiver of the basis adjustment.

Tax basis is used to determine the LIHTC credit amount, which establishes equity in affordable housing developments. Without this waiver, coordination of the energy efficiency tax incentives with the LIHTC program will be difficult to achieve.

Sections 45M – Energy Efficient Appliance Credit

Because nearly half of all the energy consumed in a home is from residents' behaviors – lighting, appliance usage, electronics, NAHB supports tax incentives that will support increased levels of efficiency for all of the components of a home, not only those related to the construction. For example, Section 45M of the tax code allows a credit to manufacturers of certain energy efficient appliances prior to 2011. The credit amount is determined by the type of appliance and the amount produced, with the program capped at \$75 million per manufacturer.

This program reduces the cost of energy efficient appliances, such as dishwashers, clothes washers, and refrigerators, for homeowners, renters, remodelers and builders. Because the delivery of these more efficient appliances to the market will help speed the introduction of those appliances for use in homes, NAHB recommends the program be extended for 2011 and beyond as a way to further promote energy savings from all components of a home, not just the building envelope/construction aspects.

Conclusion

Supporting energy efficiency enhancements to the nation's housing and building stock through a variety of tax incentives is sound public policy. Measures to support efficiency within the construction of new homes, renovation of old homes, and in components used in homes will ultimately deliver energy savings and environmental benefits that lead to greater economic benefits and recovery for the housing industry, to more job creation, and to increasing the value of the largest store of personal and individual wealth for most Americans: their home.

As many environmentalists and efficiency advocates will agree, the most effective way to save energy is to never use it in the first place. Congress cannot solely support incentivizing the production of green or renewable energy, but it must also actively support effective policies to incentivize building efficiency so that once a mature renewable and green energy production-based economy is established, the homes and buildings that support it will be using that energy in the most efficient and effective way possible.

Because of the efficacy and efficiency of using the tax code to implement energy policy and to quickly and effectively deliver results to consumers, the tax incentives outlined in this statement are the best tools to deliver meaningful savings – both in resources and administrative burdens and in utility bills for American consumers. NAHB urges Congress to continue to expand and extend a variety of important tax incentives for energy-efficient home construction – specifically Section 45L, which expired in 2009.