GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2011

Legislative Fiscal Note

BILL NUMBER: House Bill 485 (First Edition)

SHORT TITLE: New Home Purchase Stimulus.

SPONSOR(S): Representatives Brubaker, Gillespie, Johnson, and Barnhart

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15	FY 2015-16
REVENUES:					
General Fund			***See Assumptions and Methodology***		
Economic Impact			***See Assumptions and Methodology***		

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: NC Dept. of Revenue

EFFECTIVE DATE: Effective for taxable years beginning on or after July 1, 2011, and expires for taxable years beginning on or after July 1, 2012.

BILL SUMMARY:
Enacts new GS 105-151.33 to permit an individual who purchases or contracts for the construction of a permanent residence during the tax year to apply for a credit against the individual income tax imposed by Part 2 of Article 4 of GS Chapter 105. Provides that the total amount of the tax credit equals $10,000. However, the total credit may not be taken in the taxable year in which the residence was purchased. Provides that the tax credit must be taken in five equal installments beginning with the taxable year in which the residence is purchased. Sets additional limits on the amount of the credit allowed and the conditions under which the credit may or may not be allowed.

Provides criteria for applying for the credit in the case of a permanent residence purchased or contracted for jointly by a husband and wife or by two or more individuals who are not married.
Provides that to be eligible for the tax credit, the taxpayer must file an application for the credit with the Secretary of Revenue (Secretary) on a form prescribed by the Secretary and include any supporting documentation that the Secretary may require. Provides timeline for filing with the Secretary for the tax credit. Sets a ceiling for the total aggregate cost of all tax credits allowed to taxpayers under this section for purchases or contracts for the construction of permanent residences at a maximum of $100 million. Also sets the total aggregate annual cost of all tax

credits for taxpayers under this section at a maximum of $20 million annually. Provides that if the total aggregate tax credits claimed in a calendar year are more than $20 million, the Secretary will allocate the credits claimed in the required applications on a first-come, first-served basis.

Calls for forfeiture of the tax credit by an individual, who receives the allowed credit and who within 24 months after the date of purchase or execution of the contract for the construction of a permanent residence either (1) disposes of the permanent residence or (2) fails to occupy the residence. Provides an exception to the forfeiture of the credit if the disposal or failure to occupy occurs (1) as a result of the death of the individual, (2) as a result of the transfer by the individual of the residence to a spouse as a part of a divorce proceeding, or (3) because the residence is destroyed in part or whole or seized and condemned by a state or local government entity, and the taxpayer acquires a new residence within six months of being reimbursed for the destruction, seizure, or condemnation.

Requires a taxpayer allowed a credit under the proposed section to maintain and make available for inspection any records or information as required by the Secretary and states that the burden of proving eligibility for the credit is on the individual.

ASSUMPTIONS AND METHODOLOGY:

General Fund Tax Revenue Loss

The tax credit is capped at $20 million per year over five years, for a total of $100 million. This analysis assumes a base of 26,000 new homes constructed each year. Since the $20 million cap would be reached after 10,000 taxpayers receive the credit, it is assumed the cap will be reached and revenues will be reduced by $20 million each year.

Economic Impact Analysis

In addition to the tax revenue loss related to the credit, the stimulus effect of the credit is expected to result in greater economic activity and General Fund revenues. This section of the analysis will evaluate the impact of the credit in terms of 1) additional economic impact; 2) jobs; 3) General Fund revenues; and 4) local government revenues.

This portion of the fiscal memo is based on an economic impact analysis by Dr. Michael Walden, Economics Professor at NC State University. The analysis is based on several assumptions, which are noted below:

- All of the new homes eligible for the tax credit are assumed to be constructed after the effective date of the bill.
- New home prices are based on the Moody's Economy.com forecast and are projected at $211,048 for 2011.
- The effect of the credit is to reduce the price of the home by $10,000. Although this reduction takes place over a 5-year period, the credit is assumed to have the same incentive effect as a $10,000 credit given in the first year. Normally, the effect of the credits taken in the future would be discounted using an interest rate on a safe investment. Current interest rates on short-term Treasury securities are near zero, so the discount is considered to be $10,000.

- A price elasticity of demand of 1.5 is used to estimate the increased sales created by the credit. Because the $10,000 tax credit represents a 4.7% discount on the average new home value, the number of home sales is projected to increase by 7.05% (4.7% * 1.5).
- A base of 26,000 new homes per year is assumed, so the number of new homes sold as a result of the credit is 1,833 (7.05% * 26,000). In addition, because the tax credit would cause the price of new homes relative to existing homes to fall by 4%, a corresponding increase of 1,040 (26,000 * 0.04) in new home sales is assumed as a result of demand shifting from existing to new homes. As a result, the total number of additional new homes sold because of the credit is 2,873 (1,040 + 1,833).
- The multiplier used for general retail spending is 1.6. The multiplier used for residential construction is 2.53.
- Total employment impacts related to new construction is calculated as 16 workers for each $1 million of new construction value.
- The employment impact related to direct spending in the economy is 32 jobs per $1 million.
- New jobs created by the tax credit stimulus are assumed to reduce Medicaid spending by $41 million for each percentage drop in the unemployment rate. This analysis assumes that each new job created takes one person off of unemployment. The employment base used to calculate the impact on unemployment is 4,470,657.
- Impact to the General Fund is estimated as 7% of the dollar value of total economic impact. This is the ratio of General Fund revenue to personal income in North Carolina.

Economic Impact of New Home Sales

Based on the assumptions above, Dr. Walden estimates that 2,873 additional new homes will be constructed and sold as a result of the credit. These are additional sales that would not have occurred without the credit.

To calculate the economic impact of new home construction, Dr. Walden uses the formula (#units constructed) x ($ price) x (proportion of NC inputs used) x (multiplier). A value of 0.6 is used for the proportion of NC inputs, which is higher than the typical value of 0.4. The higher value is used because of the slack demand for construction during the economic downturn. Using 0.6 for the proportion of NC inputs and the multiplier and price assumptions stated above yields the results in Table 1.

Table 1. Economic Impact of New Home Sales Generated by New Home Tax Credit

Units	Price	Proportion NC Inputs	Multiplier	Economic Impact
2,873	$211,048	0.6	2.53	$920,425,492

Impact from Homebuyers who would have Bought a Home Regardless of the Credit

An additional impact will occur due to the income boosting effect of the tax credit that is taken by homebuyers who would have purchased a home with or without the tax credit. Dr. Walden estimates the number of buyers purchasing a home as a result of the credit as 2,873; thus, the number of other homebuyers taking the credit is 7,127 (10,000 – 2,873 = 7,127). The tax credit for these homebuyers will serve as additional income. Dr. Walden assumes that 40% of the credit will be spent in North Carolina with a multiplier for general retail spending of 1.6. The total value of this economic impact is demonstrated in Table 2.

Table 2. Economic Impact Tax Credit Received by Remaining Homebuyers (Homebuyers who would have purchased a home without the tax credit incentive.)				
Taxpayers	Tax Credit	Percent NC Spending	Multiplier	Economic Impact
7,127	$10,000	40%	1.6	$45,612,800

Jobs Created

The number of jobs created is determined based on the assumptions state above. Thus, new home construction is assumed to generate 16 jobs for each $1 million of new construction value. The employment impact of direct spending in the economy is 32 jobs per $1 million. This results in 14,727 jobs related to construction spending and 1,472 jobs related to direct consumer spending for a total employment impact of 16,199.

General Fund Impact

The potential General Fund Impact is calculated as 7% of the economic impact. The total economic impact from tables 1 and 2 is $966 million and the corresponding potential increase in General Fund revenues is $67.6 million. In addition, a reduction in General Fund Medicaid spending is estimated by using the assumption of $41 million in reduced Medicaid expenditures per 1% reduction in the unemployment rate. This calculation results in $15.2 million in reduced General Fund spending for a total General Fund impact of $82.8 million.

The economic benefit to the General Fund would occur in the first year of the tax credit (FY 11-12), while the revenue loss from the tax credit would be spread over five years as illustrated in Table 3.

Table 3. Potential General Fund Impact of New Home Tax Credit ($millions)					
	FY 11-12	FY 12-13	FY 13-14	FY 14-15	FY 15-16
Cost of Credit	-$20.0	-$20.0	-$20.0	-$20.0	-$20.0
Additional General Fund Revenues	$67.6	$0.0	$0.0	$0.0	$0.0
Reduction in Medicaid Expenditures	$15.2	$0.0	$0.0	$0.0	$0.0
Potential General Fund Impact	$62.8	-$20.0	-$20.0	-$20.0	-$20.0

Local Government Impact

The local government impact would occur in the form of property taxes collected from homes constructed as a result of the credit. This impact is calculated by multiplying the number of homes constructed as a result of the credit (2,873) by the average value of the homes ($211,048) and the weighted average statewide property tax rate (0.87%).[1] This results in an annual impact of $5.3 million in local revenue.

Table 4 provides a 5-year summary of state and local impacts.

Table 4. Potential General Fund and Local Government Impact of New Home Tax Credit ($millions)					
	FY 11-12	FY 12-13	FY 13-14	FY 14-15	FY 15-16
General Fund	$62.8	-$20.0	-$20.0	-$20.0	-$20.0
Local Governments	$5.3	$5.3	$5.3	$5.3	$5.3

1. The weighted average statewide property tax rate was obtained from the NC Department of Revenue Statistical Abstract and is based on the 2009-10 tax year rates.

SOURCES OF DATA: *Estimated Economic and General Fund Impact of the Proposed North Carolina Tax Credit for the Purchase of a New Home*, Dr. Michael L. Walden, Reynolds Distinguished Professor, North Carolina State University

TECHNICAL CONSIDERATIONS: None

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