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Statement of
LUIS P. SALAVERIA
Director
Department of Business, Economic Development, and Tourism
Before the

HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS

Friday, February 10, 2017
9:00a.m.
State Capitol, Conference Room 309

In consideration of
HB 644
RELATING TO NEW MARKET TAX CREDITS.

Chair Nakashima, Vice-Chair Keohokalole, and Committee members.

The Department of Business, Economic Development, and Tourism (DBEDT) offers comments for HB 644. DBEDT appreciates the intent of HB 644, which is to promote economic development and leverage available federal funding sources. We are concerned, however, about the cost implications this proposal could have on the department's and overall State's budget.

This bill does not provide the necessary funding for loan guarantees within the Community-Based Economic Development (CBED) Revolving Fund, nor for staff with the necessary expertise to administer complex financial instruments such as the Federal government's New Market Tax Credits.

Also of concern, is the new addition to Section 210D-9 Loans, No. 3, which adds new language to the statute, "Loans to entities that capitalize qualified community development entities that use the proceeds to make loans to borrowers." This addition directly conflicts with Chapter 116, Hawaii Administrative Rules, Section 15-116-4 Purpose of loans, which states, "Loans shall not be made where the direct or indirect purpose or result would be to: (5) Provide funds to an applicant to engage in the business of lending or investing money."

Thank you for the opportunity to testify.

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GOVERNOR

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To: The Honorable Mark M. Nakashima, Chair
and Members of the House Committee on Economic Development and Business

Date: Friday, February 10, 2017
Time: 9:00 A.M.
Place: Conference Room 309, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 644, Relating to New Market Tax Credits

The Department of Taxation (Department) appreciates the intent of H.B. 644, defers to the Department of Business, Economic Development, and Tourism (DBEDT) on the merits of this bill, and provides the following additional comments regarding H.B. 644 for your consideration.

Among other things, H.B. 644 adds a definition of "Community Development Entity" (CDE) to Section 210D-2, Hawaii Revised Statutes, which is intended to provide financing to businesses in Hawaii through a structure that facilitates the use of the federal New Market Tax Credit (NMTC). The measure is effective on July 1, 2017.

The NMTC Program was enacted by Congress as part of the Community Renewal Tax Relief Act of 2000, and is found in section 45D of the Internal Revenue Code (IRC). It permits individual and corporate taxpayers to receive a credit against federal income taxes for making Qualified Equity Investments (QEIs) in qualified CDEs. These investments are expected to result in the creation of jobs and material improvement in the lives of residents of low-income communities. Examples of expected projects include financing small businesses, improving community facilities such as daycare centers, and increasing home ownership opportunities.

A "low-income community" is defined as any population census tract where the poverty rate for such tract is at least 20% or in the case of a tract not located within a metropolitan area, median family income for such tract does not exceed 80% of statewide median family income, or in the case of a tract located within a metropolitan area, the median family income for such tract does not exceed 80% of the greater of statewide median family income or the metropolitan area median family income. As part of the American Jobs Creation Act of 2004, IRC section 45D(e)(2) was amended to provide that targeted populations may be treated as low-income communities.

The NMTC program is intended to attract capital to low income communities by providing private investors with a federal tax credit for investments made in businesses or economic development projects located in distressed communities in the nation. A NMTC investor receives a tax credit equal to 39 percent of the total QEI made in a CDE, with the credit taken over a seven-year period: 5 percent annually for the first three years and 6 percent in years four through seven. If an investor redeems a NMTC investment before the seven-year term has run its course, all credits taken to date are recaptured with interest.

It should be first noted that the NMTC has been extended through 2019 under the Protecting Americans from Tax Hikes Act of 2015. The NMTC is a highly technical credit. Generally speaking, the CDE must first enter into an allocation agreement with the Community Development Financial Institutions Fund (CDFI), which specifies the terms of the NMTC allocation under IRC section 45D(f)(2). The CDE must provide notice to any investor who makes a QEI in the CDE at its original issue that the equity investment is in fact a QEI entitling the investor to claim the NMTC, and must be provided by the CDE to the taxpayer no later than 60 days after the date the investor makes the equity investment in the CDE. The notice must contain the amount paid to the CDE for the QEI at its original issue and the CDE's taxpayer identification number. (Treas. Reg. § 1.45D-1(g)(2)(A)).

Under IRC section 45D(c)(1), a CDE is any domestic corporation or partnership:

1. Whose primary mission is serving or providing investment capital for low-income communities or low-income persons;
2. That maintains accountability to residents of low-income communities through their representation on any governing board or advisory board of the CDE; and
3. Has been certified as a CDE by the CDFI Fund.

Therefore, before any credits can be allocated, it is imperative that any CDE created by this measure be certified by the CDFI fund. The CDFI Fund is responsible for establishing the credit application process, eligibility guidelines, and a scoring model for ranking applicants requesting allocations of NMTC. The CDFI Fund in turn grants credit authority to the CDE- i.e. the ability to issue a specific amount of NMTC in exchange for equity investments. The CDE must then invest substantially all of the cash in low-income communities within 12 months of receiving the funds.

Because making loans and ranking eligible businesses for funding is not a function of the Department, and one in which it has no expertise, the Department has no objection to the measure as currently written.

Thank you for the opportunity to provide comments.

SUBJECT: MISCELLANEOUS, Align Community-Based Economic Development Financial Assistance Program to Federal New Markets Tax Credit

BILL NUMBER: SB 765; HB 644 (Identical)

INTRODUCED BY: SB by WAKAI, ENGLISH, ESPERO, GALUTERIA, KEITH-AGARAN, NISHIHARA, TANIGUCHI, S. Chang, Harimoto, Ihara, K. Kahele, Riviere; HB by CULLEN, NAKASHIMA

EXECUTIVE SUMMARY: The measure amends DBEDT's existing community-based economic development technical and financial assistance program so that it is able to lend to investors who are capitalizing a "qualified community development entity" or QCDE. We question whether the State should be helping the investors, who might not even be here, as opposed to the low-income individuals and businesses that are here and need the help.

BRIEF SUMMARY: Amends HRS section 210D-8 to allow DBEDT to provide loans, grants, guarantees, and credit enhancements; and to provide, participate in, and acquire loans used to capitalize QCDEs and similar entities.

Defines a QCDE the same as in Internal Revenue Code section 45D(c)(1). Section 45D is the law authorizing the federal New Markets Tax Credit (NMTC).

EFFECTIVE DATE: July 1, 2017.

STAFF COMMENTS: The NMTC Program, enacted by Congress as part of the Community Renewal Tax Relief Act of 2000, is defined in section 45D of the Internal Revenue Code. This Code section permits individual and corporate taxpayers to receive a credit against federal income taxes for making Qualified Equity Investments in qualified community development entities (QCDEs). The amount of the credit is 39% of the amount of investment, spread over seven years.

These investments are expected to result in the creation of jobs and material improvement in the lives of residents of low-income communities. Examples of expected projects include financing small businesses, improving community facilities such as daycare centers, and increasing home ownership opportunities.

A "low-income community" is defined as any population census tract where the poverty rate for such tract is at least 20% or in the case of a tract not located within a metropolitan area, median family income for such tract does not exceed 80 of statewide median family income, or in the case of a tract located within a metropolitan area, the median family income for such tract does not exceed 80% of the greater of statewide median family income or the metropolitan area median family income.

As part of the American Jobs Creation Act of 2004, IRC §45D(e)(2) was amended to provide that targeted populations may be treated as low-income communities. A "targeted population" means individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments.

"Targeted population" also includes the Hurricane Katrina Gulf Opportunity (GO) Zone, where individuals' principal residences or principal sources of income were located in areas that were flooded, sustained heavy damage, or sustained catastrophic damage as a result of Hurricane Katrina.

In the Internal Revenue Code, a QCDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons, (2) that maintains accountability to residents of low-income communities through their representation on any governing board or advisory board of the CDE, and (3) has been certified as a QCDE by the U.S. Treasury Department's Community Development Financial Institutions (CDFI) Fund.

A QCDE certification lasts for the life of the organization unless it is revoked or terminated by the CDFI Fund. To maintain its QCDE certification, a QCDE must certify annually during this period that the QCDE has continued to meet the qualification requirements.

Both for-profit and non-profit QCDEs may apply to the CDFI Fund for an allocation of New Markets Tax Credits, but only a for-profit QCDE is permitted to provide the credits to its investors. Thus, if a non-profit QCDE receives an allocation of credits from the CDFI Fund, it must "sub-allocate" its NMTC allocation to one or more for-profit QCDEs.

Here, the point of DBEDT's existing program appears to be to provide financial and technical assistance to start-up businesses in economically challenged areas. The NMTC is a program to accomplish similar goals, but does so by providing incentives to private investors who will capitalize the QCDEs, entities that are required to be focused on their target low-income individuals or communities. One effect of the bill is to provide additional or enhanced incentives to these private investors, who then would be able to leverage State funds instead of using their own money to reap federal credits. Why do the private investors, who probably aren't even in Hawaii, deserve State money for that purpose? If we are trying to help targeted individuals or communities, which is the apparent goal of DBEDT's program, why can't we just aid them directly?

Digested 1/26/2017

LATE

DATE: February 10, 2017

TO: Chair Mark M. Nakashima, Vice-Chair Jarrett Keohokalole and Members of the House Committee on Economic Development and Business

MEASURE: HB644

SUBJ: Testimony in Strong Support of HB644

Good morning Chair Nakashima, Vice-Chair Keohokalole and Members of the House Committee on Economic Development and Business. My name is Bob Hall, Partner with Pacific Growth Associates, and I submit testimony in strong support of HB644.

Community Based Organizations (CBOs) in Hawaii have played an important role in bringing about social and economic improvement to our communities. CBOs support our well being by means of providing economic, educational, environmental, health care, and housing services within their respective communities. They are catalytic in nurturing local, sustainable initiatives. Most seek grant and private funding year round for operational support and key community projects. Many also seek Legislative support each year through State Grant-in-Aid.

The Hawaii Community Based-Economic Development (CBED) Technical and Financial Assistance Program, facilitated by DBEDT, was established to provide financial assistance to community-based businesses and enterprises through low-interest loans and grants to qualifying applicants. HB644 provides yet another financing "tool" utilizing public-private partnerships that can optimize a wide variety of funding sources.

HB644 will serve as a "tool" that enables CBOs to utilize CBED financing as leverage to bring forth further equity through the federal New Markets Tax Credit (NMTC). Essentially, those who receive $1.00 in CBED financing could leverage each dollar through a NMTC transaction and create an additional $.39 in equity. HB644 also adds guarantees and credit enhancements to the program's current loan and grants provisions of §201D-8. This change compliments the intent and purpose of the CBED Technical and Financial Assistance Program and establishes leveraging opportunities through programs such as the federal NMTC program as another financing opportunity.

The federal NMTC program is currently the largest federal economic development incentive program. The program was enacted as part of the Community Renewal Tax Relief Act of 2000 to encourage investment in low-income communities. Economic incentives are important in helping low-income census tracts recover from the recession, since these areas usually have the most difficulty generating new capital.

NMTCs are a tax credit, not a tax deduction. A tax credit can be given to the IRS instead of making a cash payment for taxes owed by the investor. The investor is typically a bank or insurance company. NMTC is very flexible and can be used for a wide range of purposes. Most types of businesses, including not-for-profit businesses are eligible for

NMTC subsidy. The program has supported a wide variety of community and economic development initiatives including restaurants, childcare facilities, community centers, charter schools, supermarkets, shopping centers, manufacturing and industrial facilities, health care centers, and mixed-use buildings with affordable housing.

Pacific Growth Associates (PGA) is a strong advocate for successful CBOs. Over the past 5 years, PGA has facilitated over $70 million in private equity through the NMTC Program, which in turn has built 3 Federally Qualified Health Centers (1 FQHC is located on Hawaiian Home Lands), 1 business and retail incubator with a commercial kitchen, and 1 Community Center on Hawaiian Home Lands.

PGA strongly supports HB644 and its intended results, as it will further assist CBOs meet their mission and in turn improve the well being of our communities.

Respectfully Submitted,

Bob Hall, Partner
Pacific Growth Associates