LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

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

BILL NUMBER: SB 765, SD-2

INTRODUCED BY: Senate Committee on Ways and Means

EXECUTIVE SUMMARY: The measure amends DBEDT's existing community-based economic development technical and financial assistance program so that it can 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.

SYNOPSIS: Amends section 210D-2, HRS, to 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).

Amends HRS section 210D-8 to allow DBEDT to provide, participate in, and acquire loans used to capitalize entities that make financing available for activities and enterprises, including QCDEs.

Amends HRS section 210D-10 to change the loan limit from $250,000 to _____, and to change the maximum term of a loan from ten to ___ years.

EFFECTIVE DATE: July 1, 2050.

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 3/6/2018

DAVID Y. IGE
GOVERNOR

LUIS P. SALAVERIA
DIRECTOR

MARY ALICE EVANS
DEPUTY DIRECTOR

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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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, March 9, 2018
11:00 a.m.
State Capitol, Conference Room 309

In consideration of
SB 765, SD2
RELATING TO NEW MARKET TAX CREDITS.

Chair Evans, Vice Chair Keohokalole and Members of the Committee.

The Department of Business, Economic Development, and Tourism (DBEDT) offers comments for SB 765, SD2. We are concerned 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.

Presently, there is only $100,000 in the CBED fund which is not enough to guarantee any new market tax credit loans. An additional $400,000 is necessary for the CBED fund to guarantee average sizes of new market tax loans. In addition, DBEDT estimates that an additional $125,000 in each year of the biennium is necessary to implement and administer this measure.

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.

DATE: March 9, 2018

TO: Chair Cindy Evans, Vice-Chair Jarrett Keohokalole and Members of the House Committee on Economic Development and Business (EDB)

MEASURE: SB765, SD2

SUBJ: Testimony in Strong Support of SB765, SD2

Good morning Chair Evans, 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 SB765, SD2.

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. CBOs are tireless in seeking grant and private funding year-round for operational and community projects support. Many seek Legislative support each year through State Grant-in-Aid. Others rely on financing through low-interest loans.

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. <u>This proposed SB765, SD2 legislation will enable CBED's low-interest loans to be leveraged to bring forth further equity through the federal New Markets Tax Credit (NMTC) or other equivalent federal programs by just adding the definition of "qualified community development entity".</u> Essentially, those who receive $1.00 in CBED financing could leverage each dollar through a NMTC transaction and create an additional $.39 in equity. 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. 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 6 years, PGA has facilitated over $90 million in private equity through the NMTC Program, which in turn has built 3 Federally Qualified Health Centers, 1 business and retail incubator with a commercial kitchen, and 2 Community Centers on Hawaiian Home Lands.

PGA strongly supports SB765, SD2 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

SB-765-SD-2
Submitted on: 3/8/2018 7:10:58 AM
Testimony for EDB on 3/9/2018 11:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Diana Shaw	Individual	Support	No

Comments:

SB-765-SD-2
Submitted on: 3/8/2018 7:41:44 AM
Testimony for EDB on 3/9/2018 11:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Melodie Aduja	OCC Legislative Priorities Committee, Democratic Party of Hawai'i	Support	No

Comments:

PRESENTATION OF THE
OAHU COUNTY COMMITTEE ON LEGISLATIVE PRIORITIES
DEMOCRATIC PARTY OF HAWAII
TO THE COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS
THE HOUSE OF REPRESENTATIVES
TWENTY-NINTH LEGISLATURE
REGULAR SESSION OF 2018
Friday, March 9, 2018
11:00 a.m.
Hawaii State Capitol, Conference Room 309

RE: Testimony in Support of **SB765 SD2** RELATING TO NEW MARKET TAX CREDITS

To the Honorable Cindy Evans, Chair; the Honorable Jarrett Keohokalole, Vice-Chair and the Members of the Committee on Economic Development & Business:

Good morning, my name is Melodie Aduja. I serve as Chair of the Oahu County Committee ("OCC") Legislative Priorities Committee of the Democratic Party of Hawaii. Thank you for the opportunity to provide written testimony on **SB765 SD2** relating to Economic Development; New Markets Tax Credits; Loans; and Qualified Community Development Entity.

The OCC Legislative Priorities Committee is in favor of **SB765 SD2** and supports its passage.

SB765 SD2 is in alignment with the Platform of the Democratic Party of Hawai'i ("DPH"), 2016, as it expands methods for the delivery of funding to projects under the Hawaii community-based economic development technical and financial assistance program by providing loans to capitalize a qualified community development entity and removes the cap on loan amounts and terms under the program.

Specifically, the Platform of the Democratic Party of Hawai'i provides that "[h]ousing is a basic human need and we believe that adequate, accessible, affordable, and safe housing should be available to all residents of Hawaiʻi. Affordable housing that is fair in proportion to individual income is the basis of prosperity for our citizens and stability in our economy. Recent and past real estate bubbles have fueled disproportionate rent increases, a key contributor to homelessness. Therefore, we support efforts to promote truly affordable housing for all citizens who rent.

We also need economically affordable home ownership. To this end we support policies which re-think the current formula to determine "affordability" as this formula puts both rentals and sales out of the reach of most working families in Hawai`i.

We support circuit breaker or other relief to ensure that senior citizens are not taxed out of their homes.

We believe in the concept of "Housing First" to develop affordable, stable housing and support services to break the cycle of homelessness for people with the fewest housing options.

We support dedicated social services and housing opportunities for Hawaii's homeless population, to get them off the streets and reintegrated into society, with specific devoted services for disenfranchised groups including but not limited to the Hawaiian community, aged-out foster kids, youth, returning veterans, the aged, and lesbian, gay, bisexual and transgender homeless. (Platform of the DPH, P. 7, Lines 340-354(2016)).

Given that **SB765 SD2** expands methods for the delivery of funding to projects under the (1) Hawaii community-based economic development technical and financial assistance program providing low-interest loans and grants and removing the cap on loan amounts and terms under the program, and (2) the federal New Market Tax Credit Program providing private investors with a federal income tax credit for qualified equity investments in qualified community developments intended to attract capital for low-income communities, it is the position of the OCC Legislative Priorities Committee to support this measure.

Thank you very much for your kind consideration.

Sincerely yours,

/s/ Melodie Aduja
Melodie Aduja, Chair, OCC Legislative Priorities Committee
Email: legislativepriorities@gmail.com, Tel.: (808) 258-8889

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To: The Honorable Cindy Evans, Chair
and Members of the House Committee on Economic Development & Business

Date: Friday, March 9, 2018
Time: 11:00 A.M.
Place: Conference Room 309, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 765, S.D. 2, Relating to New Market Tax Credits

The Department of Taxation (Department) provides the following comments regarding S.B. 765, S.D. 2, for your consideration.

Among other things, S.B. 765, S.D. 2, a carryover measure from the 2017 Legislative Session, adds a definition of "Community Development Entity" (CDE) to Hawaii Revised Statutes section 210D-2, 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 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.

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 (CDFI) Fund (a unit of the United States Treasury), 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.

LATE

SB-765-SD-2
Submitted on: 3/8/2018 5:49:28 PM
Testimony for EDB on 3/9/2018 11:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Craig "Bo" Kahui	Laiopua 2020/ Villages of Laiopua Association	Support	No

Comments:

Laiopua 2020 has been the receint of NMTC in the approx. amount of $22M.

The equity investment dollars help to create and build the West Haeaii Community Health & Dental Center. which currently serves 33% of our Villages of Laiopua Homestead communty members. In addition, L2020 is currently building its new community center to serve as a workforc e and vocational training center and a gathering place for our native Hawaiian community and surrounding neighborhoods. Without NMTC, L2020 and our west Hawaii resident would not have the opputunity for a community health serevice center providing much needed health care services.

Therefore, Laiopua 2020 and the Villages of Laiopua Association Board join together in support of SB 765 and House companion HB644