WRITTEN TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
KA ʻOIHANA O KA LOIO KUHINA
THIRTY-SECOND LEGISLATURE, 2023

ON THE FOLLOWING MEASURE:
S.B. NO. 1295, S.D. 1, PROPOSING AMENDMENTS TO ARTICLE VII, SECTIONS 12 AND 13, OF THE HAWAII CONSTITUTION TO EXPRESSLY PROVIDE THAT THE LEGISLATURE MAY AUTHORIZE THE COUNTIES TO ISSUE TAX INCREMENT BONDS AND TO EXCLUDE TAX INCREMENT BONDS FROM DETERMINATIONS OF THE FUNDED DEBT OF THE COUNTIES.

BEFORE THE:
SENATE COMMITTEE ON WAYS AND MEANS

DATE: Wednesday, February 15, 2023 **TIME:** 10:30 a.m.

LOCATION: State Capitol, Room 211

TESTIFIER(S): **WRITTEN TESTIMONY ONLY.**
(For more information, contact Randall S. Nishiyama, Deputy Attorney General, at 808-586-1267)

Chair Dela Cruz and Members of the Committee:

The Department of the Attorney General (Department) provides the following comments and suggests wording that better defines the term "tax increment bonds" to replace the current wording on page 4, line 14, through page 5, line 3.

This bill proposes to amend article VII, section 12, of the Hawaii State Constitution to expressly permit the counties to issue tax increment bonds and exclude tax increment bonds in calculating the debt limit of the political subdivisions. Tax increment bonds can be used to finance public improvements for redevelopment and for economic development within a designated tax increment area.

Tax increment bonds work as follows:

1. A county establishes a tax increment district with specified boundaries.
2. When the tax increment district is formed, the total assessed value of the taxable real property in the tax increment district becomes the basis for allocating future real property taxes on that property (the "assessment base").
3. Each year, the real property tax generated by applying the tax rate to the assessment base is deposited into the county's general fund. The

> increment of tax generated by applying the tax rate to the amount by which the then current assessed value exceeds the assessment base is used to pay the tax increment bonds.

The function of tax increment bonds is to use the incremental real property taxes (which the private developer or property owner would be paying in any event) to pay for qualifying project costs, and not to use any county moneys to fund such projects.

While section 46-103, Hawaii Revised Statutes (HRS), permits a county council to provide for tax increment financing, and section 46-104(2), HRS, grants a county the power to issue tax increment bonds, we note that tax increment bonds do not neatly fit within the categories of bonds that the Legislature may authorize a political subdivision such as a county to issue under article VII, section 12, of the Hawaii State Constitution.

In addressing the ability of a county to issue bonds, article VII, section 12, of the Hawaii State Constitution provides that "[t]he legislature by general law shall authorize political subdivisions to issue general obligation bonds, bonds issued under special improvement statutes and revenue bonds and shall prescribe the manner and procedure for such issuance."

Tax increment bonds are not general obligation bonds, that is, bonds supported by the full faith and credit of a county. See section 46-106(i), HRS. Further, tax increment bonds do not appear to be special improvement bonds within the scope of sections 46-80.1 and 46-80.5, HRS. Also, tax increment bonds do not fit within the category of revenue bonds under article VII, section 12, of the Hawaii State Constitution, which are "bonds payable from the revenues, or user taxes, or any combination of both, of a public undertaking, improvement, system or loan program." Moneys collected from tax increments under section 46-105, HRS, are not revenues as defined by section 49-1, HRS, nor are they user taxes, as also defined in section 49-1. Consequently, we believe that this bill's amendments to article VII, section 12, of the Hawaii State Constitution, are necessary to authorize tax increment bonds for the counties.

Further, we note that tax increment bonds do not fit within the categories of bonds that the Legislature may authorize a county to exclude for debt limit purposes under article VII, section 13, of the Hawaii State Constitution. Therefore, the amendments to article VII, section 13, of the Hawaii State Constitution, as proposed in the bill, are necessary to exclude tax increment bonds for debt limit purposes.

In accordance with the above, the Department recommends replacing the current definition of tax increment bonds in the bill (page 4, line 14, through page 5, line 3) with the following (for purposes of this recommendation, only the suggested changes are bracketed and stricken or underscored). :

> 10. The term "tax increment bonds" means all bonds, the principal of and interest on which are payable from and secured solely by [~~all~~] the amount of real property taxes levied and collected by a political subdivision, such as a county, on the difference between the assessed [~~valuation~~] value of the taxable real property [~~in~~] located within the boundaries of a tax increment district established by [~~the~~] a political subdivision [~~that is in excess of~~] in a given year and the assessed [~~valuation~~] value of the taxable real property [~~for the fiscal year prior to the effective date specified by resolution of the political subdivision of the specified public works, public improvements or other actions by the political subdivision with the~~] in such tax increment district[~~.~~] during the year of creation of such tax increment district.

We respectfully ask the Committee to consider our comments.

HAWAIʻI COMMUNITY DEVELOPMENT AUTHORITY

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JOSH GREEN, M.D.
GOVERNOR

CHASON ISHII
CHAIRPERSON

CRAIG K. NAKAMOTO
EXECUTIVE DIRECTOR

Statement of
Craig K. Nakamoto, Executive Director
Hawaiʻi Community Development Authority

before the
SENATE COMMITTEE ON COMMITTEE ON WAYS AND MEANS

Wednesday, February 15, 2023
10:30 AM
State Capitol, Conference Room 211 & Videoconference

In consideration of
S.B. 1295, S.D.1
Proposing Amendments to Article VII, Sections 12 and 13, of the Hawaii Constitution to Expressly Provide That The Legislature May Authorize The Counties to Issue Tax Increment Bonds and to Exclude Tax Increment Bonds From Determinations of The Funded Debt of The Counties.

Chair Dela Cruz, Vice Chair Keith-Agaran, and members of the Committee.

The Hawaiʻi Community Development Authority (HCDA) **supports S.B. 1295, S.D.1**, that proposes to amend the Hawaiʻi Constitution to allow the Legislature to authorize the counties to issue tax increment bonds and to exclude tax increment bonds from the funded debt of the counties.

Tax increment bonds would offer a means of financing for the construction of large public infrastructure like streets, sidewalks, utilities, storm water and sea level management systems on state and private lands, allowing the counties to provide these needed improvements and pay for them later with the anticipated increase in tax revenues subsequent development in the area will generate.

Thank you for the opportunity to testify in support of this measure.

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM
KA ʻOIHANA HOʻOMOHALA PĀʻOIHANA, ʻIMI WAIWAI A HOʻOMĀKAʻIKAʻI

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Statement of
CHRIS J. SADAYASU
Director
Department of Business, Economic Development and Tourism
before the
SENATE COMMITTEE ON WAYS AND MEANS
Wednesday, February 15, 2023
10:30 AM
State Capitol, Conference Room 211
In consideration of
BILL NO. SB1295, SD1
PROPOSING AMENDMENTS TO ARTICLE VII, SECTIONS 12 AND 13, OF THE HAWAII CONSTITUTION TO EXPRESSLY PROVIDE THAT THE LEGISLATURE MAY AUTHORIZE THE COUNTIES TO ISSUE TAX INCREMENT BONDS AND TO EXCLUDE TAX INCREMENT BONDS FROM DETERMINATIONS OF THE FUNDED DEBT OF THE COUNTIES.

Chair Dela Cruz, Vice Chair Keith-Agaran, and members of the Committee on Ways and Means:

The Department of Business, Economic Development and Tourism (DBEDT) **strongly supports** SB 1295, SD1, an Administration Bill, which proposes amendments to the State Constitution to expressly provide that the legislature may authorize the counties to issue tax increment bonds; and exclude tax increment bonds in calculating the debt limit of the counties.

The ability for counties to use tax increment bonds as a value capture financing tool has been hampered by uncertainty in the allowance of its use in the State Constitution, although they are authorized under HRS Chapter 46. This constitutional cloud could be lifted by passage of this bill, which includes a ballot question to be posed to the electorate in the upcoming election.

Tax increment financing (TIF) is widely used in other states to capture the increased property values in dense, mixed-use transit-oriented development, and used to fund the required regional public infrastructure improvements.

Thank you for the opportunity to testify.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: CONSTITUTIONAL AMENDMENT, Allow Counties to Issue Tax Increment Bonds and Exclude from County Debt Limit

BILL NUMBER: SB 1295 SD 1

INTRODUCED BY: Senate Committee on Judiciary

EXECUTIVE SUMMARY: Proposes amendments to the Constitution of the State of Hawai‘i to expressly provide that the legislature may authorize political subdivisions, such as counties, to issue tax increment bonds and to exclude tax increment bonds in calculating the debt limit of the political subdivisions.

SYNOPSIS: Amends Article VII, Section 12 of the Constitution to add the definition of "tax increment bonds" as all bonds, the principal of and interest on which are payable from and secured solely by all real property taxes levied by a political subdivision, such as a county, on the assessed valuation of the real property in a tax increment district established by the political subdivision that is in excess of the assessed valuation of the real property for the fiscal year prior to the effective date specified by resolution of the political subdivision of the specified public works, public improvements or other actions by the political subdivision within the tax increment district.

Authorizes counties to issue tax increment bonds.

Amends Article VII, Section 13 of the Constitution to exclude from the debt limit tax increment bonds, but only to the extent that the principal of and interest on the bonds are in fact paid from the real property taxes levied by a political subdivision, such as a county, on the assessed valuation of the real property in a tax increment district established by the political subdivision that is in excess of the assessed valuation of the real property for the fiscal year prior to the effective date specified by resolution of the political subdivision of the specified public works, public improvements or other actions by the political subdivision within the tax increment district.

EFFECTIVE DATE: Upon compliance with article XVII, section 3, of the Constitution of the State of Hawaii.

STAFF COMMENTS: This is an Administration measure sponsored by DBEDT and designated BED-12 (23).

The proposed measure would allow each of the counties to issue tax increment bonds and utilize the concept of tax increment financing as another means of financing capital improvements. The concept of tax increment financing is based on increased property tax revenue generated from rising property tax assessments which result from the improvements. Under a tax increment financing plan, a specific geographic area would be designated as a tax increment district for which tax increment bonds would be sold to cover capital improvement project costs within that district.

Upon the designation of a tax increment district an "assessment base" is established, based on the total assessed value of taxable real property in a tax increment district at that time. A "tax increment," which is the amount by which the current valuation of the real property exceeds the assessment base, is then determined. The revenues derived from the assessment base would be paid into the county's general fund while the revenues derived from the tax increment would be deposited into the tax increment fund. In addition to the revenues derived from the determination of the tax increment, the proceeds of tax increment bonds are also to be deposited into the tax increment fund. The total revenues in the tax increment fund are then be used to finance capital improvements including debt repayment made to the tax increment district which, in turn, will result in increased property valuations due to renovation and increased capital improvements within the designated district.

While this concept provides another means for the financing of capital improvements, caution should be exercised to ensure that the amount of revenues generated within a tax increment district will be enough to cover the debt service of the tax increment bonds issued. Provisions should be made to ensure that this method of financing is not abused as it has been in other states. Specifically, it should be provided that once a tax increment financing district has been designated and the project costs estimated, such districts may not be enlarged nor shall expenditures exceed projections to include purposes other than originally authorized without specific local government approval.

In other words, in designating such districts, certification of assessment values should be done to ensure that valuations of properties within the tax increment district will increase sufficiently to generate enough revenues to repay the cost of the bonds sold. Conversely, specific provisions should be made to ensure that any excess revenues are returned to the county general fund.

The measure also provides that tax increment bonds shall be excluded from the determination of funded debt of the counties for purposes of the constitutional spending ceiling. It is questionable why tax increment bonds should be treated differently from any other debt of the counties.

As the Hawaii Supreme Court explained in *Convention Center Authority v. Anzai,* 78 Haw. 157, 890 P.2d 1197 (1995), Hawaii's Constitution has had some form of debt limitation in place essentially from its inception. Under the Organic Act, the debt limit was set at ten percent of the assessed value of real property. The limit was subsequently increased to fifteen percent at the 1950 Constitutional Convention. The present structure of the debt limit and its exceptions was adopted by the 1968 Constitutional Convention, where the delegates were particularly wary of the implications of pledging the full faith and credit of the state behind an undertaking that was not "self-sustaining" or whose revenues, and/or the user taxes derived from the undertaking, could not cover the debt service charges. That is why the present constitutional provisions provide for the excludability of reimbursable general obligation bonds from the debt limit to the extent that "reimbursements are in fact made from the net revenue, or net user tax receipts, or combination of both, as determined for the immediately preceding fiscal year." Haw. Const. art.

VII, § 13(6). In other words, the amounts that are not directly reimbursed to the general fund by revenue and/or user taxes are not excludable from the debt limit. This compromise position carefully balances the competing interests of flexibility and security.

We question the wisdom of writing an exception into our constitutional debt limit safeguards for debt that is supposed to be paid back by increased property tax revenues from development that has yet to occur. If the development does not deliver as advertised, government remains on the hook to repay the bonds, meaning that all of us suffer.

Digested: 2/12/2023

TO: Members of the Committee on Ways and Means

FROM: Natalie Iwasa, CPA, CFE
808-395-3233

HEARING: 10:30 a.m. Wednesday, February 15, 2023

SUBJECT: SB 1295, SD1, Proposed Constitutional Amendment to Authorize Counties to Issue Tax Increment Bonds – **OPPOSED**

Aloha Chair Dela Cruz and Committee Members,

Thank you for allowing the opportunity to provide testimony on SB 1295, SD1, which proposes a constitutional amendment to authorize counties to issue tax increment bonds and to exclude such bonds from county debt limits. I oppose this bill.

Tax increment bonds are used to fund capital improvements, which then theoretically result in increased assessed values of the underlying properties, which result in higher taxes that are used to pay off the bonds.

What happens if the increased assessed values and resulting taxes fall short of projections?

Tax increment bonds would provide incentive for increasing assessed values or rates (or both), perhaps beyond amounts that would otherwise be determined.

The other part of the bill would exclude the debt from county debt limits. I see no good reason to exclude tax increment bonds from county debt limits.

Please vote "no" on SB 1295, SD1.