Date of Hearing: April 23, 2019

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY
Sabrina Cervantes, Chair
AB 1259 (Luz Rivas, Cervantes, and E Garcia) – As Introduced February 21, 2019

SUBJECT: Personal income taxes: corporation taxes: credits: California New Markets Tax Credit

POLICY FRAME: Although California demonstrates policy leadership regarding the future of its economy in areas that emphasize our state's roles as a technology giant, leader in environmental sustainability, significant participant in global supply chains, and driver for middle-skill workforce development, California remains short on one crucial piece. California's increasing income inequality remains noticeably outside the scope of the state's primary economic development programs. Addressing the state's growing disparities among different geographic regions and population groups requires public policy solutions that bring market opportunity to the neighborhood level and establish access points for these low-income neighborhoods to become more integrated with their regional and state economies.

AB 1259 authorizes a new tool for delivering private capital to very low-income neighborhoods in a manner that incentivizes investors and empowers these communities in an innovative way. Used as an incentive to attract Opportunity Zone investors, the California New Markets Tax Credit (C-NMTC) offers an effective means for ensuring community benefits are realized.

The policy committee analysis includes a discussion of how a C-NMTC may address the state's increasing income disparities, challenges in accessing business capital, background on the federal NMTC (F-NMTC) Program, reports and assessments of the federal program, and examples of NMTC programs in other states. Technical amendments are suggested in Comment 11.

SUMMARY: AB 1259 establishes the C-NMTC, a $100 million annual tax credit award program, for the purpose of attracting new private capital to very low-income neighborhoods in California. In general, the new state credit parallels the F-NMTC Program. Specifically, **this bill**:

1) **Purpose of the Credit**: Establishes the C-NMTC Program, administered by the Governor's Office of Business and Economic Development (GO-Biz), for the purpose of stimulating private sector investment in lower-income communities, as specified.

2) **Annual Credits Awards**: Authorizes GO-Biz, beginning in 2020 and concluding in 2025, to award authority to designate qualified equity investments up $100 million per tax year to qualified community development entities (CDEs) and other entities authorized to participate in the federal program, including qualified community development financial institutions (CDFIs) and small business investment corporations (SBICs). [*In order to finalize the designation of the qualified equity investment, the qualified CDE obtains cash from a taxpayer in the form of a qualified equity investment. Once the investment moneys are raised, the CDE submits documentation to GO-Biz, verifying that the investment funds have been obtained. This process is referred to as the "issuance of the qualified equity investment" by the CDE. Following the issuance, the qualified equity investment is available for deployment in qualified low-income communities in qualified active low-income community businesses. Most commonly, funds are deployed in the form of low-cost debt instruments.*]

3) **Value of Individual Credits**: Authorizes a 39% tax credit to a taxpayer who makes a qualifying deposit with a CDE for a minimum of seven years **and** the CDE uses those funds in a manner

consistent with the NMTC requirements. The credit may be applied against the taxpayer's personal or corporate tax liability. A 2% credit may be applied in the first two tax years of the investment. In tax year three, a 6% credit may be applied, and in years four through seven, a 7% credit may be applied. [*The federal credit allows taxpayers to apply the credit in the first year, as follows: 5% in the first three years and 6% in the final four years.*]

4) **Program Guidelines**: Requires GO-Biz to adopt guidelines as necessary and appropriate to meet its responsibilities related to the allocation, monitoring, and management of the C-NMTC. Below is a list of required elements of these guidelines.

   a) ***Allocation Process***: The tax credit allocation process is required, at a minimum, to include or address the following:

      i) The first applications are required to be accepted by GO-Biz on or before May 15, 2020, to the extent the C-NMTC is authorized for that year, as specified.

      ii) The application process is required to result in an equitable distribution of projects within qualified low-income communities so that low-income community populations across the state are engaged and have an opportunity to benefit from the program.

      iii) Applicants are required to demonstrate they can meet organizational capacity standards including business strategy, targeted community outcomes, capitalization strategy, and management capacity. [*These standards are consistent with the F-NMTC allocation process.*]

      iv) Consideration is given in the awards process of an applicant's prior experience in making investments in low-income areas, including, but not limited to, qualified low-income community investments.

      v) Priority is provided to applications that:

         (1) Commit to addressing the hardest to serve and undercapitalized lower-income populations.

         (2) Support neighborhood revitalization strategies driven by local grassroots stakeholders.

      vi) Applicants are provided a five-day cure period for applications GO-Biz determines to be incomplete.

      vii) Members of the application review committee are prohibited from having any financial conflicts of interest, as specified.

   b) ***Operating Costs***: GO-Biz is required to set fees to cover the costs for administering the program, including one fee to cover the costs associated with the allocation process and a separate fee to cover program monitoring costs which are only paid by successful applicants, as specified. All fees are required to be deposited in the California New Markets Tax Credit Fund, which is established by this bill.

   c) ***Raising Investment Capital***: After receiving certification from GO-Biz of an award, the qualified CDE has 200 calendar days to obtain equity investments from taxpayers up to the value of the certified award and to notify GO-Biz that the CDE has successfully issued the qualified equity investment.

   d) ***Reversion of Unused Investment Authority***: Any portion of the certified award that is not covered by a qualified equity investment at the end of 200 days lapses and the value of the unused award reverts to GO-Biz.

e) ***Recording Tax Payer IDs***: A qualified CDE that issues a qualified equity investment is required to notify GO-Biz of the names of taxpayers that are eligible to utilize tax credits pursuant to this program.

f) ***Deploying Capital***: A qualified CDE that issues a qualified equity investment is required to submit a report to GO-Biz that includes documentation demonstrating that at least 85% of the qualified low-income community investments has been deployed within one year in qualified active low-income community businesses.

g) ***Ongoing Reporting on Deployed Capital***: In years two through seven following the issuance of the qualified equity investment, the qualified CDE is required to annually report to GO-Biz on the social, economic, and environmental impacts of the qualified low-income community investments, as specified.

h) ***Process for Recapturing Credits***: GO-Biz is required to work with the Franchise Tax Board on establishing a process for recapturing tax credits when the conditions of the C-NMTC are not met during the mandated seven years of compliance. Enforcement of the recapture provisions are subject to a six-month cure period.

i) ***Reallocation of Undesignated or Recaptured Credits***: Specifies that the value of any undesignated qualified equity investments and recaptured credits may be re-awarded by GO-Biz without affecting the $100 million per year allocation limit, as specified.

5) **Annual Reporting Details**: Requires annual reporting on all of the following in the second through seventh years following the issuance of the qualified equity investment:

   a) The social, environmental, and economic impact of the qualified equity investment on qualified low-income communities during the report period and cumulatively.

   b) The amount of money invested in qualified active low-income community businesses.

   c) The number of employment positions created and retained, and the average annual salary of such positions.

   d) The number of operating businesses assisted by industry and number of employees.

   e) The number of owner-occupied real estate projects.

   f) The geographic locations of the assisted businesses.

   g) Summary of the outcomes of each of the revenue impact assessments undertaken during the report period.

   h) Any other information requested by the GO-Biz, as specified.

6) **Use of Tax Credits by Taxpayers**: Specifies the following provisions relative to the application of tax credits to a taxpayer's tax liability:

   a) Limits the application of a tax credit to only those calendar years in which the Legislature appropriates funds in the California New Markets Tax Credit Fund to pay for the cost of administering the C-NMTC program.

   b) Prohibits a taxpayer from taking another state tax credit for the same investment.

   c) Allows the C-NMTC to be taken in addition to the F-NMTC.

   d) Authorizes a taxpayer to carry forward excess credits up to seven years.

7) **Transfer of Investment Authority**: Authorizes a qualified CDE to transfer all or a portion of its certified qualified equity investment authority to its controlling entity or any subsidiary qualified community development entity of the controlling entity, as specified. GO-Biz is required to be notified within 30 days of the transfer and the transferee is subject to the same rules, requirements, and limitations applicable to the transferor.

8) **Definition of Qualifying Business**: Defines a qualified active low-income community business as meeting the requirements of federal law, including having the business organized under a nonprofit or for-profit tax structure, with several modifications.

   a) The qualified active low-income community business shall:

      i) Have less than 250 employees, with one exception. This requirement does not apply to a business located in a tribal trust land held communally by a federally recognized tribe and managed by the tribal government, as defined. [*There are no size limitations in F-NMTC.*]

      ii) Derive less than 15% of its annual revenue from rental or sale of real estate, as specified. [*There are no similar limitations in F-NMTC. However, reports by the Congressional Budget Office suggest that land development and property management companies may not be the highest and best use of the credits.*]

      iii) Be physically located in a census tract that meets one of the following criteria: a poverty rate above 30%, a median income less than 60% of California median income, or an unemployment rate 1.5 times the national average. [*This is the federal definition for severely distressed and is more stringent than the general eligibility of the F-NMTC, which is 20% poverty or 80% median income.*]

   b) Excluded from the definition of a qualified active low-income community business are any businesses that:

      i) Operate or derive revenues from the operation of a charter school. [*There are no similar exclusions in the F-NMTC. Removal of this activity from the California credit focuses the use of the credit on economic development-based investments.*]

      ii) Operate or derive revenues from the operation of a country club or golf course from C-NMTC funding.

      iii) Operate or derive revenues from the operation of gaming establishments, massage parlors, liquor stores, and sexually oriented businesses, as defined, from qualifying as an active low-income community business. [*There are no similar exclusions in the F-NMTC. There are, however, other state tax credits which have similar limitations, including the California Competes Tax Credit.*]

9) ***Measuring Success of C-NMTC***: Provides the following metrics for evaluating the success of the C-NMTC program:

   a) Sets the goal, purpose, and objective of C-NMTC as attracting private sector investment in lower-income communities in California.

   b) Sets the performance indicator as the:

      i) Amount of qualified low-income community investments issued.

      ii) Amount of dollars deployed in qualified low-income community investments.

iii) Number of operating businesses assisted as a result of qualified low-income community investments. This data shall be compared to business development, including startups, tax revenues, and new investments within the most immediate geographic area for which data is reasonably available for the 12 and 24 months prior to the use of the C-NMTC in that area.

iv) Number of employment positions created and retained as a result of qualified low-income community investments and the average annual salary of those positions. These numbers shall be compared to the area median income and unemployment and poverty rates for the most immediate geographic areas for which data is reasonably available for the 12 and 24 months prior to the use of the C-NMTC in that area.

c) Sets the following baseline measurements and data collection requirements:

i) The baseline measurements include:

(1) The amount of tax credits issued in the year.
(2) The unemployment rate of the area.
(3) The poverty rate of the area.

ii) Data to collect includes:

(1) The amount of tax credits issued in the year.
(2) The number of operating businesses located in a low-income community that are assisted.
(3) The number of jobs created and retained as a result of qualified low-income community investments.

10) **Sunset**: Contains a sunset of December 1, 2025.

11) **Severability**: Contains a severability clause.

12) **Tax Levy**: Takes immediate effect as a tax levy.

EXISTING FEDERAL LAW

1) **F-NMTC**: Authorizes a taxpayer to claim a federal tax credit for qualified investments made to qualified CDEs, as specified. The value of the federal NMTC is 39% of the qualified equity investment. The credit is applied by the taxpayer over a seven-year period.

2) **F-NMTC Applicants**: Limits applications under the F-NMTC program to only federally certified CDEs, CDFIs, and small business investment companies.

a) **Community Development Entity**: The F-NMTC program defines a qualified CDE as any domestic corporation or partnership that meets the following three requirements:

i) The entity has as its primary mission the serving or providing of investment capital for low-income communities or low-income persons.

ii) The entity maintains accountability to residents of low-income communities through representation on its governing board or an advisory board sponsored by the entity.

iii) The entity has been certified by the CDFI Fund at the U.S. Treasury as meeting the requirements of (i) and (ii).

b) **Community Development Financial Institution**: The F-NMTC program has a special rule that allows certified CDFI to apply for an award. A certified CDFI:

i) Is a legal entity at the time of certification application;

ii) Has a primary mission of promoting community development;

iii) Is a financing entity;

iv) Primarily serves one or more target markets;

v) Provides development services in conjunction with its financing activities;

vi) Maintains accountability to its defined target market;

vii) Is a non-government entity and not under the control of any government entity (Tribal governments excluded); and

viii) Is certified by the CDFI Fund at the U.S. Treasury as meeting the requirements of (i) through (vii).

c) **Small Business Investment Company**: A SBIC is a type of privately-owned and -managed investment fund that is licensed and regulated by the Small Business Administration. An SBIC uses its own capital, plus funds borrowed with an SBA guarantee, to make equity and debt investments in qualifying small businesses.

3) **Definition of Qualified Investment**: Defines a qualified low-income community investment to mean the same as in the F-NMTC:

a) Any capital or equity investment in, or loan to, a qualified low-income business, as defined;

b) Any capital or equity investment in, or loan to, a real estate project in a low-income community;

c) The purchase of a loan from another CDE that meets the other requirements for a low-income community investment;

d) Financial counseling and other services in support of business activities to businesses and residents of a low-income community; or

e) Any equity investment in, or a loan to, a CDE. [*An equity investment includes any stock, other than nonqualified preferred stock, in a corporation or any capital interest in any partnership.*]

FISCAL EFFECT: Unknown

COMMENTS & CONTEXT:

1) **Economic Justice**: Research shows that the inequality between the residents in low-income communities and those that reside in California's most affluent communities has dramatically increased in the past several decades. For example, the pretax income among the highest 1% of California taxpayers increased from 9.82% in 1980 to 25.1% of total income in 2013. This rise in economic disparity has significant social and economic ramifications for everyone in the state and directly challenges the state's global competitiveness and long-term economic health.

   Programs like the NMTC program proposed in this measure are based on the economic principle that targeting significant incentives to lower-income communities allows these communities to more effectively compete for new businesses and retain existing businesses, which results in increased tax revenues, less reliance on social services, and lower public safety costs. Residents and businesses also directly benefit from these more sustainable economic conditions through improved neighborhoods, business expansion, and job creation.

2) **Challenges to Accessing Capital**: Access to debt and equity financing is critical for promoting the efficient operation and expansion of small businesses. Small businesses rely on adequate short-term debt (working capital) and long-term debt as well as equity financing to purchase new equipment, replenish inventories, fund ongoing operations, and market their services long before those activities generate revenue. While financial institutions routinely extend working capital and long-term debt products to established, larger businesses, smaller businesses are often bypassed because they lack the collateral or establishment history, or need too small of a loan.

   The same dynamic occurs when small businesses attempt to access equity financing, with investment funds often bypassing smaller businesses because they lack the operating history and revenue generating track record of larger businesses. The situation often results in a "chicken or the egg" scenario whereby businesses are told they need to grow in order to access financing, while simultaneously being denied access to the financing they need to grow.

   AB 1259 supports the development of new capital resources for businesses in low-income neighborhoods. According to the U.S. Treasury report on the F-NMTC program from inception through 2016, over 90% of investments were made at below market interest rates, 50.9% had more flexible borrower credit standards, 47.3% had lower than standard debt service coverage ratios, and 30.0% had subordinated debt.

3) **Federal New Markets Tax Credit Program**: Congress enacted the NMTC as part of the Community Renewal Tax Relief Act of 2000 to stimulate equity investments in low-income communities. Under the program, CDE's apply to the U.S. Treasury's CDFI Fund for an allocation of federal tax credits which the CDE can then offer to individual and corporate investors in exchange for making an equity investment in the CDE or its subsidiary.

   In this way, the CDE serves as a community and financial intermediary between sources of private capital and low-income communities. The value of the federal credit to the investor is 39% of the original investment amount, claimed over a period of seven years (5% for each of the first three years, and 6% for each of the remaining four years). The investment in the CDE cannot be redeemed before the end of the seven-year period.

   Through 14 competitive application rounds (2003 to 2017, inclusive), the CDFI Fund has made 1,105 F-NMTC awards for a total of $54 billion in tax credits. This $54 billion includes $3 billion in Recovery Act Awards and $1 billion of special allocation authority to be used for the recovery and redevelopment of the Gulf Opportunity Zone.

   New Markets Tax Credits are uniquely designed to attract private capital to very low-income neighborhoods, including drawing money from national investment pools. Since its inception, the CDFI Fund has allocated tax credit authority to 413 CDEs headquartered in 45 states, the District of Columbia, Puerto Rico, and Guam. Of the qualified equity investments deployed, more than 75% were in severely distressed areas and 55% with unemployment rates 150% above the statewide average. The federal General Accounting Office (GAO) reports that the presence of the federal credit attracts capital for projects that may otherwise be overlooked.

Based on program activities reported through Fiscal Year 2016, CDEs and CDFIs disbursed a total of $44.4 billion in qualified equity investment proceeds toward 5,333 projects. Since 2003, the NMTC Program has created or retained an estimated 197,585 jobs nationally. The largest amount of investments by industry sectors went to single and mixed-use real estate (29.0%), followed by health care and social services (19.2%), manufacturing (11.2%), and educational services (9.5%). These investments supported the construction of 32.4 million square feet of manufacturing space, 74.8 million square feet of office space, and 57.5 million square feet of retail space. The U.S. Department of the Treasury reports that a secondary benefit of the program is that as these communities develop through F-NMTC investments, they become more attractive to other investors, catalyzing a ripple effect that spurs further investments and revitalization.

According to the U.S. Treasury, for every $1 invested by the federal government, the NMTC Program generates over $8 of private investment. Over 75% of NMTC investments have been made in highly distressed areas, meaning the household income was less than 60% of statewide median income and the poverty rate was higher than 30%.

Under legislation signed by President Obama in December 2015, $3.5 billion in New Markets Tax Credits will be available annually through 2019. Legislation is currently pending in both the U.S. House of Representatives and the U.S. Senate to permanently extend the NMTC Program. Congresswoman Terri Sewell (D-AL) and Congressman Tom Reed (R-NY), introduced the House bill and Senators Roy Blunt (R-MO) and Ben Cardin (D-MD) introduced the Senate bills.

4) **California New Markets Competiveness**: Community and economic developers have expressed concern that California communities are not receiving a greater benefit for the F-NMTC program. The New Markets Tax Credit Coalition, a nonprofit organization of CDEs, reports that states that regularly receive the largest shares of the federal credits are often the same states that offer parallel state tax credit programs or other resources that encourage community development within lower-income communities.

Since inception, California-based CDEs, CDFIs, and SBICs received 113 F-NMTC awards, and 187 awards went to a CDE, CDFI, or SBIC that serves California. Total qualified equity investments that were expended in California were $3.9 billion of the $54 billion. While that may seem like a considerable amount of money, it represents less than 10% of funds. California ranks 33rd among states in terms of per capita income and represents over 12% of the U.S. population. The state has 14.3% of individuals living under the federal poverty line, and 19% of individuals living below the supplemental poverty rate that includes, among other things, the cost of shelter.

In 2017, 73 F-NMTC awards were made for a total of $3.5 billion. California's share is as follows:

- Five F-NMTC applicants serving California received $225 million; and
- Two F-NMTC applicants serving multiple states including California received $120 million.

Compounding the impact of less than equitable F-NMTC allocations is that not every California-based CDE, CDFI, or SBIC uses the money raised through the federal credit in the state where they are headquartered. In fact, there are over 100 CDEs that have national service areas. In the 2013 and 2014 funding rounds, $3.7 billion in tax credit authority was awarded to 78 CDEs and CDFIs with a national service area. Of these 78 national awards, only 35% stated in their application that California would be a preference area. Relative to award level, of the $3.7 billion awarded, $1.3 billion (35%) went to national CDEs and CDFIs that were committed to trying to do projects in California.

5) **Other State New Markets Tax Credits**: Since the inception of federal NMTC, more than one dozen other states have enacted matching programs to help leverage more federal dollars in NMTC investments, including Ohio, Florida, Missouri, Louisiana, Mississippi, Kentucky, Illinois, Oklahoma, and Connecticut. According to information provided by the offices of authors of similar bills previously introduced, several of these states have experienced a return on investment of 13 to 1. More details on state programs are provided below:

   a) In Missouri, the state New Markets Tax Credit paid for itself during its first two years of operation, bringing in more in additional investment dollars than was allocated in state funds for the entire seven-year period.

   b) In Illinois, federal allocations of NMTC funds more than doubled after the Legislature implemented a matching state program in 2008. In the first year of implementation, allocations jumped to $875 million. Prior to the 2008 law, federal allocations never exceeded $400 million.

   c) The Ohio NMTC program awards $10 million annually to CDEs with federal allocations or who anticipate federal allocations. The award cycles are synced so that a CDE could co-apply at the time they are applying for the federal credit.

6) **Impact of the Recession on F-NMTC Program**: The 2014 GAO report covers F-NMTC investments made between 2010 and 2012. While this represents the most recent program data available at the time, it also represents the deployment of F-NMTCs at the height of the global recession. With global capital markets frozen, public policy makers, including the President and the U.S. Congress, were taking drastic actions to substitute public moneys where previously there would have been private funds. Most notably, the federal government passed the Stimulus Package (2009) and the Small Business Jobs Act (2011). It may have been useful if the GAO, among its other findings and recommendations, would have also addressed the potential impact of the assessment period on the complexity of the financial structures and the increase in the use of other government programs.

7) **Federal Tax Cut and Jobs Act of 2017**: The federal Tax Cuts and Jobs Act of 2017 (Federal Act) made a number of enhancements to federal community development tools. Among other actions, the Federal Act extended the NMTC and created Opportunity Zones (OZs), a new incentive for investors to deploy capital in lower-income neighborhoods.

   Under the new Federal Act, Governors were authorized to nominate up to 25% of their respective states' eligible low-income census tracts for designation. Up to 5% of the 25% of the nominated census tracts could be from census tracts adjacent to the eligible low-income census tracts. Once approved by the U.S. Treasury, census tracts remain designated for a term of 10 years.

   - ***Eligible Census Tracts***: An Opportunity Zone is defined as any census tract that has either: (1) a poverty rate of at least 20%, or (2) a median family income that does not exceed 80% of statewide median income.

   - ***California Eligible Areas***: Based on guidance from the U.S. Treasury, California had 3,516 eligible low-income census tracts, meaning California was able to nominate up to 879 census tracts. As census tracts are designed to capture geographic areas of approximately 4,000 people, more than 3 million Californians are potentially living within an Opportunity Zone. Link to online resources related to designated census tracts: http://www.dof.ca.gov/Forecasting/Demographics/opportunity_zones/index.html

Most significantly, the geographic specifications of the Opportunity Zone align with those in the NMTC program. The target areas also align with another federal tax credit program, the Workforce Opportunity Tax Credit, which provides credits to businesses who hire and retain workers who have historically faced barriers to employment.

Federal law authorizes a broad range of Opportunity Zone business investments, including investments in stock, partnership interest, and business property. A qualified OZ business property investment may include new and substantially improved tangible property, including commercial buildings, equipment, and multifamily housing complexes. The essential eligibility requirement of the tax incentive is that the investment must be made through a qualified Opportunity Fund. For investors who properly place moneys in a qualified Opportunity Fund, they will receive:

- A temporary deferral of inclusion in taxable income for capital gains reinvested in an Opportunity Fund. The deferred gain must be recognized on December 31, 2026, or earlier if the Opportunity Zone investment is disposed;
- A step-up in basis for capital gains reinvested in an Opportunity Fund. The basis is increased by 10% if the investment in the Opportunity Fund is held by the taxpayer for at least five years and is increased by an additional 5% if held for at least seven years, thereby excluding up to 15% of the original gain from taxation; and
- A permanent exclusion from taxable income of capital gains from the sale or exchange of an investment in an Opportunity Fund if the investment is held for at least 10 years. This exclusion only applies to gains accrued after an investment in an Opportunity Fund.

It is difficult to accurately identify the scope of new investment dollars Opportunity Funds represent. The Economic Innovation Group, one of the early sponsors of the Opportunity Zone Program, estimates that there are up to $6.1 trillion in unrealized capital gains, including investments headed by U.S. households and corporations.

AB 1259 builds on these efforts by providing another financial resource to help lower the risk of development and to help California communities attract Opportunity Zone investors.

8) **Leveraging NMTC to Attract Opportunity Zone Investments**: California Forward, who serves as the secretariat for the California Economic Summit, is a lead partner in several strategic conversations on how California can maximize the use of the Opportunity Zone to direct private capital investment into lower-income communities across the state.

While the Opportunity Zone tax incentive has no mandate for community benefits, communities can use their existing authorities and resources to identify priority projects, remove regulatory impediments, and potentially provide local incentives to be more attractive to investors, such as permit streamlining, approvals of master land use plans, and dedicating community development funds. Creating new programs, such as the C-NMTC, provide broad-based support to lower-income neighborhoods, which can provide an extra financing tool for projects.

Below is a short overview of the top-five recommendations from the California Forward-facilitated discussions, based on notes from a meeting hosted by the Bay Area Council and which reflect contributions from numerous meetings around the state.

1. State programs and resources should be reviewed and made ready for layering with Opportunity Zone investments in order to bolster their effectiveness in achieving community benefits.
2. State tax laws should be amended to conform with the new federal capital gains rules to meet state policy objectives. It is reported that 34 other states have revised their tax structures to conform their treatment of capital gains to the new federal rules.
3. State financial assistance is needed for local capacity building in order for communities to be "Opportunity Zone Ready."
4. Where possible, state and local regulatory processes should be streamlined, as well as other actions to create a short pathway to project implementation.
5. Results should be measured using performance-based models so that outcomes can be tracked over time to ensure new investments are actually improving local conditions.

The Milken Institute, a nonprofit and nonpartisan economic policy think tank known for developing financial innovations, also believes that states can play a vital role in the deployment of Opportunity Fund moneys within their respective states. While investors are already seeking deals, it is in the best interest of states to "align incentives for the spectrum of deals (e.g., mixed-use real estate, new business formation) in order to structure deal flow with smart exits. In doing so, states are building community benefit prerequisites into the process, creating a mechanism that retains the intended tangible benefits of the investment." Ideally, according to Milken, states will benefit from having a pipeline of shovel-ready projects and a framework to direct Opportunity Zone deals.

9) **NMTC Research Findings**: Over the years the F-NMTC Program has been reviewed and evaluated by a number of sources including the GAO, Pacific Community Ventures; and the Urban Institute.

In 2010, the GAO released one of several statutorily mandated reports on the New Markets Tax Credit program that found:

a) Since 2003, NMTC investments totaling $26 billion have been made in all 50 states, the District of Columbia, and Puerto Rico;

b) NMTCs are often used as "gap financing," accounting for a portion of total project costs; and

c) NMTC investments in low-income community businesses generally use leveraged structures, where equity is left in the businesses, or subsidized loan structures, where below market interest rate loans are offered.

According to a January 2011 case study prepared by Pacific Community Ventures on the NMTC program, *Impact Investing: A Framework for Policy Design and Analysis*:

"Through 2009, CDEs made more than $16 billion in NMTC investments in low-income communities. Approximately 95% of NMTC funds are invested in designated areas of distress. For every dollar of forgone tax revenue, NMTC leverages $12-$14 of private investment."

In 2013, the Urban Institute released a report on the first four years of the program (2002-2006). This was the first independent evaluation of the F-NMTC program requested by the CDFI Fund:

a) The vast majority of qualified active low-income community businesses (93%) either could not otherwise have obtained financing or, compared with other available financing, received better rates and terms in conjunction with F-NMTCs;

b) 77% of projects increased payroll, property, sales, corporate, or other taxes to the benefit of the local community; and

c) 60% of projects saw an increase in their employment levels of more than 33% compared with pre-NMTC levels.

10) **July 2014 Report from the Government Accountability Office**: In the summer of 2014, the GAO issued a special report at the request of U.S. Senator Tom Coburn (R-OK) regarding the F-NMTC Program. The report was critical of the complexity of the projects and the lack of consistent reporting. More specifically, the report made the following findings:

a) Investments have become more complex and less transparent over time. One reason is the practice of combining New Markets Tax Credits (NMTCs) with other government assistance. While the GAO agrees that this can help finance projects that would not otherwise be economically viable, it raises questions about whether some amount of these additional subsidies are unnecessary.

b) The increasingly complex financial structures may also be masking investors' actual rates of return. The GAO is concerned that the return on investment (ROI) may be above market and cite a 24% ROI reported by one investor. The GAO reports that the IRS and U.S. Treasury have the authority but have not updated guidance to reflect the inclusion of other government resources.

c) GAO also recommends that the CDFI Fund collect additional data on fees and other charges collected by the CDEs. Finally, the GAO report expresses concern over the lack and quality of data on equity remaining with the business in low-income areas and failure rates of NMTC projects.

In conclusion, the GAO recommended the U.S. Treasury issue further guidance to ensure:

a) Appropriate means for combining the F-NMTC with other government programs;

b) Adequate controls to limit the risks of unnecessary duplication and above-market rates of return;

c) That more complete and accurate data are collected on fees and costs, the equity remaining in the business after 7 years, and loan performance; and

d) That the CDFI Fund issues instructions to clarify the reporting of loan performance and making the reporting of that data mandatory.

The U.S. Treasury agreed with GAO's recommendations to improve data collection on loan performance and equity remaining with the low-income business. The GAO also established a working group in response to the report to consider the other recommendations.

11) **Proposed Amendments**: Below is a list of amendments the committee members may wish to review when considering the bill.

a) Postpone the awarding of tax credit awards for one year to allow for development of the program and for the credits to be reflected in the 2020-21 state budget.

b) Modify the deadline for the first application round from March 15, 2020, to January 15, 2021, and make other technical and conforming amendments.

c) Modify schedule for earning tax credits by increasing the first and second year to 6% and lowering the third year to 3%.

d) Replace the requirement to create a new fund within the State Treasury with the creation of an account within an existing GO-Biz-related fund, the California Economic Development Fund.

e) Modify the authority for an applicant to add omitted information to an application after it has been submitted to GO-Biz, to allow applicants to correct minor and non-substantive errors and omissions after the application has been submitted to GO-Biz.

f) Revise the tax credit allocation limitation to only be those years in which funds are appropriated to administer the program.

g) Remove the limitation on the application of the credit to only those years that GO-Biz is awarded funds to administer the program.

h) Require annual documentation to GO-Biz as to the amount and percentage of equity investments deployed in qualified low-income community investments in qualified active low-income community businesses located in California during the reporting period.

i) Add authority for the Franchise Tax Board to adopt rules and have access to relevant information held by GO-Biz.

j) Make other technical and conforming changes.

12) **Related Legislation**: Below is a list of bills from the current and prior sessions.

a) ***AB 185 (E. Garcia and Medina) State New Markets Tax Credit***: This bill would have authorized the creation of a New Markets Tax Credit for qualified investments made in low-income communities beginning in the 2016 tax year. The NMTC Program would have been administered through the Governor's Office of Business and Economic Development. The bill would have authorized $40 million in tax credits over a five-year period for a total program of $200 million in credits. Total private investment raised was estimated at $512 million. Tax credit authority would have come from the reallocation of the unused portion of the State Sales and Use Tax Exclusion Program. Status: Returned to the Desk without action by the Assembly Committee on Appropriations, 2016.

b) ***AB 305 (V. Manuel Pérez) State New Markets Tax Credit***: This bill would have authorized the creation of a New Markets Tax Credit for qualified investments made in low-income communities beginning in the 2013 tax year. The NMTC Program would have been administered through the California Tax Credit Allocation Committee. The bill would have authorized $30 million in tax credits over a seven-year period for a total program of $200 million. Tax credit authority would have come through the elimination of the underutilized Small Business New Hire Credit. Status: Held in the Assembly Committee on Appropriations, 2013.

c) ***AB 1399 (Medina and V. Manuel Pérez) State New Markets Tax Credit***: This bill would have authorized the creation of a New Markets Tax Credit for qualified investments made in low-income communities beginning in the 2015 tax year. The NMTC Program would have been administered through the Governor's Office of Business and Economic Development. The bill would have authorized $40 million in tax credits over a five-year period for a total program of $200 million in credits. Total private investment raised was estimated at $512 million. Tax credit authority would have come from the reallocation of the unused portion of the State Sales and Use Tax Exclusion Program. Status: Vetoed by the Governor, 2013. The veto message states, "*This bill creates a New Markets tax credit that will cost – over time - $200 million. I certainly endorse* *programs that result in private investments to help low-income areas, but a bill to spend this much should be considered with other priorities during the annual budget.*"

d) ***AB 1715 (JEDE Committee) California New Markets Tax Credit***: This bill would have authorized the creation of a New Markets Tax Credit for qualified investments made in low-income communities beginning in the 2018 tax year. Funding for the credit would have come from the renegotiation of the Governor's Economic Development Initiative (GEDI), an underperforming initiative which was created to replace the California Enterprise Zone Program. Status: Following discussions with Assembly Budget Subcommittee Four regarding the reworking of GEDI tax incentives, the bill was used for another purpose, 2017.

e) ***AB 2037 (Davis and V. Manuel Pérez) California New Markets Tax Credit***: This bill would have authorized the creation of a New Markets Tax Credit for qualified investments made in low-income communities beginning in the 2011 tax year. The NMTC Program would have been administered through the California Tax Credit Allocation Committee. Tax credit authority would have come through the elimination of the underutilized Small Business New Hire Credit. Status: Held in the Assembly Committee on Appropriations, 2011.

f) ***AB 2647 (E. Garcia and Medina) California New Markets Tax Credit***: This bill would have established a $40 million tax credit program for five years for the purpose of attracting new private capital to very low-income neighborhoods in California. In general, the new state credit would have paralleled the federal New Markets Tax Credit (F-NMTC) Program. Status: Held in the Assembly Committee on Appropriations, 2016.

g) ***AB 643 (Davis and V. Manuel Pérez) California New Markets Tax Credit***: This bill would have created a New Markets Tax Credit for qualified investments made in low-income communities beginning in the 2012 tax year. The State Treasurer's Office would have administered the new credit program and allocated credits of up to $50 million per year for a total amount equal to $300 million over six years. Status: Held in the Assembly Committee on Appropriations, 2012.

h) ***SB 1316 (Romero) California New Markets Tax Credit***: This bill would have authorized the creation of a New Markets Tax Credit for qualified investments made in low-income communities beginning in the 2011 calendar year. The State Treasurer's Office would have administered the new credit program and allocated credits in an amount equal to the estimated revenue gains resulting from the temporary elimination of specified like-kind property exchanges. Status: Died on the Senate inactive file, 2010.

13) **Double Referral**: The Assembly Committee on Rules has referred this measure to the Assembly Committee on Jobs, Economic Development, and the Economy and to the Assembly Committee on Revenue and Taxation (R&T). Should this measure pass the committee, it will be referred to R&T for further policy consideration.

REGISTERED SUPPORT / OPPOSITION:

Support

California Association for Micro Enterprise Opportunity

Opposition

None on File

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