Dr. Julia Sass Rubin
Edward J. Bloustein School of Planning and Public Policy, Rutgers University

March 19, 2019 testimony on the Washington Rural Development and Opportunity Zone Act

Chairman Mullet, Ranking Member Wilson, and members of the Financial Institutions, Economic Development & Trade Committee, thank you for the opportunity to appear before you to discuss the Rural Development and Opportunity Zone legislation. My name is Julia Sass Rubin and I am a Professor at the Edward J. Bloustein School of Planning and Public Policy at Rutgers University. I am not speaking on behalf of the University.

I have been researching the use of equity and debt investments for economic and community economic development since I wrote my dissertation on this topic at Harvard University, 20 years ago.

In 2001, I and my colleagues Professor David Barkley of Clemson University and Dr. Deborah Markley of the Center for Rural Entrepreneurship first researched and wrote about the CAPCO program, the antecedent to this legislation, with funding from the US Department of Agriculture. I have been following the program since then and would like to share with you some of the reasons why I believe the Rural Development and Opportunity Zone legislation, now before your committee, would be both very ineffective and very expensive for Washington State taxpayers.

The Washington Rural Development and Opportunity Zone Act is the latest iteration of an almost 40 year ongoing lobbying campaign to convince state legislatures to give billions in taxpayer dollars to a handful of firms who make their living by traveling around the country, selling this kind of legislation.[1] These firms adjust the product's marketing as necessary to fit whatever the buyers – various state legislatures – are willing to purchase.

There have been three general types of legislation that these firms have marketed.

The first was CAPCOs. Those began in Louisiana in 1983 and were aggressively promoted to different states through approximately 2011.

As reports about the failures of CAPCOs in states such as Florida, Colorado, Missouri, and others began to emerge, it became harder for the firms to sell that product. So they repackaged it as state New Markets Tax Credit programs.

Although the CAPCO program had a new name, key aspects of it were still in place, enabling the same handful of firms to profit substantially off state taxpayers.

As reports about the abuses of the state-based New Markets Tax Credit programs began to surface, the firms modified their product once again to target rural economic development. Since the passage of the federal Tax Cuts and Jobs Act of 2017, they have added "Opportunity Zone" language to some of those bills.

[1] The New York State Department of Taxation and Finance notes that "the same small group of financiers … have managed 60% of the $2.6 billion credit-subsidized CAPCO-type investments made in states for which information is available"(2018, October 29). Re: S.4727-B-Providing Tax Credit for Investments Made in Rural Business Growth Funds, p. 5.

To give you a sense of the breadth of these firms' operations, here are some of the bills they have marketed in other states during the last two years:

2017	The NY Agriculture and Rural Jobs Credit
2017	Georgia Agribusiness and Rural Jobs Act
2017	Utah Rural Jobs Act
2017	North Carolina Rural Job Creation Fund
2017	South Carolina Agribusiness and Rural Jobs Act
2018	South Carolina Agribusiness, Rural, and Opportunity Zone Jobs Act
2018	Michigan Rural Development Fund
2018	Show Me (Missouri) Rural Jobs Act
2018	New Hampshire Small Business Jobs Fund and Tax Credit
2019	Kentucky Rural and Opportunity Zone Jobs Act
2019	Massachusetts Rural Jobs Act
2019	Texas Rural and Opportunity Funds
2019	Mississippi Agribusiness and Rural Jobs Act
2019	Florida Rural Job and Business Recovery Act

Although these bills have slightly different names, their key features are very similar to each other and to the CAPCO and New Markets Tax Credit legislation that these firms marketed in prior years.

In fact, a Florida Senate fiscal analysis of that state's Rural Job and Business Recovery Act noted that:

> Similar legislation has been proposed in several other states, including Washington. Additionally, New Markets Tax Credit Programs, which are structurally similar to the Act, are active in several other states, including Florida.[2]

These programs have several common components:

- A handful of firms, including Advantage Capital and Enhanced Capital, travel around the country, spending substantial dollars to lobby for this type of legislation in new states or to receive additional funding authorizations in states that already have these programs.

- These firms hire very well liked lobbyists, often former legislators or relatives of current legislators, to sell the program. For example, *The Atlanta Journal Constitution* reported that lobbyists for the Georgia Agribusiness and Rural Jobs Act included the son of the House Speaker and a former chief of staff to the President of the Georgia State Senate.[3]

[2] Florida Senate (2019). Bill Analysis and Fiscal Impact Statement, p. 4. https://www.flsenate.gov/Session/Bill/2019/298/Analyses/2019s00298.cm.PDF

[3] James Salzer (2017, April 3). Rural Georgia lawmakers pour hope into investment plan many questions. *The Atlanta Journal Constitution.*

- Program lobbyists make aggressive projections of job creation and economic development that will result from the program. They also claim that such programs have accomplished job creation and economic development in other states. They support both types of claims with economic modeling reports written by private firms and academics hired by the CAPCO firms.

- The language of the legislation is intentionally cumbersome, legalistic and confusing, making it difficult to understand how the programs work.

- Although key components of the legislation are consistent across all the states, these firms make minor modifications to individual state bills, enabling them to claim that they are different from one another when negative reports emerge about other states' programs.

Why is this legislation such a bad idea for the taxpayers of Washington State?

It would take substantially more time than I have today to explain everything that is wrong with this legislation so let me focus on a couple of key features.

First, the legislation includes very extensive and oddly specific requirements for certification as a Rural Development and Distressed Opportunity Zone Fund. These requirements ensure that only the handful of out-of-state firms that lobby for the legislation can take advantage of the tax credits.

An applicant for certification must:

- Be licensed as a rural business investment company or as a small business investment company
- Have invested at least $150 million in nonpublic companies located in areas that would be qualified areas if in Washington State
- Have at least one principal in a rural investment company or small business investment company who has been for at least four years an officer or employee or an affiliate on the date of submission of the application
- Submit an estimate of the number of jobs created and retained as a result of the applicant's growth investments and the assumptions used to determine the estimate
- Submit a business plan that includes a revenue impact assessment projecting state and local tax revenue to be generated by the applicant's proposed investments prepared by a nationally recognized third-party independent economic forecasting firm using a dynamic economic forecasting model that analyzes the applicant's business plan over the ten years following the date the application is submitted to the department.
- Submit a signed affidavit from each investor stating the amount of credit-eligible capital contributions that each taxpayer commits to make and against which of the two tax types the investor plans to apply the credit – business and occupation taxes or insurance premium taxes.
- Submit a nonrefundable application fee of $5,000.

If the legislation were to become law, starting January 1, 2020, the Washington State Department of Commerce would have to accept applications from entities seeking Rural Development and Distressed Opportunity Zone Fund certification.

The Department of Commerce would be required to approve any applicants that meet all of these criteria, and to do so **on a first come, first served basis,** with no applicant receiving more than $21 million in tax credits out of the total $60 million.

The Department of Commerce would have no ability to reject an applicant for any reason except not meeting one of these criteria.

But these criteria do not make any sense.

For example, it would be logical for financial firms based in Washington State to be certified. Local firms are more likely to understand the rural Washington State market and to continue investing in the state longer-term. But no Washington-based firms would be eligible because none of them are federal Rural Business Investment Companies or Small Business Investment Companies and being in one of those programs is a criterion for certification.

The legislation also does not require applicants for certification to demonstrate that they have made successful investments in rural areas or have created high quality jobs - or any jobs.

In fact, the applicants can have a terrible record of job creation and still be approved.

The applicants also can promise in their applications that they will create very few jobs. That would not matter because the Department of Commerce would not be allowed to evaluate them on what they are proposing to do for the rural areas of Washington State. The Department of Commerce could only evaluate them on whether they meet this list of irrelevant criteria – and it must do so within 30 days.

These application requirements are designed to ensure that only the handful of firms marketing these programs can take advantage of the tax credits.

Most important for that purpose is the requirement to submit an affidavit from each eligible investor in the Rural Development and Distressed Opportunity Zone Fund, stating the amount of their commitment of credit-eligible capital contributions.

Insurance companies make up a large portion of eligible investors and the firms marketing this program have long-term relationships with insurance companies that have participated in prior CAPCO, New Markets Tax Credits, and Rural Jobs programs. Those relationships enable the handful of firms marketing the program to obtain affidavits from the insurance companies attesting to whatever level of capital contributions they need, and to do so very quickly.

Since the tax credits are awarded on a first come, first served basis, the ability to obtain those investor affidavits quickly ensures that the firms marketing the legislation are able to get all the tax credits and take advantage of the multiple loopholes in the legislation.

And this legislation is full of loopholes. I will highlight just a few examples.

The legislation does not require a targeted small business, which is eligible to receive funding, to maintain its status as such during the entire time that the Rural Development and Distressed Opportunity Zone Fund maintains its investment in that business. So a Rural Development and Distressed Opportunity Zone Fund could make a small initial investment in a qualifying targeted small business and then make any subsequent larger investments after the business has stopped qualifying as a targeted small business, perhaps because it has moved to an urban or affluent part of the state, or because it no longer has a significant employee base in the state of Washington, or because it has left the state entirely.

The Rural Development and Distressed Opportunity Zone Funds also can ask the Department of Commerce to determine if a business qualifies as a targeted small business. If the Department of Commerce cannot make that determination within 15 business days, the business automatically qualifies and so do any subsequent investments in that business.

The 15 days allotted is even less time that the 20 business days that similar legislation in New York State stipulated for that purpose. In its analysis of that legislation, the New York State Department of Taxation and Revenue indicated that the 20 business days constituted

> an unreasonably short time frame within which the Department would be required to assess the business's historic net income, its payroll and the residences of its employees. Because the failure to make a determination within 20 days would result in automatic qualification, business entities would have absolutely no incentive to cooperate in the Department's inquiries. As a result, it is highly likely that many, if not most, of the business entities deemed to be qualified rural business concerns will not meet even the modest criteria this bill would establish.[4]

Another set of loopholes enables the accountability provisions to look stringent but not actually to be stringent.

Here is how those accountability provisions would work.

After six years, a Rural Development and Distressed Opportunity Zone Fund may apply to the Department of Commerce for permission to exit the program.

The Department of Commerce has 30 days after receiving that application to evaluate the number of jobs created and retained and the aggregate state and local government revenues generated as a result of investments by the Fund, and to determine if any accountability provisions are triggered.

The first accountability provision consists of limited repayment requirements if the jobs created and retained do not meet the promises made by the Rural Development and Distressed Opportunity Zone Fund in its initial application.

However, the job creation and retention numbers that the Funds promise when submitting their applications to the Department of Commerce at the start of the program can be very modest because those promised job numbers have no bearing on whether the applicant receives Rural Development and Distressed Opportunity Zone Fund designation. As I explained earlier, that designation is determined solely on the basis of a long list of irrelevant criteria. So applicants for certification as Rural Development and Distressed Opportunity Zone Funds can low-ball their job projections so as to minimize the chances that they will be penalized when they apply to exit the program.

[4] New York State Department of Taxation and Finance (2018, October 29). Re: S.4727-B-Providing Tax Credit for Investments Made in Rural Business Growth Funds, p. 4.

Furthermore, the Department of Commerce has only 30 days to evaluate the number of jobs created or retained. That is not enough time for the Department to perform a thorough assessment.

The second accountability provision stipulates that, if the aggregate amount of state and local government revenue generated at time of exit is less than the value of the tax credits, the Fund must repay to the state the difference between the total amount of tax credits issued and the revenues generated.

However, the legislation does not allow the Department of Commerce to assess how much revenue has been generated by the Fund, even if it could somehow do so in the 30-day window. Instead, Section 9.3a of the legislation stipulates that those revenues "must be calculated by a nationally recognized third-party independent economic forecasting firm using a dynamic economic forecasting model." The handful of firms marketing the Rural Jobs program have ongoing relationships with a few economic forecasting firms that do these analyses for them.

So the Department of Commerce has only 30 days from whenever an exit request is submitted by a Rural Development and Distressed Opportunity Zone Fund to conduct an assessment of jobs created and retained and to have a nationally recognized third-party independent economic forecasting firm conduct an assessment of revenues generated using a dynamic economic forecasting model. That is not a feasible timeline nor is this a process likely to result in a comprehensive and accurate evaluation of the program's impacts.

The Department of Commerce can only reject the request for exit from the program if the Rural Development and Distressed Opportunity Zone Fund has had any tax credits revoked.

Furthermore, the Department of Commerce may not revoke a tax credit certificate after a Rural Development and Distressed Opportunity Zone Fund exits the program.

So once it exits the program, a Fund would become completely free of any obligations and could keep the millions of dollars it received from Washington State taxpayers, with no fear of recapture or repayment.

I very much appreciate the need to address high unemployment rates in rural parts of Washington State. However, the Rural Development and Opportunity Zone legislation is a very ineffective and expensive way to meet this objective.

The Rural Development and Distressed Opportunity Zone Funds are not even required to make equity investments. They can structure all the capital they provide to businesses as debt.

So **Washington State would be spending $60 million in taxpayer dollars to generate $100 million in loans to companies that may or may not be in rural areas and may or may not even be in Washington State.**

That is an incredible deal for the handful of out-of-state firms marketing this program, but a terrible deal for Washington State taxpayers.

Multiple states have evaluated the various iterations of this program and have published very critical reports. Last fall, the New York State Department of Taxation and Finance sent Governor Cuomo a six-page analysis of the New York Agriculture and Rural Jobs Credit program's many deficiencies and encouraged him to veto it, which he did.

In their analysis, the New York Department of Taxation and Finance noted that the State had

> tried this type of investment credit before, without success. The State's CAPCO program gave tax credits to insurance companies that invested in venture capital companies in the State starting in 1999, making available up to $400 million in tax credits to fully reimburse program investments. In 2011, the Insurance Department reported that the program had spurred a total of $324.6 million in investments in qualified businesses. Those businesses reported a total increase of 188 jobs over the 14 year life span of the program, with some of the increase in employees stemming from mergers and acquisitions, rather than actual job creation; half of these businesses reported decreased employment over the life of the program."[5]

That comes to $1,726,596 per job created.

If Washington were to adopt this program and have comparable rates of job creation, it would result in the creation of 35 jobs in exchange for $60 million in tax credits.

Fortunately, **there are much, much, better and more cost effective ways to incentivize debt and equity investments in rural and distressed regions of Washington State.**

That same $60 million in future tax credits could be monetized via an online auction that enables firms eligible for the tax credits to bid against each other for those credits, as was done by the State of Maryland.[6]

The resulting funds could be used to create an evergreen loan fund that would provide patient capital to businesses located in rural parts of the state, on an ongoing basis.

The resulting funds also could be invested in venture capital firms that would have to compete for those dollars by demonstrating a record of investments that created economic development and jobs. The venture capital firms selected would be required to invest the taxpayers' funds in rural Washington businesses and, at the end of ten years, to return to the State of Washington both the dollars they received from the State plus 80% of any profits they earned on those investments.

The Rural Development and Opportunity Zone legislation does not require any of the $60 million to come back to the taxpayers of Washington state. Those dollars would stay with the handful of out-of-state firms marketing this program.

In summary, the Rural Development and Opportunity Zone legislation is an inordinately expensive and ineffective way to bring capital to businesses located in rural and distressed regions of Washington State.

Thank you again for inviting me to testify this morning. I would be happy to answer any questions.

[5] New York State Department of Taxation and Finance (2018, October 29). Re: S.4727-B-Providing Tax Credit for Investments Made in Rural Business Growth Funds, p. 6.

[6] See http://mgaleg.maryland.gov/2011rs/fnotes/bil_0000/sb0180.pdf