DEPARTMENT OF AUDITS AND ACCOUNTS

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March 13, 2017

Honorable Chuck Hutstetler
Chairman, Senate Finance
121-C Capitol
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill 314 (LC 37 2389ERS)

Dear Chairman Hufstetler:

The bill would establish qualified low-income community rural investment funds and tax credits. The tax credit value is based on the amount of the taxpayer's investment that a qualifying rural fund has invested in an eligible business's equity or long-term debt. The credit amount is 15 percent of the eligible investment per year beginning in the third year after the investment is made and continuing through the sixth year, for a total credit equal to 60 percent of the eligible investment. The credit is nonrefundable but may be carried forward indefinitely. The amount of credits available is subject to a cumulative cap of $100 million. The bill has an effective date of July 1, 2017 and would be applicable to all taxable years starting January 1, 2018.

Impact on State Revenue

Georgia State University's Fiscal Research Center (FRC) estimated that the bill would reduce state revenue by $1.25 million to $2.5 million in FY 2020 (Table 1). The revenue reduction is estimated at $6.25 million to $12.5 million in FY 2022. The high and low scenarios differ in assumptions as to how quickly the cap is reached. Details of the analysis and assumptions are available in the attached appendix.

Table 1. Estimated State Revenue Effects of LC 37 2317ER

($ million)	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**
High Estimate	-	-	($2.50)	($7.50)	($12.50)
Low Estimate	-	-	($1.25)	($3.75)	($6.25)

The bill also requires rural fund applicants to pay a non-refundable application fee of $5,000 to the Department of Community Affairs (DCA). Neither FRC nor DCA know the number of applicants that will be submitted, but DCA anticipates the number to be less than 10. Ten applications would result in additional one-time state funds of $50,000.

Impact on State Agency Costs
The Departments of Community Affairs (DCA) and Revenue (DOR) both anticipate the need for additional funding to implement the provisions of the bill.

DCA anticipated the need for two additional personnel to review applications, transfer capital investment authority, ensure capital investment occurs, and recapture unused credits. These individuals are estimated to cost approximately $150,000 annually (salaries and benefits), with associated costs (IT, communications, travel) of approximately $25,000.

DOR estimated that the bill would result in approximately $57,000 in one-time costs and $133,000 in annual costs. One-time costs include approximately $43,000 for IT system changes, $7,400 for training, $3,600 for updating forms and other documents, and $2,300 for taxpayer outreach. The $133,600 in annual costs would cover the cost of two additional personnel to review, verify, and apply credits.

Sincerely,

Greg S. Griffin
State Auditor

Teresa A. MacCartney, Director
Office of Planning and Budget

GSG/TAM/mt

Analysis by the Fiscal Research Center

The Georgia Agribusiness and Rural Jobs Act establishes criteria for setting up rural investment funds and conditions for rural investors to qualify for the tax credit. The Department of Community Affairs (DCA) is tasked with verifying all the requirements and administering the program. Conditions for qualifying as a rural fund or rural investor under the act, and for an investment to qualify for the credit include, but are not limited to, the following:

- The applicant or an affiliate of the applicant must be licensed either as a rural business investment company (RBIC) under 7 U.S.C. Section 2009cc or a small business investment company (SBIC) under 15 U.S.C. Section 681.
- The applicant or affiliates of the applicant must have invested at least $100 million in nonpublic companies located in rural areas within the United States.
- The applicant must provide an estimate of the number of jobs to be created or retained in the state as a result of the investment, and a business plan that includes a revenue impact assessment projecting state and local tax revenue to be generated by the applicant's proposed eligible investments prepared by a nationally recognized, third-party, independent economic forecasting firm.
- The rural investor must have raised at least 10 percent of their capital investment from individuals including affiliates of the rural investor, including officers, directors, members, and employees of such affiliates.
- Credits are subject to recapture if, among other things, the rural fund fails to invest 100 percent of its capital investment authority in eligible businesses in Georgia within two years of the date of closing of investment by rural investors in the rural fund, with at least 10 percent of its initial capital investment authority invested in eligible businesses engaged in agribusiness in the state.

The total (cumulative) amount of investment eligible for the tax credit is capped at $100 million.

To estimate how quickly the $100 million-dollar cap on these investments would be reached, we relied on SBA loan guarantee data from rural counties as well as aggregate data on SBIC investments from the Small Business investor Alliance (SBIA). Note that data on the nature of individual investments made by RBICs and SBICs are not readily available. A rural county is defined as one with no more than 75,000 in population in the most recent decennial census, here 2010. By this definition, 129 counties in Georgia would qualify as rural counties.

SBICs are much more prevalent and have greater flexibility in their investment activities than RBICs. SBICs also can leverage funds they raise in private markets through SBA loan guarantees. This is not available to RBICs.

Data on the SBIC industry from the SBA for federal fiscal years 2013-15 showed roughly 300 licensed SBICs in each year. The average individual SBIC investment in small businesses each year ranged from $1.9 million to $2.4 million. The number of financings increased from 1,846 in 2013 to 2,815 in 2015. Based on these data, the average SBIC total annual investment was roughly $12 million, divided among roughly six firms in 2013. By 2015, the average SBIC investment increased to roughly $20 million in total, invested across roughly 9 firms. Due to the information intensive and hands-on nature of SBIC equity and debt investing, these funds tend to invest regionally. Data from the SBIA indicates that there are roughly 44 licensed SBICs in Georgia and its border states.

Data on actual investments by SBICs and RBICS in Georgia are not readily available. However, information on SBA loan guarantees on loans to businesses in the Georgia counties considered rural under the proposed bill is available from USASpending.gov. We thus examined SBA loan guarantees to try to estimate the size of the potential investment market for SBICS and RBICs making investments in the state.

During federal fiscal years 2014-16, the SBA guaranteed roughly $200-$300 million in new loans per year in rural Georgia counties. For FY 2016, $290.4 million of SBA loan guarantees were made in these counties in 371 transactions, for an average loan guarantee of about $783,000. In the three years, the number of loan guarantees over $1 million dollars ranged from about 50 to 60 per year.

The SBA loan guarantee data suggests that there is a market for either debt or equity investments that matches up with the typically larger amounts that SBICs tend to invest in portfolio businesses. There also seem to be sufficient numbers of SBICs in our near Georgia to take advantage of these investment opportunities.

While it is possible that the $100 million cap could be reached more quickly, with SBICs and RBICs displacing a large portion of SBA-guaranteed loans currently made through other funding channels, it is assumed for the high case estimates that investment by SPICs and RBICs will reach the $100 million cap under the law in three years. This level of annual investment, $33.3 million per year, could be reached if 10-12 SBICs or RBICs invested $2 million-$3 million each in a small number of Georgia firms.

The low case estimates assume a slower pace of adoption, with the cap being reached in six years at $16.7 million of investment per year. The amount of eligible investment and the value of state tax credits eligible for redemption by calendar or tax year through CY 2023 are shown in Table 2. The state revenue effects shown in Table 1 above are generated from these figures, adjusting to state fiscal years and assuming an impact on collections through a reduction in estimated tax payments throughout the tax year.

Because rural investors in the eligible rural funds are expected to be principles of the funds, institutional investors, or higher income and net worth individuals, it is assumed that the credits will be fully utilized against state tax liabilities for the years in which they are first eligible to be taken. The credit may be used by an entity to offset state tax liabilities for personal and corporate income taxes, and the insurance premium tax.

Table 2. Estimated Investment Activity and Tax Credits Available Due to LC 37 2317ER

($ million)	**CY 2018**	**CY 2019**	**CY 2020**	**CY 2021**	**CY 2022**	**CY 2023**
High Case:						
Investment	$33.3	$33.3	$33.3	$0.0	$0.0	$0.0
Credits Available	$0.0	$0.0	$5.0	$10.0	$15.0	$20.0
Low Case:						
Investment	$16.7	$16.7	$16.7	$16.7	$16.7	$16.7
Credits Available	$0.0	$0.0	$2.5	$5.0	$7.5	$10.0