SB 632

Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 632 (Senator Rosapepe)
Finance Appropriations

Maryland Smart Growth Investment Fund

This bill requires the Department of Commerce (Commerce) to issue a request for proposals (RFP) to select a management entity to establish the Maryland Smart Growth Investment Fund (fund) as specified. The Governor *may* appropriate $3.75 million in fiscal 2020 and 2021 to the fund; however, Commerce is not required to invest the appropriated funds if the committed capital in the fund is less than $25.0 million on December 31, 2020. The Governor must also nominate population census tracts as qualified Opportunity Zones under the federal Tax Cuts and Jobs Act of 2017, subject to specified conditions, and notify the U.S. Secretary of the Treasury of the nominations. **The bill takes effect June 1, 2018.**

Fiscal Summary

State Effect: General fund expenditures increase by $0.3 million in FY 2019, $4.1 million in FY 2020, $3.9 million in FY 2021, and $0.1 million annually thereafter, as explained below. Revenues are not affected.

($ in millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0.3	4.1	3.9	0.1	0.1
Net Effect	($0.3)	($4.1)	($3.9)	($0.1)	($0.1)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: The bill does not directly affect local government finances or operations.

Small Business Effect: None.

Analysis

Bill Summary: The investment fund established by the management entity must be (1) based on the recommendations of the 2013 report of the Maryland Smart Growth Investment Fund Workgroup and (2) designed to meet the requirements for a Qualified Opportunity Fund under the federal Tax Cuts and Jobs Act of 2017. To carry out the purposes of the bill, Commerce may create, own, control, or be a member of a corporation, limited liability company, partnership, or any other entity, whether operated for-profit or not-for-profit.

The Governor must nominate population census tracts as qualified Opportunity Zones under the federal Tax Cuts and Jobs Act of 2017 that:

- constitute up to 25% of the census tracts in the State that are eligible low-income communities, as defined in federal law;
- are located in State priority funding areas (PFAs), as defined in the Economic Development Article; and
- are fairly distributed among urban, suburban, and rural areas of the State.

Current Law/Background:

Maryland Smart Growth Investment Fund Workgroup

Chapter 592 of 2013 established the Maryland Smart Growth Investment Fund Workgroup to make recommendations for the design and creation of an investment fund that would encourage and support smart growth in targeted areas. The workgroup included members of the General Assembly, representatives from the Department of Housing and Community Development (DHCD), Commerce, local governments, and the private sector, among others. The workgroup report can be found on the Department of Legislative Services' (DLS) website.

The workgroup recommended that the Maryland Economic Development Corporation (MEDCO) should "sponsor" the fund and act as an intermediary between the State and the private sector. At the time, MEDCO agreed to develop a plan for the creation of the fund and to select a fund manager and to determine investment criteria. However, according to MEDCO, the fund was not established. MEDCO advises that this was due to DHCD deciding to use internal funds, as discussed below.

The *2017 Joint Chairmen's Report* (page 164) asked DHCD to provide information related to why the fund had not been established. DHCD's response to that request indicates that DHCD has "met the programmatic intent" of the Maryland Smart Growth Investment Fund

Workgroup by establishing the Neighborhood Business Loan Program under its expanded Neighborhood Business Works Program authority. The program provides loans for business lending projects funded through a combination of private capital sourced by the Community Development Administration in DHCD and State special and general obligation bond funds. The DHCD response can be found on the DLS website.

Opportunity Zones

The Federal Tax Cuts and Jobs Act of 2017 established the Qualified Opportunity Zones Program to incentivize private investment in distressed communities. Under the Act, states may nominate up to 25% of specified low-income census tracts for designation by the U.S. Treasury as opportunity zones. The initial deadline for nomination was March 21, 2018, but states were allowed to request a single 30-day extension. Maryland requested an extension and DHCD, which is overseeing the nomination process, advises that the nominations will be made prior to the April 20, 2018 deadline.

In Maryland, most eligible low-income census tracts are in or near Baltimore City, northeast of the District of Columbia, and in Western Maryland and the Eastern Shore. A map of the potential low-income census tracts can be found here. The bill requires that the Governor nominate census tracts that are in PFAs, which are shown in **Appendix 1**. A qualified Opportunity Fund is a privately managed investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified Opportunity Zone property and that holds at least 90% of its assets in such property. Qualified Opportunity Zone property includes stock, a partnership interest, and tangible property used in a trade or business.

The program offers three tax incentives related to capital gains: (1) a temporary tax deferral for capital gains reinvested in an Opportunity Fund; (2) a step-up in basis for capital gains reinvested in an Opportunity Fund, which excludes up to 15% of the original capital gain from taxation; and (3) 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. More information on the tax incentives, including illustrative examples, can be found on the Economic Innovation Group's website.

State Fiscal Effect: General fund expenditures increase by $335,360 in fiscal 2019, which reflects a four-month start-up delay. This estimate reflects the cost of hiring one contract manager to oversee the RFP process and provide related, ongoing oversight. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses. It also includes $250,000 for the management entity hired by Commerce to establish the fund, an estimate that is based on Commerce's previous experience with hiring a vendor to assist with setting up the tax credit sale for the InvestMaryland program and the likely timing of such expenditures.

Position	1
Salary and Fringe Benefits	$80,001
Fund's Management Entity	250,000
Operating Expenses	$5,359
Total FY 2019 State Expenditures	**$335,360**

Future year expenditures reflect a full salary with annual increases and employee turnover and ongoing operating expenses. Future year expenditures also assume (1) an additional $250,000 for the fund's management entity in fiscal 2020 and (2) a $3.75 million appropriation is made in fiscal 2020 and 2021, although the bill does not establish a mandated appropriation. Thus, this analysis assumes that the fund receives at least $25 million in investments by December 2020. After fiscal 2021, it is assumed that the fund's ongoing operating expenses are paid for with fees assessed on those investments.

Although the bill requires the fund to be established, it does not establish the fund as a special fund in statute. This analysis assumes that the fund is not a budgeted special fund, and also is not considered a nonbudgeted fund. To the extent that this is not the case, State nonbudgeted revenues and expenditures increase to reflect the receipt and expenditure of general fund appropriations and, under these assumptions, at least $25 million received from investors.

In future years, if there is sufficient money in the fund, a portion of the fund's earnings could potentially be used to pay for Commerce's annual expenditures associated with its oversight role. This has not been reflected in the above estimates.

Given the final April 20, 2018 deadline for Opportunity Zone nominations specified in the federal Tax Cuts and Jobs Act and the fact that the Administration intends to submit nominations prior to that date, the bill's requirement for the Governor to do so has no effect on State finances or operations.

Additional Information

Prior Introductions: None.

Cross File: Although designated as a cross file, HB 817 (Delegate Lafferty – Appropriations) is not identical.

Information Source(s): Department of Commerce; Department of Budget and Management; Department of Housing and Community Development; Maryland Economic Development Corporation; Economic Innovation Group; Policymap.com; Department of Legislative Services

Fiscal Note History: nb/rhh

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Appendix 1 – Priority Funding Areas