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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND
MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

WRITTEN ONLY

TESTIMONY BY WESLEY K. MACHIDA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT,
TOURISM AND TECHNOLOGY
ON
HOUSE BILL NO. 1449, H.D. 1

March 13, 2017
1:15 p.m.
Room 414

RELATING TO INNOVATION BUSINESS INTERACTION

House Bill No. 1449, H.D. 1: establishes the Impact Loan Fund for Hawaii (HI-Impact Loan Program) in the High Technology Development Corporation to support dual-use technology small businesses; establishes the HI-Impact Special Fund (HISF); and appropriates an unspecified amount of general funds for FY 18 and FY 19 to be deposited into the HISF.

As a matter of general policy, the Department of Budget and Finance does not support the creation of any special fund which does not meet the requirements of Section 37-52.3, HRS. Special funds should: 1) serve a need as demonstrated by the purpose, scope of work and an explanation why the program cannot be implemented successfully under the general fund appropriation process; 2) reflect a clear nexus between the benefits sought and charges made upon the users or beneficiaries or a clear link between the program and the sources of revenue; 3) provide an appropriate means of financing for the program or activity; and 4) demonstrate the capacity to be financially self-sustaining. In regards to House Bill No. 1449, H.D. 1, it is difficult to determine whether the proposed special fund would be self-sustaining.

Thank you for your consideration of our comments.



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Statement of
Karl K. Fooks
President

Hawaii Strategic Development Corporation

Before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT, TOURISM, AND TECHNOLOGY

Monday, March 13, 2017
1:15 PM
State Capitol, Conference Room 414

With Comments on

HB 1449 HD1
RELATING TO INNOVATION BUSINESS INTERACTION

Chair Wakai, Vice Chair Taniguchi and Members of the Committee:

The Hawaii Strategic Development Corporation offers comments on HB1449 HD1, a bill to establish the HI-Impact Loan Program.

Not a loan program, but an equity investment program

The bill requires the HI-Impact Loan Program to invest in convertible notes issued by pre-revenue technology companies, or technology companies that have raised less than \$500,000 of equity. Convertible notes are a form of equity investment used to invest in these very early stage technology companies. This is because startups at this stage do not have the cash flow to support a true loan.

If a startup is successful in developing its business, it will most likely require additional investment. The new providers of capital will not want their new investment to be used to pay back the convertible note and will require the note to convert to equity. Similarly, if a company is successful, the holder of the convertible note will want to convert it into an equity stake in the company in order to earn a higher return on its investment.

The investor in convertible notes will have to assess the potential of the company to raise additional financing and the potential equity value of the company to establish key terms for the investment, for example, the cap on the value of the company when the note converts, in order to adequately protect their investment.

Program success will depend on access to later stage financing

If a company receiving an investment from the HI-Impact Loan Program is successful in developing its business, it will most likely require additional investment. The success of the HI-Impact Loan Program will depend on the ability of its portfolio of companies to

access later stage financing. The Maryland program cited as the model for the HI-Impact Loan Program has been successful because the Maryland program is part of a broader capital program that includes a significant state-run venture capital investment program that works to mobilize the later stage financing for the companies receiving investments under its seed funding program.

Overlap with HSDC investment activities

An equity investment program that helps companies attract later stage venture capital investment overlaps with HSDC's activities. For example, HSDC recently established Reef Fund II, an investment fund that will provide convertible note financing and mentorship to Hawaii companies commercializing technologies developed by research grants. Blue Startups also provides convertible note financing and mentorship to technology companies.

However, unlike HSDC's equity investment programs or the Maryland program cited in the bill, the HI-Impact Loan Program will not require an in-kind or capital investment by the private sector to match the public investment.

Thank you for the opportunity to submit testimony.



Written Statement of
Robbie Melton
Executive Director & CEO
High Technology Development Corporation
before the
Senate Committee on Economic Development, Tourism, and Technology
Monday, March 13, 2017
1:15 p.m.
State Capitol, Conference Room 414

In consideration of
HB1449 HD1
RELATING TO INNOVATIVE BUSINESS INTERACTION.

Chair Wakai, Vice Chair Taniguchi, and Members of the Committee on Economic Development, Tourism, and Technology.

The High Technology Development Corporation (HTDC) **supports** HB1449 HD1 that establishes the impact loan fund for Hawaii (HI-impact loan program) in the High Technology Development Corporation to support small businesses with innovative technology.

As part of HTDC's vision to create 80,000 new innovation jobs in Hawaii earning \$80,000 or more by 2030, HTDC supports initiatives aimed at promoting technology and innovation jobs.

The proposed impact loan program fills a critical void with the capital required for many technologies to advance to market and achieve profitability. The program requires companies to secure a commitment from a paying customer to be eligible. This ensures the product the company is developing has an immediate customer base and reduces the risk of providing the loan. One of the greatest challenges for a company is getting access to the market. This proposed bill would help companies break that barrier.

The convertible debt is a proven effective financing structure to move technologies further along the commercialization pathway, increase the company's valuation, and lead to follow-on investment for further growth while providing the state opportunity to financially benefit from the success of the company and recoup some capital to sustain the program. The financing structure allows for risk capital to be applied with a balance of economic development and venture capital objectives, which means loans may be provided to companies suited to grow and remain in Hawaii instead of exclusively funding high growth opportunities. In addition, the program's success relies on the impact loan program administrator providing mentorship to the companies.

We respectfully request correction of the defective effective date. HTDC comments that \$1.25 million would be an appropriate amount to fund this program. We support this initiative as long as it does not replace our priorities requested in the Executive Budget.

Thank you for the opportunity to offer these comments.



Written Statement of
DR. PATRICK K. SULLIVAN
PRESIDENT/CEO OCEANIT

Before the
**SENATE COMMITTEE ON ECONOMIC DEVELOPMENT, TOURISM AND
TECHNOLOGY**

March 13, 2017

1:15 p.m.

Conference Room 414

HB1449 RELATING TO INNOVATION BUSINESS INTERACTION

To: Senator Glenn Wakai, Chair, Senator Brian Taniguchi, Vice Chair and Members of the Committee

From: Dr. Patrick Sullivan, President/CEO

Re: Testimony in **SUPPORT** of HB1449

Honorable Chairs, Vice-Chairs and Committee Members:

Thank you for the opportunity to submit testimony in **SUPPORT of HB1449**

Oceanit is a local diversified science and engineering company with capabilities/facilities in advanced technology, life sciences, information systems, aerospace, energy, oil and gas and consulting engineering services.

In this twenty first century global economy, the creation and growth of technology companies is crucial for the State of Hawaii. It has been proven that through various federal funding sources, Hawaii companies have demonstrated the ability to develop “disruptive technologies” for the U.S. Department of Defense. However, the ability to take disruptive technologies to the next level or for dual use, ie, tourism industry, agriculture industry, sports industry, finance industry, building and construction industry and other industries, has been a challenge. Federal R&D funding is restricted to research and development activities, i.e., no marketing or commercialization activities allowed. Furthermore, only a small percentage of tech businesses are venture fundable. So how do we help the majority of Hawaii technology companies who are stuck in the “ditch” between research and product realization?

Innovative strategies are needed to move Research & Development into commercially viable products and services to expand and diversify Hawaii’s economy. HB1449 will enable Hawaii companies to collaborate with commercial partners to commercialize products and services in the State of Hawaii.