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STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES

POST OFFICE BOX 621
HONOLULU, HAWAII 96809

Testimony of
SUZANNE D. CASE
Chairperson

Before the Senate Committee on
WAYS AND MEANS

Tuesday, February 19, 2019
9:30 AM
State Capitol, Conference Room 211

In consideration of
SENATE BILL 1394, SENATE DRAFT 1
RELATING TO HISTORIC PRESERVATION

Senate Bill 1394, Senate Draft 1 proposes to amend Chapter 235, Hawaii Revised Statutes (HRS), creating a tax credit for certified rehabilitation of certified historic buildings. **The Department of Land and Natural Resources (Department) supports this measure and recommends amendments.**

Tax incentives for rehabilitation of historic buildings have been proven to be enormously effective in preserving important buildings, ensuring their continuing economic viability, revitalizing communities, especially historic downtowns, preserving community character, and promoting heritage tourism. The Department believes that tax credit programs such as this can make an important contribution to the comprehensive state historic preservation program established by Chapter 6E Hawaii Revised Statutes.

In its 2018 report on the federal historic tax credit program, the National Park Service (NPS) prepared in collaboration with Rutgers University (copy attached for your reference), notes that NPS certified 1,035 completed historic rehabilitation projects. The report documents \$6.5 billion in rehabilitation investment during federal fiscal year 2017 (the last year for which figures are available), helped create 106,900 jobs, and \$6.2 billion of gross domestic product.

If Senate Bill 1394 is enacted, Hawaii will join the 38 states that already provide tax credits for the rehabilitation of historic structures. The nature of each state program is different, so it is difficult to extract information from them that could be directly useful in evaluating the effect of the program proposed in this measure. All states report that their programs are successful both in giving new life and continuing utility to significant historic structures, leveraging private investment at between $4 and $5 per tax credit dollar, contributing significant positive economic impact to affected communities…. At between 4 and 9 years, depending on the state and the level of the credit, generating revenue to the state exceeding the decrease in revenue due to the tax credit. Since the credit is paid out after the project is completed, the revenue payback begins from taxes on wages, goods, and services, before the credit is claimed.

Testimony before the Senate Committee on Labor, Culture and the Arts suggests that Senate Bill 1394 Senate Draft 1 needs to be revised to reflect the comments of the department of taxation and to make additional clarifying revisions. Accordingly, the Department recommends that be amended by replacing Senate Bill 1394, Senate Draft 1 in its entirety and replace it with as follows:

SECTION 1. Chapter 235, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

"**§235- Historic preservation income tax credit.** (a) Notwithstanding any law to the contrary, there shall be allowed to each taxpayer subject to tax imposed by this chapter an income tax credit for substantial rehabilitation of a certified historic structure that shall be deductible from the taxpayer's net income tax liability, if any, imposed by this chapter for the taxable year in which the tax credit is properly claimed. The amount of the tax credit for substantial rehabilitation of a certified historic structure that is certified by qualified professional staff of the department of land and natural resources' state historic preservation division, shall be:

(1) Twenty-five per cent of the qualified rehabilitation expenditures; or

(2) Thirty per cent of the qualified expenditures in the event that:

(A) At least twenty per cent of the units are affordable rental housing; ~~or~~

(B) At least ten per cent of the units are affordable homeownership units; or;

(C) In structure with mixed residential and non-residential uses, at least thirty per cent of the total square footage of the structure is for affordable rental housing, affordable homeownership units, or both.

(b) The tax credit allowed under this section shall be available in the taxable year in which the substantially rehabilitated certified historic structure is placed into service. In the case of projects completed in phases, the tax credit shall be prorated to the substantially rehabilitated identifiable portion of the certified historic structure placed into service during that taxable year.

(c) In the case of a partnership, S corporation, estate, trust, or any developer of a rehabilitated certified historic structure, the tax credit allowable shall be as provided under subsection (b) for the taxable year. The cost upon which the credit is computed shall be determined at the entity level and the distribution and share of the tax credit shall be determined pursuant to section 704(b) of the Internal Revenue Code.

If a deduction is taken under section 179 (with respect to the election to expense depreciable business assets) of the Internal Revenue Code, no tax credit shall be allowed for that portion of qualified expense for which the deduction is taken.

The basis of eligible property for depreciation or accelerated cost recovery system purposes for state income taxes shall be reduced by the amount of the credit allowable and claimed. In the alternative, the taxpayer shall treat the amount of the credit allowable and claimed as a taxable income item for the taxable year in which it is properly recognized under the method of accounting used to compute taxable income.

(d) If the tax credit under this section exceeds the taxpayer's income tax liability, the excess of the credit over the liability may be used as a credit against the taxpayer's income tax liability in subsequent years until either the credit is exhausted, or for a period of ten years, whichever is earlier. All claims—for the tax credit under this section, including any amended claims, shall be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to comply with foregoing provision shall constitute a waiver of the right to claim the credit.

(e) The state historic preservation division shall develop rules pursuant to chapter 91 for the approval of rehabilitation of certified historic structures for which the tax credit under this section is sought. These standards and criteria shall take into account whether the rehabilitation of a certified historic structure will preserve the historic character of the property.

(f) Following the completion of rehabilitation of a certified historic structure, the owner shall notify the state historic preservation division that the rehabilitation has been completed. The owner shall provide the state historic preservation division with documentation of the costs incurred in rehabilitating the historic property and shall submit certification of the costs incurred in rehabilitating the historic property. The state historic preservation division shall review the rehabilitation and verify that the rehabilitation project complied with the rehabilitation plan. The administrator of the state historic preservation division shall certify in writing that the rehabilitation has been completed in accordance with the approved rehabilitation plan, and provide that certification to both the project proponent and the director of taxation.

(g) The director of taxation shall prepare any forms that may be necessary to claim the tax credit under this section. The director may also require the taxpayer to furnish reasonable information to ascertain the validity of the claim for credit made under this section and may adopt rules necessary to effectuate the purposes of this section pursuant to chapter 91.

(h) The aggregate amount of the tax credits claimed for qualified tax credits claimed for qualified rehabilitation projects not exceed:

(1) $ for the 2020 tax year;

(2) $ for the 2021 tax year;

(3) $ for the 2022 tax year;

(4) $ for the 2023 tax year; and

(5) $ for the 2024 tax year and every year thereafter.

(i) On an annual basis, the state historic preservation division, in consultation with the department of taxation, shall determine the information necessary to enable a quantitative and qualitative assessment of the outcomes of the tax credit to be determined. Each taxpayer claiming this credit shall, no later than the last day of the taxable year following the close of the tax year in which qualified costs were expended, submit a written, certified statement to the state historic preservation division containing the qualified rehabilitation expenditures incurred by the taxpayer and any other information the state historic preservation division or department of taxation may require.

Any taxpayer failing to submit information to the state historic preservation division in a manner prescribed by the state historic preservation division prior to the last day of the taxable year following the close of the tax year in which the qualified costs were expended shall not be eligible to receive the tax credit for those expenses, and any credit already claimed for that taxable year shall be recaptured in total. The amount of the recaptured tax credit shall be added to the taxpayer's tax liability for the taxable year in which the recapture occurs.

All information in the statement submitted under this section shall be a public document, except for information that is otherwise exempt from public disclosure in accordance with chapter 92F.

(j) Recapture of a previously claimed tax credit shall be required from any taxpayer who received the credit if any of the following occur:

(1) The projected qualified expenditures do not materialize;

(2) The qualified rehabilitation plans do not proceed in a timely manner and in accordance with the approved plans;

(3) In the case of the thirty per cent tax credit, less than twenty per cent of the units qualify as affordable rental housing; or

(4) In the case of the thirty per cent tax credit, less than ten per cent of the units qualify as affordable homeownership units.

Any credit under this section shall be recaptured following the close of the taxable year for which the credit is claimed if the department of land and natural resources notifies the department that the taxpayer has failed to comply with the requirements of this section or its related rules promulgated by the state historic preservation division.

(k) On an annual basis, the state historic preservation division, in consultation with the department of taxation, shall submit a report to the legislature at least twenty days prior to the convening of each regular legislative session evaluating the effectiveness of the tax credit. The report shall include findings and recommendations to improve the effectiveness of the tax credit to further encourage the rehabilitation of historic properties.

(l) For the purposes of this section:

"Affordable homeownership units" means housing that meets the guidelines published by the United States Department of Housing and Urban Development for the year in which the units are initially offered for sale.

"Affordable rental housing" means rental housing that meets the guidelines published by the United States Department of

Housing and Urban Development for the year in which the units are put into service.

"Certified historic structure" means any structure that is:

(1) Individually listed in the Hawaii register of historic places or the national register of historic places;

(2) Located in a historic district listed in the Hawaii register of historic places or the national register of historic places and certified by the state historic preservation division as contributing to the significance of the historic district; or

(3) A structure that the state historic preservation division has determined is eligible for inclusion in the Hawaii register of historic places, and which is listed in that register by the date of certification by the administrator of the state historic preservation division in accordance with subsection (f).

"Qualified rehabilitation expenditures" means any costs incurred for the physical rehabilitation, renovation or construction of a certified historic structure pursuant to a rehabilitation plan; provided that the term shall not include the owner's personal labor.

"Qualified staff" means a staff person meeting the Secretary of the Interior's Professional Qualification Standards for an architectural historian or historic architect.

"Rehabilitation plan" means any construction plans and specification for the proposed rehabilitation of a historic structure in sufficient detail for evaluation of compliance with the rules adopted by the state historic preservation division.

"Substantial rehabilitation" means that qualified rehabilitation expenditures on a certified historic structure ~~that~~ exceed twenty-five per cent of the assessed value of the structure."

SECTION 2. There is hereby established one temporary position in the state historic preservation division to assist with the establishment and administration of the Hawaii historic preservation income tax credit program. The authorization for this temporary position shall expire at the end of fiscal year ________.

SECTION 3. The department of land and natural resources shall be authorized to collect reasonable fees to defray the expenses incurred as reviewing and certifying plans pursuant to carrying out section 235- , Hawaii Revised Statutes. Fees collected for these purposes shall be deposited into the Hawaii historic preservation special fund established pursuant to section 6E-16, Hawaii Revised Statutes.

SECTION 4. There is appropriated out of the general revenues of the State of Hawaii the sum of $85,000 or so much thereof as may be necessary for fiscal year 2019-2020 and the same sum or so much thereof as may be necessary for fiscal year 2020-2021 for one temporary position in the state historic preservation division to assist with the establishment and administration of the Hawaii historic preservation income tax credit program pursuant to this Act.

The sums appropriated shall be expended by the department of land and natural resources for the purposes of this Act.

SECTION 5. New statutory material is underscored.

SECTION 6. This Act, upon its approval, shall apply to the taxable years beginning after December 31, 2019; provided that sections 2, 3 and 4 shall take effect on July 1, 2019.

Thank you for the opportunity to comment on this measure.

DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LIEUTENANT GOVERNOR

LINDA CHU TAKAYAMA
DIRECTOR

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
830 PUNCHBOWL STREET, ROOM 221
HONOLULU, HAWAII 96813
http://tax.hawaii.gov/
Phone: (808) 587-1540 / Fax: (808) 587-1560
Email: Tax.Directors.Office@hawaii.gov

To: The Honorable Donovan M. Dela Cruz, Chair
and Members of the Senate Committee on Ways and Means

Date: Tuesday, February 19, 2019
Time: 9:30 A.M.
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 1394, S.D. 1, Relating to Historic Preservation

The Department of Taxation (Department) offers the following comments regarding S.B. 1394, S.D. 1 for the Committee's consideration.

S.B. 1394, S.D. 1 establishes a new refundable tax credit for taxpayers who rehabilitate historic structures pursuant to a rehabilitation plan certified by the Department of Land and Natural Resources' State Historic Preservation Division (SHPD). A summary of key provisions are as follows:

- Adds a new section to Hawaii Revised Statutes (HRS) chapter 235, creating a refundable tax credit for qualified expenses incurred as part of rehabilitation of a historic structure certified by the SHPD;
- Sets the amount of the credit at 25% of the qualified expenses or 30% if at least twenty percent of the units are for affordable rental housing or at least ten percent are sold for affordable homeownership under affordable housing guidelines;
- Requires the SHPD to develop rules for the approval of rehabilitation plans;
- Requires owners of certified historic structures to notify the SHPD when the rehabilitation has been completed and requires the SHPD to review the rehabilitation and verify that it has been completed in accordance with the approved rehabilitation plan;
- Creates an unspecified aggregate cap on the total amount of credits that may be claimed for qualified rehabilitation projects;
- Requires SHPD, in consultation with the Department, to determine the information necessary to enable a quantitative and qualitative assessment of the outcomes of the tax credit to be determined.
- Requires taxpayers to submit a written, certified statement to the SHPD containing their

qualified rehabilitation expenses and any other information the SHPD or the Department may require;

- Specifies that all information submitted in the statement to SHPD by taxpayers claiming the credit is public information.
- Provides for recapture of the tax credit if the projected expenditures do not materialize, the rehabilitation plans do not proceed in a timely manner or in accordance with the approved plan, or the amount of affordable units differs from the projected amount;
- Requires the SHPD, in consultation with the Department, submit an annual report to the Legislature;
- Authorizes the Director of Taxation to require proof of the claim for the tax credit; and
- Has a defective effective date of January 1, 2050.

First, the Department notes that this credit is refundable. The Department prefers nonrefundable credits because refundable credits are more prone to abuse and improper claims.

Second, the Department notes that this credit does not contain a provision that disallows the credit if a deduction is claimed nor does it contain a provision that reduces the basis of the property by the amount of credit. Accordingly, the Department suggests that subsection (c) be amended to read as follows:

> (c) In the case of a partnership, S corporation, estate, or trust, the tax credit allowable is for qualified expenses incurred by the entity for the taxable year. The cost upon which the tax credit is computed shall be determined at the entity level. Distribution and share of credit shall be determined pursuant to section 704 of the Internal Revenue Code.
>
> If a deduction is taken under section 179 (with respect to election to expense depreciable business assets) of the Internal Revenue Code, no tax credit shall be allowed for that portion of the qualified expense for which the deduction is taken.
>
> The basis of eligible property for depreciation or accelerated cost recovery system purposes for state income taxes shall be reduced by the amount of credit allowable and claimed. In the alternative, the taxpayer shall treat the amount of the credit allowable and claimed as a taxable income item for the taxable year in which it is properly recognized under the method of accounting used to compute taxable income.

Third, the Department notes that it appreciates the inclusion of a recapture provisions in subsections (i) and (j). However, the Department suggests placing all language relevant to recapture in the same subsection. Further, the Department notes that it lacks the subject matter expertise to determine if any of the events allowing recapture in this bill come to pass. The Department recommends adding the following language to subsection in which recapture language is located:

> Any credit under this section shall be recaptured following the close of the taxable year for which the credit is claimed if the department of land and natural resources notifies the department that the taxpayer has failed to comply with the requirements of this section or its related rules promulgated by the state historic preservation division.

Thank you for the opportunity to provide comments.

LATE

SB-1394-SD-1
Submitted on: 2/18/2019 9:37:15 AM
Testimony for WAM on 2/19/2019 9:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Melodie Aduja	Testifying for O`ahu County Committee on Legislative Priorities of the Democratic Party of Hawai`i	Support	No

Comments:

SUBJECT: INCOME, Historic Preservation Tax Credit

BILL NUMBER: SB 1394, SD-1

INTRODUCED BY: Senate Committee on Labor, Culture and the Arts

EXECUTIVE SUMMARY: Establishes a refundable tax credit based on the qualified rehabilitation expenses of a historic structure. The adoption of this credit would provide tax relief to taxpayers regardless of their need for tax relief. It also would shift the burden of paying for government to the rest of us.

SYNOPSIS: Adds a new section to HRS chapter 235 to allow a credit for a rehabilitation plan or a certified historic property that is certified by the historic preservation division of DLNR.

The credit is to be 25% of the qualified rehabilitation expenditures, or 30% if (A) at least 20% of the units are rental units and qualify as affordable housing, or (B) at least 10% of the units are individual homeownership units and qualify as affordable housing.

The credit is available in the taxable year in which the substantially rehabilitated structure is placed into service. If completed in phases, the tax credit shall be prorated to the identifiable portion of the building placed into service during that taxable year.

Tax credits that exceed the taxpayer's income tax liability may be refunded.

For a partnership, S corporation, estate, or trust, the cost upon which the credit is computed shall be determined at the entity level and the distribution and share of the tax credit shall be determined pursuant to section 704(b) of the Internal Revenue Code.

Requires the director of taxation to prepare any forms necessary to claim a credit, may require a taxpayer to furnish reasonable information to validate a claim for the credit, and adopt rules pursuant to HRS chapter 91. Requires claims for the credit, including any amended claims, to be filed on or before the end of the twelfth month following the taxable year for which the credit is claimed. Failure to comply with the foregoing provision shall constitute a waiver of the right to claim the tax credit.

The aggregate amount of tax credits claimed shall not exceed $_____ for the 2020 tax year, $_____ for the 2021 tax year, $_____ for the 2022 tax year, $_____ for the 2023 tax year, and $_____ for the 2024 tax year and every year thereafter.

Provides that following the completion of rehabilitation of a certified historic structure, the owner shall notify the state historic preservation division that the rehabilitation has been completed. The owner shall provide the state historic preservation division with documentation of the costs incurred in rehabilitating the historic structure and shall submit certification of the costs incurred in rehabilitating the historic structure. The state historic preservation division shall review the rehabilitation and verify that the rehabilitation project complied with the rehabilitation plan. The administrator of the state historic preservation division shall certify in writing that the rehabilitation has been completed in accordance with the approved rehabilitation plan, and provide that certification to both the project proponent and the director of taxation.

Provides that each taxpayer claiming this credit shall, no later than the last day of the taxable year following the close of the tax year in which qualified costs were expended, submit a written, certified statement to the state historic preservation division containing the qualified rehabilitation expenditures incurred by the taxpayer and any other information the state historic preservation division or department of taxation may require. If this information is not submitted, the taxpayer shall not be eligible to receive the tax credit for those expenses, and any credit already claimed for that taxable year shall be recaptured in total. A recaptured tax credit shall be added to the taxpayer's tax liability for the taxable year in which the recapture occurs.

Provides for recapture of a previously claimed tax credit if any of the following occur: (1) the projected qualified expenditures do not materialize; (2) the qualified rehabilitation plans do not proceed in a timely manner and in accordance with the approved plans; (3) in the case of the thirty per cent tax credit, less than twenty per cent of the units qualify as affordable rental housing; or (4) in the case of the twenty per cent tax credit, less than ten per cent of the units qualify as affordable homeownership units.

Defines "qualified rehabilitation expenditures" as any costs incurred for the physical construction involved in the certified rehabilitation of a certified historic structure; provided that for projects involving mixed residential and non-residential uses, at least thirty per cent of the total square footage of the rehabilitation is placed into service for residential use. "Qualified rehabilitation expenditures" shall not include the owner's personal labor.

Defines "rehabilitation plan" as any construction plans and specification for the proposed rehabilitation of a historic structure in sufficient detail for evaluation of compliance with the rules adopted by the state historic preservation division.

Defines "substantial rehabilitation" as the qualified rehabilitation expenditures of a historic structure that exceed twenty-five per cent of the assessed value of the structure.

EFFECTIVE DATE: Credit affects taxable years beginning after December 31, 2050.

STAFF COMMENTS: Lawmakers need to keep in mind two things. First, the tax system is the device that raises the money that they, lawmakers, like to spend. Using the tax system to shape social policy merely throws the revenue raising system out of whack, making the system less than reliable as there is no way to determine how many taxpayers will avail themselves of the credit and in what amount. The second point to remember about tax credits is that they are nothing more than the expenditure of public dollars, but out the back door. If, in fact, these dollars were subject to the appropriation process, would taxpayers be as generous about the expenditure of these funds when our kids are roasting in the public school classrooms, there isn't enough money for social service programs, or our state hospitals are on the verge of collapse?

If lawmakers want to subsidize the rehabilitation of certified historic buildings, then a direct appropriation would be more accountable and transparent.

Furthermore, the additional credit would require changes to tax forms and instructions, reprogramming, staff training, and other costs that could be massive in amount. A direct appropriation may be a far less costly method to accomplish the same thing.

Finally, the credit is directed to persons who might have no need for financial assistance.

Technical changes that are needed in the bill as it is now drafted include the following:

- As drafted, the bill appears to allow for credit to be claimed for estimated rehabilitation costs, with recapture to occur later if the costs were not actually expended or the documentation is insufficient. Once money goes out the door, however, it may be difficult to recover.
- As drafted, the bill appears to contemplate certification of the costs by the historic preservation division before the credit can be claimed. This does not seem to be consistent with the parts of the bill contemplating allowing a credit claim based on estimated costs. We suggest that the credit claim be allowed only for actual costs that are certified by the historic preservation division.
- The bill does not clearly task either the historic preservation division or the department of taxation with keeping track of the aggregate cap on the credit, and does not provide direction as to what to do if the claims exceed the cap.
- The recapture condition in (j)(4) is not consistent with (a)(2)(B) because if 10% are individual homeownership units that qualify as affordable housing, a 30% credit is awarded. There is no 20% credit in the bill as now drafted.
- The definition of "substantial rehabilitation" as now drafted does not make sense. The following may have been intended: "Substantial rehabilitation" means that qualified rehabilitation expenditures of a historic structure exceed twenty-five per cent of the assessed value of the structure.

Digested 2/16/2019

LAND USE RESEARCH
FOUNDATION OF HAWAII
1100 Alakea Street, Suite 408
Honolulu, Hawaii 96813
(808) 521-4717
www.lurf.org

LATE

February 18, 2019

Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Senate Committee on Ways and Means

Comments in Strong Support of SB 1394, Relating to Historic Preservation (Establishes a historic preservation tax credit. Appropriates funds for one temporary position to assist with the establishment and administration of the Hawaii historic preservation income tax credit program.)

<u>WAM Hrg</u>: Tuesday, February 19, 2019 at 9:30 a.m. in Conf. Rm. 211

The Land Use Research Foundation of Hawaii (LURF) is a private, non-profit research and trade association whose members include major Hawaii landowners, developers, resort operators and utility companies. LURF's mission is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources, and public health and safety.

LURF appreciates the opportunity to provide comments in **strong support of SB 1394, SD1.**

<u>SB 1394, SD1</u>. This bill establishes a historic preservation tax credit for qualified construction expenses incurred in rehabilitation of historic structures that produces affordable housing units; and appropriates funds for one temporary position to assist with the establishment and administration of the Hawaii historic preservation income tax credit program.

<u>LURF's Position</u>. LURF members maintain and are stewards of historic properties and structures. LURF and its members believe that preserving and appropriately using historic structures are ways to maintain and enhance a living display of Hawaii's history and community character, and also, in some cases, encourage heritage tourism.

Also, the lack of affordable housing remains a significant problem affecting Hawaii and finding ways to provide sufficient housing for Hawaii's residents has continued to be a major objective for the Legislature, state and county agencies, and members of the housing industry and business community.

Tax credit programs to encourage historic preservation have proven to be successful incentives for rehabilitating historic structures and returning them to useful life, and affordable housing tax credits have also resulted in the construction of sorely needed affordable housing units.

Logical changes to existing laws such as the historic preservation tax credit proposed by this bill are therefore significant, necessary and should be welcomed as a method to assist with both the preservation of historic structures and addressing the diminished supply of affordable housing in Hawaii. This seemingly small tax credit measure has the potential to result in substantial and positive impacts on the preservation of historic structures and affordable housing, as well as invigorating the local construction industry and advancing the State's economy and general welfare.

For these reasons, LURF is in **strong support of SB 1394, SD1**, and respectfully urges your favorable consideration.

Thank you for the opportunity to provide comments relating to this measure.