

**REPORT TO THE TWENTY-FOURTH STATE LEGISLATURE
STATE OF HAWAII**

**FINAL REPORT ON THE
INCENTIVES FOR IMPORTANT AGRICULTURAL LANDS
ACT 183, SLH 2005**

**PREPARED BY:
DEPARTMENT OF AGRICULTURE**

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SECTION I

Background

A. Act 183, 2005 Session Laws of Hawaii

The identification and designation of Important Agricultural Lands (IAL) was proposed at the 1978 Constitutional Convention and subsequently approved by voters in the same year. Enacted as Article XI, Section 3, of the Constitution of the State of Hawaii,

“The State shall conserve and protect agricultural lands, promote diversified agriculture, increase agricultural self-sufficiency and assure the availability of agriculturally suitable lands. The legislature shall provide standards and criteria to accomplish the foregoing.

Lands identified by the State as important agricultural lands needed to fulfill the purposes above shall not be reclassified by the State or rezoned by its political subdivisions without meeting the standards and criteria established by the legislature and approved by a two-thirds vote of the body responsible for the reclassification or rezoning action.”

After decades of debate about how the constitutional requirement was to be implemented, farmers and landowners formed a historic alliance and joined with the Department of Agriculture, State Land Use Commission, Office of Planning and members of the legislature to pass what is rightfully described as “landmark” legislation for Hawaii’s agricultural industry. Act 183, signed by Governor Linda Lingle on July 1, 2005, provides the standards, criteria, and processes to fulfill the intent and purpose of Article XI, Section 3.

Act 183 recognizes that viable agricultural operations are the key to preserving agricultural lands in Hawaii. Thus Act 183 focuses on providing farmers with needed support to spur and assist agricultural viability and activity on agricultural lands.

B. Policies Governing Important Agricultural Lands

The policy statement found in Act 183 (see below) is clear that both the State and counties are responsible for promoting the long-term viability of agricultural use of IAL. The policy statement provides guidance in the identification and mapping process (policies 1-3) and the creation of incentives (policies 4-8). Policy 4 is primarily a county responsibility while policies 5-8 can be carried out by both the State and counties.

State and county agricultural policies, tax policies, land use plans, ordinances, and rules shall promote the long-term viability of agricultural use of important agricultural lands and shall be consistent with and implement the following policies:

- (1) Promote the retention of important agricultural lands in blocks of contiguous, intact, and functional land units large enough to allow flexibility in agricultural production and management;

- (2) Discourage the fragmentation of important agricultural lands and the conversion of these lands to nonagricultural uses;
- (3) Direct nonagricultural uses and activities from important agricultural lands to other areas and ensure that uses on important agricultural lands are actually agricultural uses;
- (4) Limit physical improvements on important agricultural lands to maintain affordability of these lands for agricultural purposes;
- (5) Provide a basic level of infrastructure and services on important agricultural lands limited to the minimum necessary to support agricultural uses and activities;
- (6) Facilitate the long-term dedication of important agricultural lands for future agricultural use through the use of incentives;
- (7) Facilitate the access of farmers to important agricultural lands for long-term viable agricultural use; and
- (8) Promote the maintenance of essential agricultural infrastructure systems, including irrigation systems.

It can be concluded from the policy language, i.e. “basic level of infrastructure...”, “minimum necessary...” “essential agricultural infrastructure...” that sufficient resources must be committed to the incentives now and in the future in order that agricultural entities on IAL have access to the critical resources needed to be truly viable and positioned to grow.

C. Role of the Hawaii Department of Agriculture

Pursuant to Section 9 of Act 183, the Hawaii Department of Agriculture (HDOA), with the assistance of the Department of Taxation (DoTAX), submits this report that contains incentives to promote agricultural viability, sustain growth of the agricultural industry, and encourage the long-term use and protection of Important Agricultural Lands (IAL) for agricultural use in Hawaii by farmers and landowners, and an analysis of the costs, benefits and expected outcomes, a justification for their inclusion and a description of the process through which the incentives were identified, selected, and approved.

SECTION II

Process and Deliberations

A. Incentive Development Process

A two-phase process was designed by HDOA. The first phase encompassed the period of July 1 to December 31, 2005 with the goal of establishing an organizational and informational foundation for Phase II. At the end of Phase I, a Preliminary Report to the Legislature was submitted (a copy of this report may be viewed on HDOA's website at www.hawaiiag.org/hdoa).

Phase II began January 1, 2006 and concludes with the submittal of this report.

B. Incentive Development Activities

1. Organizational

Act 183 requires that stakeholder discussions be inclusive and use a consistent voting procedure. In Phase I, HDOA formed a core group of twelve organizations referred to as the Forum. The Forum is comprised of members representing farmers and landowners (43%), state government (36%), county government (14%), and agricultural research, education, and technical service providers (7%).

HDOA chairs the Forum and has six representatives (Chairperson, Board of Agriculture; Deputy; Planner; Executive Director, Agribusiness Development Corp.; Administrator, Agricultural Loan division; Administrator, Agricultural Resource Management division).

The Hawaii Farm Bureau Federation (HFBF), and the Land Use Research Foundation (LURF) are each allocated six members.

Other organizations and their number of representatives are:

- Department of Taxation (DoTAX) (2)
- University of Hawaii College of Tropical Agriculture and Human Resources (CTAHR) (1)
- Department of Business, Economic Development & Tourism (DBEDT) (1)
- Office of Planning (1)
- Hawaii Agriculture Research Center (HARC) (1)
- City & County of Honolulu Planning Department (1)
- County of Maui Planning Department (1)
- County of Kauai Planning Department (1)
- County of Hawaii Planning Department (1)

Names of each Forum member can be found in Appendix B.

2. Decision-Making Process

The Forum has met nine times throughout Phases I and II. In addition, sub-groups were formed around specific incentive areas and these groups have met multiple times to conceptualize and develop incentives for presentation to the whole Forum. Forum meetings have been open to the agricultural community and discussions at the meetings have been candid. Some of the county planning directors or their staff participated through a conference call or periodically attended the meetings in person. Ideas for incentives and feedback from as broad a spectrum of individuals and organizations as possible have been solicited.

The Forum considered a number of incentive proposals. Some of the proposals required more extensive county engagement than occurred and ultimately, county approvals, and these, along with others, have been deferred for future consideration. A discussion of the Transfer of Development Rights/Purchase of Development Rights programs, which the Forum believes can be very valuable incentives if supported by the counties, is included in the report.

The Forum finalized a list of nineteen incentives and presented these incentives at the Hawaii Farm Bureau Federation Annual Convention and at the Ag. Conference, both held in October 2006. Attendees at each of the conferences were surveyed for their opinion on the incentives.

In addition, individuals who participated in statewide farmer meetings were e-mailed a survey form and description of incentives.

Forum members were asked to rank the incentives in priority order as a separate group. In order to maintain a fair and consistent voting procedure, each of the 28 members of the Forum was allotted one vote.

HDOA used the combined survey results and the analysis of costs provided by the Department of Taxation and opinions expressed at the Forum and statewide meetings with farmers in order to compile the high priority incentives which are discussed in Section II.

3. Outreach

During Phase I and II, HDOA and Forum members, particularly HFBF, LURF, and the Office of Planning have been active in creating awareness within the agricultural community and the general public of the expectations and implications of Act 183. Dean Okimoto, President of HFBF and Dean Uchida, Executive Director of LURF have authored editorials and letters printed in the Honolulu newspapers and spoken to their memberships about the importance of Act 183.

HDOA's Deputy, Duane Okamoto, has made presentations about Act 183 to farmer groups and all of the Governor's Advisory Councils on every island. Anthony Ching, Executive Officer of the State Land Use Commission was a co-presenter on the IAL

mapping process at many of the Advisory Council meetings and was accompanied by Mary Lou Kobayashi, from the Office of Planning. HDOA's Chairperson, Sandra Lee Kunimoto and Dean Uchida spoke to the Hawaii State Bar Association's 2005 annual convention and Duane Okamoto and Dean Uchida spoke about IAL incentives to the assembled delegates of HFBF's 2005 annual convention. Both Chairperson Kunimoto and Deputy Okamoto conducted meetings with groups of farmers throughout the state to solicit their ideas for incentives for IAL. A representative list of idea contributors and meeting participants is included in Appendix E.

Forum members Dean Uchida, Mae Nakahata, Sandra Lee Kunimoto, and Dean Matsukawa presented the Forum's incentives to the attendees of the 2006 Ag. Conference.

HDOA created a link to IAL incentive related information and materials on its official website. Visitors can access the link at www.hawaiiag.org/hdoa/ial.htm. Since its launch in December 2005, the site has been visited over 1,600 times.

4. Research

During Phase I, HDOA conducted an extensive research effort to identify laws, ordinances, and programs to protect and promote agriculture on the U.S. mainland and around the world that might have application in Hawaii. HDOA was able to access the resources of the American Farmland Trust and the contributions of Mr. Bob Wagner, who provided his time and support. A description of the research findings can be found in the Preliminary Report.

The Forum was very fortunate to have the participation of the Hawaii State Department of Taxation. Mrs. Johnnel Nakamura and Mr. Jason Healy were actively involved in researching the various incentive proposals developed by the Forum and the Department of Taxation Research Office assisted the Forum with projections of estimated cost to the state.

In addition, HDOA engaged the services of the Tax Department of KMH LLP, a Honolulu based full-service accounting, auditing, and tax services firm to provide comments and analysis of the financial incentives.

SECTION III

Developmental Framework

A. Overview

The incentives recommended for adoption are those that have the highest level of support from Forum members and are further validated by responses from other farmers and landowners who responded to surveys distributed at the HFBF convention and the Ag. Conference as well as e-mailed to participants in the statewide farmer meetings. There is a high degree of consistency in the ranking of the incentives which is indicative of a broad range of support.

The proposed incentives are beneficial to all types of landowners, farmers, ranchers, or aquaculturists. They are “crop neutral” in that they can be beneficial to anyone involved in agriculture. Future producers of biodiesel and ethanol fuel stocks will find them as beneficial as producers of Hawaii’s current crops. However, they are specifically targeted to commercial scale producers. The incentives are not meant for “gentlemen” estates, hobbyists, and others who are not in agriculture as a profession with the intention to operate as a business on IAL.

B. Monitoring and Evaluation

During the discussion of incentives in the Forum meetings, members were united in the belief that impact and outcomes from the incentives need to be measurable and that eligibility for the incentives has to be verified. Suggestions were made that either HDOA or the Agribusiness Development Corporation should conduct the monitoring and evaluation. Given the resources available and the expertise required, HDOA is in a far better position to take on the responsibility. The HDOA will be involved in the measurement and evaluation of outcomes on an on-going basis as well as verifying eligibility for the incentives, monitoring and reporting on the successes resulting from the incentives, and addressing any problems with the incentives that may occur.

HDOA will require funds and a position to conduct this critical function. This additional position combined with the analytical expertise of the Hawaii Agricultural Statistical Service and economists within the Agricultural Development division will provide the accountability to the Legislature and the public that is required and essential. HDOA Forum members have worked closely with the Department of Taxation to include safeguards in the incentives to prevent abuse, a means to collect and verify reported information, and confirm eligibility as a bonafide IAL landowner or lessee. HDOA is in the best position to build upon and strengthen the existing relationship with the Department of Taxation, which is essential in fulfilling the monitoring and evaluation role.

Forum members also recognized that the full utilization of IAL lands, even with a range of incentives in place, may take a long time and require amended or different incentives. This further emphasizes the need to establish a means to collect and analyze data to

arrive at an objective conclusion about the effectiveness of the incentives. The authority and funding to perform this essential responsibility has been incorporated into the appropriate incentives.

C. Range of Incentives Considered by the Forum

The Policy statement found in Act 183 addresses the need to create agricultural viability on IAL through incentives that will encourage landowners to dedicate their lands as IAL and for farmers on IAL to improve their profitability and productivity. Within the broad scope of the policies, a number of types of incentives were considered. The review of different types of incentives, as well as disincentives, was started in the period of July-December 2005 and continued through to the completion of this report.

On one end of the range of incentives is protecting against the threat of eminent domain or the involuntary but compensated “taking” or threat of taking of lands for a public purpose. Legal review did not discern a satisfactory method of protecting IAL against this threat.

The Forum also considered amendments to clarify the State’s guidance on zoning and land use planning as a type of incentive. However, it was decided that land use planning would be addressed separately outside of the IAL incentives report. Without sufficient county support and involvement, zoning changes would be difficult to pursue as an incentive.

The Forum concluded that the types of incentives that would have the greatest appeal to landowners and farmers and would result in true agricultural viability would be those that provide financial benefits, regulatory relief and dependable sources of water.

D. Efficacy of Incentives

Tax Credits

While some of the proposed incentives have little or no cost impact on the State, the tax credit incentives in particular will require a substantial investment for a prolonged period of time. However, unlike many existing tax credits whose outcomes are difficult to assess, at least some of the most important benefits of the proposed IAL incentives will be immediately obvious.

In order for the incentives to be accessed, lands will have to first be designated IAL by the LUC either through the voluntary or county-led process. This action will serve to identify the specific agricultural lands to be the recipient of activities and programs to “...conserve and protect agricultural lands, and assure the availability of agriculturally suitable lands”. Other incentives will then, over time, “...promote diversified agriculture, increase agricultural self-sufficiency,” thus, in combination, fulfilling the constitutional mandate called for in Article XI, Section 3 and ensuring the permanency of a strong, and viable agricultural industry.

Tax credits have been used by both the federal government and most states as economic incentives for many years. In Hawaii, the Act 221/215 (SLH 2001) tax credits have been both criticized and praised by commentators and practitioners, and no definitive study has been issued analyzing its effectiveness. It should be noted that the purpose of Act 221/215 is significantly different from the IAL tax incentives. The purpose of Act 221/215 is to encourage investment in high technology businesses in Hawaii, with the ultimate goal to “set Hawaii apart as a tech-friendly place to do business for both technical and non-technical businesses.”¹ The IAL tax incentives are designed to protect existing agricultural lands by stimulating the viability of agriculture.

Another major difference in the tax credit incentives is that it is very likely that the agricultural tax credits will rise for a period of time but then plateau and then decline. Unlike high tech companies, there is a finite acreage of IAL and number of IAL landowners. Once the major infrastructure and other investments are made, there will be a substantially reduced need to make additional investments.

Although studies on the economic impact of tax credits vary, several studies do indicate that tax credits are beneficial to the state economies and can have the intended results.

The University Georgia Center for Agribusiness and Economic Development issued a study in June 2006, titled “Estimated Cost and Economic Impact of a Dairy Tax Credit in Georgia.” This study was summarized as follows:

Milk production across much of the southeastern United States has been declining for more than two decades. This decline, coupled with an increasing population in the region, and hence an increasing demand for milk, has sparked considerable interest in examining the causes, effects, and potential remedies for declining milk production. Several southeastern states have launched initiatives aimed at stabilizing or growing their local dairy industries. One such state is South Carolina, which in 2005 enacted the South Carolina Dairy Tax Credit program. Calculating a hypothetical tax credit for each qualifying dairy farm in Georgia for 2005, based on South Carolina's dairy tax credit rules, yields a total of \$10,811,250 in total tax credits on 1,362,784,556 pounds of milk, or the equivalent of about 79.3 cents per cwt (hundred pounds of milk). A tax credit of this magnitude has the potential to increase milk production in Georgia and create additional economic impacts in the form of general business activity related to the support of dairy operations.

In March 2005, Lipman Frizzell & Mitchell LLC prepared a study titled “Rhode Island Historic Preservation Investment Tax Credit: Economic & Fiscal Impact Analysis.” In summarizing the economic impact of these Rhode Island credits, the study concluded:

Viewed from the perspective of the State’s investment, its estimated investment of \$145.47 million will leverage a total of \$795.25 million in economic activity at all levels throughout the State. Each \$1.0 million of State tax credits, therefore,

¹ Act 221, section 1.

leverages \$5.47 million in total economic output (calculated as follows: \$1.64 million in output divided by \$.3 million in tax credits).

These studies indicate that, if properly structured, tax credits can have the desired effect.

Throughout the incentive development process, the Department of Taxation provided a number of recommendations that addressed many of the criticisms of tax credits. The Forum also carefully considered some of the recommendations issued by the Tax Review Commission and adopted those concerning increased transparency, timely disclosure, and mandatory data reporting.

Water

Dependable sources of affordable water are essential for agriculture. Policies that ensure the availability of water for agriculture on IAL will provide the degree of stability and reduced risk that farmers require to make operational decisions. It is reasonable to assume that agriculture on IAL will be entrepreneurial in nature as a result of the other incentives available to the farmers and that additional production for in-state and export will result if water is available. It is the opinion of the Forum that in order to protect and promote agricultural use of important agricultural lands as called for in the Constitution, it is equally important to protect and ensure the availability of water for State important agricultural lands.

Summary

While some members of the Forum strongly believe that without county incentives the incentives "package" is incomplete, HDOA recommends that the incentives process continue to move forward. New or modified incentives, including county incentives, can be added in the future. It is imperative that the protection of important agricultural lands begins as soon as possible as further delay brings more development pressure.

It is HDOA's belief that the proposed incentives will bring about significant and measurable changes to Hawaii agriculture. Changes will likely be incremental in the first few years that the incentives are implemented but measured over a five, ten, and twenty year time period, we would expect to see patterns of agricultural growth and expansion, profitability and new market development occurring at a far accelerated pace than if the IAL incentives were not available.

HDOA would expect that with full county participation in developing incentives that address permitting, real property taxation, infrastructure requirements, rural designation and other issues that affect agriculture, that the pace of agricultural development on IAL will be even more impressive.

SECTION IV

Description of Possible IAL Incentives

This section includes a description of all of the incentives that were given consideration by the Forum. Those incentives that are included in sub-section A below have the highest level of support by Forum members, and Hawaii Farm Bureau and Ag. Conference attendees. The other incentives have been included for the legislature's perusal and to understand the range of ideas that were investigated by the Forum.

A. High Priority State Provided Incentives

1. Expected Outcomes

a. Incentives are necessary to improve the economic viability of existing agri-business operations, enhance the likelihood of new agri-business start-ups on Important Agricultural Lands (IAL), and encourage landowners to put their lands into agricultural production.

Incentives that will achieve this outcome include:

- Important Agricultural Land Infrastructure Tax Credit
- Agri-business Investment Tax Credit
- IAL Exemption from Income and General Excise Tax (GET).

b. The availability of good land and assurance of sufficient quantities of affordable potable and non-potable water are fundamental to all agricultural activities. It serves no purpose to protect agricultural lands unless you also protect adequate sources of water for these lands. Therefore, incentives are needed not only to support the maintenance and construction of the physical systems required to develop and deliver these waters to important agricultural lands, but for the regulatory and legal systems as well, to ensure water for important agricultural lands is recognized as a high priority.

An incentive that will achieve this outcome is:

- Water for Important Agricultural Lands

c. Incentives should help agri-businesses achieve viability by increasing the availability of financing to expand or establish farming operations and reducing delays and regulatory restrictions that add to the cost of agricultural ventures or hinder the efficient operation of agri-businesses.

Incentives that will achieve this outcome include:

- Guaranty Loan Program for Important Agricultural Lands
- Air Permit Priority for Agricultural Processing Facilities

2. Description of High Priority Incentives

Important Agricultural Land Infrastructure Tax Credit

The intent of this 100% infrastructure tax credit is to encourage investment in planning, design, construction, or renovation of agricultural irrigation, roadways, utilities, agricultural processing facilities, agricultural housing, other needed infrastructure, and the purchase of necessary equipment.

Eligible expenditures for this credit shall be incurred by an agri-business with a portion of its lands utilized in the business identified and designated as important agricultural lands pursuant to part III of chapter 205. Expenditures may be for roads or utilities including distributed power generation facilities, agricultural processing facilities, water wells, reservoirs, dams, water storage facilities, water pipelines, ditches, or irrigation systems, agricultural housing specifically for laborers, and the costs incurred for equipment necessary to cultivate, grow or harvest agricultural products by an agribusiness.

The credit allowed shall be claimed against the net income tax liability for the taxable year. If the tax credit under this section exceeds the taxpayer's income tax liability, the excess of credit over liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted. The cost upon which the tax credit is computed shall be determined at the entity level.

The director of taxation shall prepare any forms that may be necessary to claim a credit under this section. The director may also require the taxpayer to furnish 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.

Taxpayers claiming the credit must provide prescribed information to the department of agriculture on an annual basis, upon request, that will enable a quantitative and qualitative assessment of the impact of the tax credit to be determined.

General funds shall be appropriated to the department of agriculture in an amount sufficient to pay the costs of collecting and analyzing the required data.

The tax credit allowed under this section shall be available for taxable years beginning after December 31, 2007, and shall not be available for taxable years beginning after December 31, 2017.

Potential Cost to State: Estimated cost of \$28.1 million in the sixth year after approval by the legislature.

Agribusiness Investment Tax Credit

The purpose of this investment tax credit is to encourage investment in qualified Hawaii agri-businesses on important agricultural lands by agri-businesses incorporated or registered in Hawaii or maintaining their principal place of business in Hawaii, as well as other sources of investment capital within and outside of Hawaii.

The maximum amount of qualified agri-business expenses eligible for the credit in each year is \$2.5 million. The credit allowed under this section shall be claimed against the net income tax liability for the taxable year.

1. 100% credit shall be taken over 5 years.
2. In the year the investment was made, 50 per cent;
3. In the first year following the year in which the investment was made, 20 per cent;
4. In the second year following the investment, 10 per cent;
5. In the third year following the investment, 10 per cent; and
6. In the fourth year following the investment, 10 per cent.
7. Recapture feature included.

If the tax credit under this section exceeds the taxpayer's income tax liability for any of the five years that the credit is taken, the excess of the tax credit over liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted.

"Qualified agri-business" means a business actively engaged in commercial agriculture, as determined by the Hawaii Department of Agriculture, with a portion of lands utilized in the business identified and designated as important agricultural lands pursuant to part III of chapter 205.

"Qualified agri-business expenses" may mean farm production expenses and, in the case of a small agri-business, small agri-business overhead expenses as well as farm production expenses as determined by the Hawaii Department of Agriculture.

"Farm production expenses" means those direct current expenses paid or incurred in connection with the operation of an agribusiness. Farm production expenses may include, but are not limited to, fertilizer, lime, and soil conditioners; chemicals; seeds, plants, vines, and trees; livestock and poultry; breeding livestock; other livestock and poultry; feed; gasoline, fuels, and oils; utilities; supplies, repairs, and maintenance; hired farm labor; contract labor; custom work and custom hauling; rent for land, buildings and grazing fees; rent and leave (lease); expenses for machinery, equipment, and farm share of vehicles; interest expense; and property taxes paid. The cost of real property shall not be considered farm production expenses.

"Small agri-business overhead expenses" means overhead expenses paid or incurred to operate a small agri-business. Small agri-business overhead expenses includes, but are not limited to, legal, accounting and other professional fees and managerial and non-farm labor expenses.

"Small agri-business" means an agribusiness whose average annual gross receipts over the past three years is less than or equal to \$5,000,000. If the agri-business has not been in existence for three years, the average annual gross receipts will be based on the number of years the agri-business has existed.

Every taxpayer operating a qualified agribusiness, before March 31 of each year following the year in which qualified agri-business expenses were paid or incurred, shall submit a written, certified statement to the director of taxation identifying qualified agribusiness expenses expended in the previous taxable year; and the amount of tax credits claimed in the previous taxable year.

The department of taxation shall maintain records of the names and addresses of the taxpayers claiming the credits under this section and the total amount of the qualified agri-business expenses upon which the tax credit is based; verify the nature and amount of the qualified agribusiness expenses; total all qualifying and cumulative qualified agribusiness expenses that the department certifies; certify the amount of the tax credit for each taxable year and cumulative amount of the tax credit; and provide access to the information collected to the department of agriculture.

Upon each determination and with the assistance of the department of agriculture, the department of taxation shall issue a certificate to the qualified agri-business verifying information submitted to the department.

The director of taxation may assess and collect a fee to offset the costs of certifying tax credits claims. All fees collected under this section shall be deposited into the tax administration special fund established under section 235-20.5.

The taxpayer operating the qualified agri-business shall file the certificate with the taxpayer's tax return with the department. Taxpayers claiming the credit must provide additional prescribed information to the department of agriculture on an annual basis, upon request, that will enable a quantitative and qualitative assessment of the outcomes of the tax credit to be determined.

General funds shall be appropriated to the department of agriculture in an amount sufficient to pay the costs of collecting and analyzing the required data.

The tax credit allowed under this section shall be available for taxable years beginning after December 31, 2007, and shall not be available for taxable years beginning after December 31, 2017.

Potential Cost to State: The estimate is based on the cost of the high technology business investment tax credit (HTBITC). However, the proposed credit for investment in agriculture on IAL differs in that investments in agriculture may entail smaller risk, so the pool of interested investors may be greater, the proposed agricultural tax credit can be claimed only against the individual and corporate net income taxes; and the proposed credit for agricultural investment is limited to \$2.5 million per investment. Estimated cost of \$50 million in the sixth year after approval by the legislature.

IAL Exclusion to Income and General Excise Tax (GET)

The intent of the income exclusion and GET exemption is to encourage landowners to voluntarily request IAL designation by increasing the net income realized from leasing their lands and to increase the amount of affordable lease lands available to farmers.

This incentive provides for an exclusion from gross income for rental income derived from agricultural leases on important agricultural lands. The exclusion shall be from the taxpayer's gross income for the taxable year in which rental income was recognized.

Taxpayers claiming the exclusion must provide prescribed information to the department of agriculture on an annual basis that will enable an aggregated quantitative and qualitative assessment of the impact of the exemptions to be conducted. General funds shall be appropriated to the department of agriculture in an amount sufficient to pay the costs of collecting and analyzing the required data.

In addition, if the lessor provides an affordable lease to a farmer lessee in the manner described, the lessor will be eligible for a GET exemption for up to twenty years and may be further eligible if the lease is extended.

1. The exclusion on income tax and GET on lease rents is available for eligible taxpayers for up to 20 years.
2. The exemption shall be allowed provided that the minimum lease term shall be established at a mutually acceptable term or 20 years, and shall be set by negotiation or appraisal, whichever results in the most favorable terms for the lessee.

Potential Cost to State: Estimated cost of \$376,000 per year in the sixth year after approval by the legislature.

Water for Important Agricultural Lands

In order to realize the full potential of the important agricultural lands, farmers must have assurance of an adequate and affordable source of water. The intent of this incentive is to provide specific guidance to the Water Commission in determining water resources for IAL. Changes proposed in the water code serve to emphasize the constitutional status of Important Agricultural Lands and the need to recognize this status whenever water issues are being considered. Changes also propose that planning activities of the State and counties consider the needs of IAL and gather and incorporate pertinent information relative to IAL.

Potential Cost to State: None

Guaranty Loan Program for Important Agricultural Lands

The intent of the guaranty is to provide low cost loans to encourage farmers to establish or expand operations on IAL and for IAL land owners or farmer associations to develop agricultural (or aquaculture) infrastructure. The guaranty will be backed by the State's general fund and administered by the director of the Department of Budget and Finance.

Under the IAL guaranty program farmers on IAL or IAL landowners/associations proposing to establish or expand their agricultural enterprises or construct/install agricultural infrastructure will apply to a lending institution, which will evaluate the proposal and qualify the borrower. The lending institution, after evaluating the proposal and determining that the proposed business is sound and viable, will certify the applicant as an eligible borrower under the IAL guaranty program. The institution will then prepare an IAL guaranty loan package and submit it to the Director of Finance. If the Director accepts the loan package, he/she will issue the IAL guaranty. A proper reserve will be maintained in the State's general fund to guarantee payment of loans made under this program.

The director of finance may guaranty loans to farmers, landowners, associations, and cooperatives from commercial lenders authorized to do business in the State for the purpose of developing agricultural and aquacultural operations and infrastructure on lands designated as Important Agricultural Lands, when the director determines that:

- (1) The project is located on Important Agricultural Lands.
- (2) The intent of the project is agricultural or aquacultural.
- (3) The bank has properly determined that the applicant and project qualifies, the bank's analysis is complete and sound and there is adequate collateral.

The guaranty for operating loans will have a maximum term of ten years. The guaranty of capital improvement loans will have a maximum term of twenty years. The guaranty of the loans may be up to 85% of the principal loan amount. The State will not charge a fee for the guaranty. The interest rate charged to the borrower will be limited to 1% below the lender's prime rate during the guaranty period.

Potential Cost to State: A reserve of 10% of outstanding loans will be recommended. Guaranteed loans are estimated to increase between Year 1 and Year 6. Estimated loan disbursements will be \$2,500,000 in Year 1; \$3,500,000 in Year 2; \$5,000,000 in Year 3; \$7,000,000 in Year 4; \$9,500,000 in Year 5; and \$12,000,000 in Year 6. Estimated reserve of \$3.95 million to be maintained by the sixth year after approval by the legislature.

Air Permit Priority for Agricultural Processing Facilities

The purpose of this incentive is to establish priority processing for air permit applications and renewals for agricultural processing facilities that process crops or livestock from an IAL agri-business.

The department of health shall establish and implement a procedure for the priority processing of permit applications and renewals, at no additional cost to the applicant, for agricultural processing facilities that processes crops or livestock from an agribusiness with a majority of the lands held, owned, or utilized by the agri-business, excluding lands held, owned, or utilized by the agribusiness in the conservation district, identified and designated as important agricultural lands pursuant to part III of chapter 205.

Potential Cost to State: None

Estimated Cost Per Year for IAL Incentives

	Yr. 1	Yr. 2	Yr. 3	Yr. 4	Yr. 5	Yr. 6
Infrastructure Tax Credit	\$10.0 M	\$15.6 M	\$19.0 M	\$23.3 M	\$25.4 M	\$28.1 M
Guaranty Loan Program	.25 M	.60 M	1.1 M	1.8 M	2.75 M	3.95 M
Water for IAL	0	0	0	0	0	0
Agri-business Investment Tax Credit	5.0 M	8.0 M	18.5	35.0 M	44.0 M	50.0 M
Air Permit Priority for Agricultural Processing Facilities	0	0	0	0	0	0
Income Tax & GET Exemption	188,000	282,000	290,000	300,000	338,000	376,000
Evaluation & Monitoring	55,000	56,100	57,222	58,366	59,534	60,724
Total	\$15.5 M	\$24.5 M	\$38.9 M	\$60.5 M	\$72.5 M	\$82.5 M

3. Outcome Indicators

HDOA will collaborate with the Department of Taxation to collect and analyze data in order to arrive at a reasonable and supportable assessment of the impact and outcomes of the IAL incentives. In order to do so, HDOA will require resources including one position and funding. HDOA will develop specific indicators to correspond with the IAL incentives that are finally approved by the legislature. The indicators may include but are not limited to the following examples:

1. No. of jobs created or saved on IAL
2. No. of IAL acres in production
3. Return on investment
4. Number of IAL acres available for lease
5. Number of farmers with leases on IAL
6. No. of IAL acres additionally placed under agricultural conservation easements
7. Number of previously vacant IAL acres placed into production
8. Number of IAL acres irrigated/accessed by irrigation and road systems
9. No. of jobs created/saved in processing facilities using production from IAL
10. Units of production from new or renovated processing facilities using production from IAL
11. Units of farm worker housing built to serve IAL.

B. County Provided Incentives

Noticeably absent from the IAL incentives are incentives provided by the counties. While the county planning departments were a part of the Forum they did not engage to the extent of developing county level incentives. The Forum strongly encourages the counties to join with the State in making a commitment to the long-term viability of agriculture by providing incentives for IAL. County incentives can only serve to further enhance the State provided incentives. The Forum invites the counties to continue the discussion of developing county incentives for IAL. In future discussions, the Forum suggests that representatives of other sections of county government be included in order to develop a comprehensive suite of county IAL incentives.

C. Other Incentives Considered by the Forum

A number of incentives were identified and discussed and ultimately, were classified as promising and having future potential, but needing additional research and refinement and a broader level of support to be included as an IAL incentive. Both the Transfer of Development Rights and Purchase of Development Rights programs are recommended for future consideration as IAL incentives, subject to county support. Other potential IAL incentives are described in this section and should be considered for future adoption.

Transfer of Development Rights & Purchase of Development Rights

Forum members spent considerable time researching and meeting with various county officials to discuss the creation of Transfer of Development Rights (TDR) and/or Purchase of Development Rights (PDR) programs in each of the four counties. While the discussions were ultimately unsuccessful in developing a recommendation, Forum members believe that with continued discussion, these programs hold promise as a means to further protect important agricultural lands.

The purchase and transfer of development rights (PDR and TDR) can be powerful tools to encourage desired patterns of settlement, protect agricultural working landscapes and increase the efficiency of public infrastructure.

TDR—The underlying problem with a TDR program in Hawaii is the value of the agricultural zoned lands. Establishing the program for “Sending” and “Receiving” areas is not a problem. The real problem is valuing the “highest and best” use for the agricultural lands that recognizes the difference between the “development rights” and the underlying fee value. Currently, existing lots of any size may be allowed one farm dwelling. Speculative values cannot be used in establishing the “development rights” that will be transferred.

PDR—Purchase development rights is something the City & County of Honolulu favors; however, the same valuation problems arise in determining what is being purchased, short of the fee simple value. Also, finding an on-going source of funding to purchase these development rights will be a challenge. Other municipalities have used a dedicated tax revenue source to fund their PDR program.

The expressed position from most of the counties seems to be reluctance at having the State involved in a PDR/TDR program for IAL designation. Both Maui and Hawaii Counties have already proceeded in identifying IAL lands as a part of their County General Plan process. This is being done independent of the State process. The “Home Rule” sentiment is quite strong and as such would diminish any TDR/PDR program if the state were to initiate one without adequate “buy-in” from one or more of the counties. Compounding the situation is the on-going effort to make better use of the rural district designation in the state. Similar to the TDR/PDR program, no county has fully embraced the effort.

At this point, there appear to be two options. The first requires a state funding commitment for IAL designation. Although not related to the TDR/PDR program, one alternative, as expressed by the City & County of Honolulu, is to have the state acquire the fee simple interest in areas they determine to be IAL and create an agricultural “Land Banking” program for IAL lands.

Another alternative that would require some funding would be to address the problem of “receiving” areas for a TDR program. All of the counties express concern about the inability to accommodate new growth in existing urban areas. In order for a TDR program to work, infrastructure capacity needs to be expanded in “receiving” areas. Used as an incentive, the legislature could consider creating an “Infrastructure Capacity Building Revolving Fund” which would loan money to the Counties at no or below market interest rates to fund infrastructure capacity building specifically for a TDR program tied to IAL lands in the County. The County could then decide if they wanted to create a TDR program and if so, they could identify the “receiving” areas by increasing capacity in those areas and putting in place incentives for redevelopment of these areas tied to a TDR program that designates IAL lands for viable agricultural operations.

Potential Cost to State/Counties: Unknown at this time. For a summary of each county’s position, please see Appendix A.

Marketing and Promotion

Provide matching marketing funds, technical information and impart knowledge to new and existing farmers on IAL to increase their proficiency in marketing and promotion of their products. Two HDOA Outreach Marketing Specialists will assist farmers on IAL in identifying and targeting markets, establish pricing, locating distribution channels and conducting appropriate promotion for farm products. Market development activities will expand marketing opportunities for new and existing farmers. The matching marketing funds will provide seed monies to improve and expand marketing and promotional activities.

Potential Cost to State: \$206,896 annually.

Capital Gains Deduction for Future Sale of Lands Committed to IAL

Incentive provides a percentage deduction of capital gains tax due on lands designated as IAL and subsequently sold with an agricultural conservation easement with a minimum term of 20 years. The deduction is based upon the ratio of IAL to the landowner's total agricultural-zoned land holdings up to a maximum of 50%. Voluntary declaration must occur within the first three years that incentives are available. Lands must remain in IAL subsequent to sale.

Buyer does not have subsequent right of deduction upon sale unless the lands have remained in IAL for a minimum of 20 years or has placed an agricultural conservation easement on the land.

Potential Cost to State: Estimated cost of \$100,000 annually.

Workforce Development, Extension Services, Agricultural Incubator Program for IAL

It is expected that IAL incentives will result in new lands being put into production and currently farmed agricultural lands being used more intensively. New markets, both in Hawaii and overseas may be developed and these initiatives will require new skills and knowledge. As a result, there will be a need for a larger and better educated workforce. These University of Hawaii, College of Tropical Agriculture and Human Resources programs are intended to increase the numbers of skilled workers available to work on IAL and to provide the necessary information to increase business success.

Establishment of Apprenticeship Program. This incentive provides short-duration stipends to students that serve as interns in local agribusinesses located on IAL. The program will pay for the initial stage of internships for 10 students from the University of Hawaii (UH) system (four year institutions and community colleges), of up to 150 hours duration each, per year.

Enhancement of Agricultural Scholarship Program. This incentive offers five scholarships (of two-year duration) every year to UH students majoring in agriculture-related programs.

Student Loan Forgiveness Program. This incentive calls for covering the cost of forgiving repayment of education loans for UH graduates who are employed by agribusinesses on IAL. Two-year loan deferrals will be offered to five new graduates per year working for companies on IAL.

Increase In UH Extension Services Personnel For Assistance on IAL (Including programs on food safety). County agents are the front-line personnel responsible for making the knowledge gained through academic research relevant and useful to members of the community. As IAL incentives promote the formation of new agri-

businesses, the already daunting workload of CTAHR's county agents will substantially increase. At present, 21 agricultural county agents working from 9 offices throughout the state are responsible for providing educational outreach to 5,500 farms and ranches. An additional agent for each county would enable the college to better serve the new farms to be established on IAL.

Expansion of the CTAHR Agribusiness Incubator Program (AIP). Strategic Plan Development; Business Plan Development; Marketing Plan Development; Project Management; Financial Systems Review; Financial Analysis; business startup assistance, identification and coordination of external resources, value-added product guidance, grants writing and bookkeeping assistance, and contract review. Establishment of a Cost of Production Information System. Addition of 4 consultants (one per county) and an additional 0.25 FTE of an administrative assistant in order to serve 24 IAL agribusiness clients per year. Cost of Production Information System will require 2 FTE. Grants writing and bookkeeping assistance will require 1.25 FTE.

Potential Cost to State: \$1,112,900 annually.

Conservation Planning

Funding for four full-time equivalent conservation planning positions (one for each county). Each will have responsibility in two major functions:

- (1) Become qualified as certified conservation planners by the USDA natural resources conservation service and located at an NRCS field office or service center, or soil and water conservation district office in each county. These four positions will provide conservation planning services on a priority basis to agribusinesses located on IAL and will supplement any county-funded conservation plan-related positions.
- (2) Responsible for seeking grant opportunities and develop programs to benefit agribusinesses on IAL and supplement IAL incentives.

Potential Cost to State: \$235,144 annually.

County Liaison

- (1) Work with county governments and councils, assisting/advising the counties with developing and implementing their IAL incentive programs and activities including identification and mitigation of impediments to agricultural development, and monitor IAL incentive indicators and status of agricultural activity on IAL.

Potential Cost to State: \$53,812 annually.

IAL Fuel Tax Credit

1. The purpose of the IAL fuel tax credit is to reduce the cost of energy incurred by agri-business owners on IAL with gross annual incomes derived from commercial agriculture activity of at least \$50,000. The fuel tax credit is limited to the State liquid fuel tax currently set at 16 cents per gallon.
2. Each principal operator of a commercial agricultural business on IAL who files an individual or corporate net income tax return for a taxable year may claim a refundable income tax credit under this section against the Hawaii state individual or corporate net income tax.
3. The tax credit shall be an amount equal to the fuel taxes imposed under section 243-4(a) and paid by the principal operator during the taxable year.
4. This tax credit shall apply to agricultural equipment operated on public highways, as section 243-4(a) provides tax relief for agricultural equipment not operated on public highways.

Potential Cost to State: \$187,983 annually.

IAL Property Tax Credit

The intent of this credit is to eliminate property taxes as a cost of holding or leasing IAL land for agricultural production. While this incentive had the support of farmers and landowners, it was given a very low priority by the counties.

1. A refundable property tax credit to qualified landowners or lessees as long as the property remains designated as Important Agricultural Lands.
2. All lands designated as IAL shall be eligible for a refundable property tax credit equal to the amount of annual property tax paid to the county.
3. The credit may continue as long as the lands remain as IAL.
4. The intent is to have the credit accrue to the entity actually paying the tax.

Potential Cost to State: \$11.0-\$13.8 million in the sixth year after approval by the legislature).

Environmental Impact Statements and IAL

Provide an exception to environmental assessment requirements for certain facilities that utilize or process biomass fuels, crops, or livestock from an IAL agri-business.

Potential Cost to State: None

SECTION V

Criteria for Determining Satisfaction with Incentives

A. Recommendation

The minimum criteria shall be met when landowners determine that the package is sufficient to incentivize them to place their lands into the IAL category and farmers determine that the incentives will create the conditions that will bring about greater profitability and operational efficiency.

Appendix A

Summary of County Comments on TDR/PDR

Hawaii County

Hawaii county is willing to use a PDR/TDR program to preserve ag. land. Hawaii County does have a limited form of TDR now, through the “Ag PUD”. Subdivisions in the ag. district in Hawaii County are controlled by zoning, e.g. A-20a zoning means that all lots must be at least 20 acres. The planning director can administratively allow an “Ag PUD”, which allows lots to be smaller as long as the average size meets the minimum. For example, a 100 acre lot zoned A-20a could be subdivided into 4 five acre lots and one 80 acre lot. The 80 acre lot cannot further be subdivided (unless the zoning was changed). This is like a TDR within one parcel (or adjacent parcels).

PDR/TDR of Existing Rights

In Hawaii County, the main rights are: (1) the right to subdivide to the minimum lot size set by zoning, if one complies with the infrastructural requirements of the subdivision code, and (2) the right to build one single-family dwelling on a lot if the lot was created before June 4, 1976, or one “farm dwelling” if the lot was created by subdivision after that date.

A PDR/TDR program could potentially purchase or transfer the right to subdivide or the right to build a home. If the existing zoning allowed the fragmentation of land into lot sizes too small to support a wide range of commercial agricultural endeavors, it would make sense to use PDR/TDR as a tool to prevent that. Almost all land in Hawaii County that is: (1) in the state land use ag. district, and (2) would probably be classified as “important agricultural land” on the basis of soil, water, or other physical factors, is currently zoned either A-40a (most of Hamakua and Waimea), A-20a (most of the rest of the island) or A-5a (Kona coffee belt and some Hamakua homestead areas.) Most of these areas are currently in much larger lots, and have not been subdivided to the extent allowed by zoning. With the end of sugar cane and the strong real estate market, there is much more economic incentive to break up these large parcels. At the present time, with the range of crops that are now grown, it is difficult to say that the A-20a or A-40a zoning is inappropriate, because many orchard and field crops can be grown economically on such lot sizes. The A-5a may be marginal in size for many crops, but many Kona coffee farms have been on 5 acre lots. The case for a PDR/TDR program to prevent subdivision to the lot sizes allowed by existing zoning would be more compelling if Hawaii county had a major crop like sugar cane that required much larger tracts to be grown competitively. There may be other good reasons to use PDR/TDR to try to keep land in larger tracts, such as preservation of open space.

Most of the value of agricultural lots in the current real estate market is due to the potential for building a home on the lot. A TDR/PDR program could be used to transfer

the homesite rights to other property, thus creating cheaper land to buy strictly for farming, while not depriving the landowner of value. One difficulty is that many farmers want to live close to their farms.

PDR/TDR of “Potential” Development Rights

In Hawaii County, if IAL is not in an area mapped for future urban development in the General Plan, the Planning Department would oppose its rezoning for urban use, and the county would rely on the regulatory system, rather than feel compelled to use a PDR/TDR program to control development. Hawaii County actually has rezoned very little property that: (1) is outside these future urban areas in the General Plan, and (2) would probably be considered IAL. If the land is mapped for future urban use in the GP, but would be considered IAL based on soil type and other physical factors, it would seem that this is a policy choice that the property should eventually be urbanized and it would be anomalous to have a program to keep these areas in agriculture through PDR/TDR.

“Sending Districts” vs. “Receiving Districts”

Generally, a TDR program involves a “sending district”, where you reduce development, and a “receiving district”, where you transfer development to. The difficulty usually comes with identifying the “receiving district.” In Hawaii today, almost all development is accompanied by some degree of controversy, and it can be hard to find an area where people agree that additional density can be added automatically through an administrative process. Also, you have to ensure that density can be added to the receiving district only by purchasing a development right. If the landowner in the receiving district can get the same result through rezoning or other land use approval, the landowner has little incentive to buy the right from the sending district.

Workable Scenario

There may be a way to a workable TDR scenario that is similar to the Hawaii County Ag PUD. Essentially, the private landowner wants to have the market value of the property; the government and farmers would like inexpensive ag. land that is actually used for ag. Much of the market value for ag. land, especially on the Neighbor Islands, is for gentleman farmer estates, which are essentially large residential lots in ag. areas. Sometimes, most of this value can be captured in a relatively small area, by confining the residential or estate lots to a smaller area with better views and amenities. The TDR program can then leave the bulk of the property at a much lower per-acre value, with limitations on residential use. This has to be done carefully on a site-specific basis.

City and County of Honolulu

The City and County is concerned about the presumption made in a TDR program that there are development rights in ag. lands beyond ag. value. Under Honolulu zoning, any land zoned agriculture, even if in state urban, can only have farm dwellings; no single-family dwellings, so even the prospect of "gentlemen's estates" is speculative.

Department of Planning and Permitting indicated a willingness to look at setting up another zoning class for IAL designated areas (i.e. agricultural production areas). This maybe as simple as moving all the Ag-1 uses and activities into this new class and tweaking it to address the concerns regarding agricultural productivity. Agriculture workforce housing would also be in this class. Existing ordinances allow for dormitory type structures or cluster developments for single family detached developments. The idea would be to list various county incentives under this new IAL Agricultural Class. This list would include but not be limited to:

1. Real property tax relief;
2. Better defined standards for workforce housing;
3. Better defined/new standards for large lot subdivisions improvement requirements;
4. New standards for infrastructure that does not compromise public health and safety;
5. Better defined standards for agricultural processing facilities;
6. Other

County of Maui

The County is having one of their sub-consultants take a look at TDR programs around the country and look for ones that are successful. Their concern is that while the program may appear to work, there are a lot of things that need to happen in order for the program to be successful.

The County of Maui is presently going through a process to update their general plan. Chris Hart Planning will be tasked with the responsibility to research the TDR program and report back as a part of the General Plan update. The timeframe is 3 to 4 months.

The County of Maui shares the City & County of Honolulu's concern that some people presume development rights on agricultural lands beyond actual ag. value. Maui County currently requires Planning Dept. approval of an ag. assessment for each ag. subdivision and Planning Dept. approval of a Farm Plan prior to issuing building permits for each farm dwelling or accessory farm dwelling.

Maui's position is that they are concerned about the non-important agricultural lands (i.e. those lands that are zoned agriculture but not identified as important agricultural lands). They do not believe that the bulk of these lands should be placed in rural as is being discussed as a part of another legislative effort administered by Office of Planning.

County of Kauai

Kauai expressed similar to concerns to those of the other counties. They did not think PDR and TDR programs would work because of the problems in identifying the receiving areas. No community wants more density right now.

APPENDIX B

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Organization

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