



STATE OF OKLAHOMA
INCENTIVE EVALUATION COMMISSION

TAX INCENTIVE EVALUATION REPORT
2018



STATE OF OKLAHOMA INCENTIVE EVALUATION COMMISSION

VOTING MEMBERS

LYLE ROGGOW
CHAIRMAN

CARLOS JOHNSON, CPA
VICE-CHAIRMAN

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COMMISSIONER

DR. CYNTHIA ROGERS
COMMISSIONER

JIM DENTON
COMMISSIONER

STEVE BURRAGE
EX-OFFICIO COMMISSIONER

DENISE NORTHRUP
EX-OFFICIO COMMISSIONER

DEBY SNODGRASS
EX-OFFICIO COMMISSIONER

The Honorable Governor Fallin, President Pro Tempore Treat and Speaker McCall:

We would like to thank each of you for the opportunity to serve as members on the Incentive Evaluation Commission (IEC). As five voting members with diverse backgrounds and qualifications, we have taken our duties and responsibilities very seriously as Commissioners.

In our third year, IEC reviewed 11 incentives during this evaluation process. We have continued our contractual relationship with Public Financial Management Inc. (PFM), who won the bid in 2016. They are a nationally recognized firm specializing in public sector finances. IEC members received draft evaluation reports on facts and findings on Oct. 1, 2018, with a formal presentation to the Commission Meeting on Oct. 4, 2018. As required in statute, a public hearing meeting took place on Nov. 1, 2018, to receive public comments regarding the consultant's recommendations.

The commission took into consideration all public comments received at the November meeting before deciding the final vote to retain, repeal or modify incentives under review. It is in hope that our votes, based on public the comments and PFM's facts and findings, help in assisting each of you and the Legislature in making imperative decisions. This year, PFM made alternative recommendations for improvement on all incentives if IEC chose to not follow the final PFM report.

Pursuant to the Incentive Evaluation Act of 2015, 32 O.S. § 7001-7005, the commission is providing the honorable governor, president pro tempore and speaker with the 2018, year three report. The report will also be made publicly available on the Oklahoma Department of Commerce website and at documents.ok.gov.

Enclosed in the packet is a commission action summation chart immediately following the letter and the compiled reports of PFM.

We hope the information provided you is helpful during the upcoming 2nd Session of the 57th Legislature.

Respectfully,

The Oklahoma Incentive Evaluation Commission

INCENTIVE EVALUATION COMMISSION ACTIONS

INCENTIVE	EVALUATION RECOMMENDATION	COMMISSION ACTION
Investment/New Jobs Tax Credit	Reconfigure: 1) Awarding credits only in the year the investment is made or when new jobs are created. 2) Limit the credit carry forward period to five years. 3) Reduce the credit amount to equal 4 percent of capital investment or \$2,000 per new job. 4) Implement strict reporting requirements and claw back provisions. 5) Restrict credit eligibility to specific industries. 6) Restrict the credit to only capital expenditure for new or expanding facilities, rather than capital replacement. 7) Increase the wage requirement for new jobs. 8) Maintain a cap on annual expenditures for tax credits awarded prior to implementation of credit changes. 9) Improve data collection.	1. 5-0 to approve the recommendation as written. 2. 5-0 to modify the recommendation from five to seven years. 3. 5-0 to approve the recommendation as written. 4. 5-0 to approve the recommendation as written. 5. 5-0 to approve the recommendation as written. 6. 5-0 to approve the recommendation as written. 7. 5-0 to modify the recommendation to match the Quality Jobs Program. 8. 5-0 to approve the recommendation as written. 9. 5-0 to approve the recommendation as written. The commission voted 5-0 to approve the PFM report with the modifications on items 2 and 7.
Quick Action Closing Fund	Retain.	5-0 to approve to retain the program with the modification that the wage threshold be equal to that of the Quality Jobs program.
New Products Development Income Tax Exemption (Incentives for Inventors)	Repeal.	4-1 to approve the recommendation to repeal the program as presented by PFM. (Mr. Johnson against.)
Technology Business Finance Program	Retain, with Changes: 1) Require program participants to respond to annual surveys. 2) Modify the annual survey to collect data determining the Oklahoma presence of program participants.	1. 5-0 to approve the recommendation as written. 2. 5-0 to modify the recommendation as written.
Quality Jobs Investment Program	Repeal.	5-0 to approve the recommendation to repeal the program.

INCENTIVE	EVALUATION RECOMMENDATION	COMMISSION ACTION
Technology Transfer Income Tax Exemption	Reconfigure: Based on the lack of comparable programs, and lack of data available to estimate its cost and benefit, the project team recommends requiring additional data to be collected and evaluated prior to determining whether to retain or repeal the program.	5-0 to approve the report as written as it relates to recommendations made by PFM as detailed in the report.
Affordable Housing Tax Credit	Retain, with modifications: 1) Shorten the 10-year credit period for future allocations. 2) Consider removing the statutory provision that precludes housing projects in Oklahoma's most populous counties from receiving funding. 3) Consider making the tax credits refundable instead of transferable.	<p>1. 5-0 to modify the 10-year credit period to a 5-year credit period for future allocations.</p> <p>2. 5-0 to approve the recommendation made by PFM.</p> <p>3. 5-0 to disapprove the recommendation made by PFM that the tax credits related to housing be nontransferable.</p>
Applied Research Support Program	Retain, with modifications: OCAST should collect more detailed information from current and former grant recipients to allow for consistent analysis. It is critical to track business activity and funding sources prior to obtaining the state financial support, and after the state monies have been spent to measure the long-term effect of the program. If a successful product or company is developed, the location where the product is sold, supported, and manufactured should be identified.	<p>4-1 to approve the report of PFM with modifications identified on page six of the report.</p> <p>(Dr. Rogers against.)</p>
Energy Efficient Residential Construction Tax Credit	Repeal.	5-0 to approve the report as presented to repeal the program.
Health Research Program	Retain, with modifications: OCAST should collect more detailed information from current and former grant recipients to allow for consistent analysis. It is critical to track business activity and funding sources prior to obtaining the state financial support, and after the state monies have been spent to measure the long-term effect of the program. If a successful product or company is developed, the location where the product is sold, supported, and manufactured should be identified.	5-0 to approve the recommendation of PFM with modification as stated on page six of the PFM report.
Small Business Incubators (Tenants and Sponsors)	Retain and Repeal: Retain the income tax exemption for <u>tenants</u> and repeal the exemption for <u>sponsors</u> .	<p>1. 4-0 to approve to retain tax exemption for tenants.</p> <p>2. 4-0 to approve to repeal tax exemption for sponsors.</p> <p>(Mr. Johnson was absent during the voting of the two items.)</p>

**INCENTIVE EVALUATION COMMISSION
REGULAR MEETING MINUTES**

Nov. 1, 2018

Oklahoma State Capitol

Rm. 419-C, 10:00 a.m.

Oklahoma City, Oklahoma

A meeting notice was filed with the Secretary of State and an agenda posted in accordance with the Open Meeting Act.

MEMBERS PRESENT: Ron Brown, Layperson
Jim Denton, CPA, Auditor of Private Firm
Carlos Johnson, Certified Public Accountant
Lyle Roggow, President of the OK Professional Economic
Development Council
Commissioner Burrage, Ex Officio; Non-voting (Tax Commission)
Secretary Snodgrass, Ex Officio; Non-voting (Dept. of Commerce)

MEMBERS ABSENT: Dr. Cynthia Rogers, Economist
Denise Northrup, Ex Officio; Non-voting (OMES)

STAFF/GUESTS: Beverly Hicks, OMES
Mary Ann Roberts, OTC
Randall Bauer, PFM
Shelley Zumwalt, OMES
David Oakley, LegisOK
Jim Dunlap, Lobbyist
Audrey Benron, FKG
Greg Shinn, Board President of OCAH
Lance Windell, Developer, Ardmore, OK
Jon Chiappe, ODOC
Jamie Herrera, ODOC
Mark Thomas, OK Press Association
Mike Jackson, State Chamber
Seth Rott, MMR
James Milner, MMR
Colby Schwartz, JES
Shawn Ashley, E Capitol

1. Call to order and establish a quorum. [Lyle Roggow, chairman]

Chairman Roggow called the meeting to order at 10:09 a.m. A roll call was taken and a quorum was established. Chairman Roggow was advised that notice of the meeting was given and an agenda posted in accordance with the Open Meeting Act.

2. Approval of minutes from the Oct. 4th meeting. [Lyle Roggow]

Mr. Denton moved to approve the meeting minutes of October 4, 2018. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, abstain; Mr. Roggow, aye.

3. Discussion and public comment on the 2018 Eleven Incentives: [Lyle Roggow]

1. Discussion and public comment on Investment/New Jobs Tax Credit. [Lyle Roggow]

Written Comment:

A written document was submitted to the Commission from Jon Chiappe, Director of Research and Economic Analysis Services.

Commissioner Denton read his report and asked that PFM review the report and calculations submitted by Mr. Chiappe, as it relates to ad valorem taxes. Mr. Bauer made known he had not seen the report before the meeting today and would review and make the necessary revisions in their calculations for the final version.

No speaker present. No action taken.

2. Discussion and public comment on Quick Action Closing Fund.

No speaker present. No action taken.

3. Discussion and public comment on New Products Development Income Tax Exemption, (Incentives for Inventors).

No speaker present. No action taken.

4. Discussion and public comment on Technology Business Finance Program.

No speaker present. No action taken.

5. Discussion and public comment on Quality Jobs Investment Program.

No speaker present. No action taken.

6. Discussion and public comment on Technology Transfer Income Tax Exemption.

No speaker present. No action taken.

7. Discussion and public comment on Affordable Housing Tax Credit.

Speakers:

1. Greg Shinn: Mr. Shinn provided the Commission the following documents:

- A letter that requests the Commission to recommend the continuation of the Oklahoma Affordable Housing Act.
- Oklahoma Affordable Housing Act Tax Credit Economic Impact, prepared by the Oklahoma Department of Commerce; Research and Economic and Analysis Division.
- Oklahoma Statewide Housing Needs Assessment Executive Summary, commissioned by the Oklahoma Department of Commerce.
- National Low Income Housing Coalition-Out of Reach Oklahoma 2018 Report.

Mr. Shinn stated that it is a priority that Oklahoma maintains its commitment to investment in the production of affordable housing. According to the 2015 Statewide Housing Needs Assessment, Oklahoma needs an additional 11,630 units of affordable housing by 2020 for households earning less than 60% Area Median Income. The State credit between 2015 and

2018 produced 2,007 units towards that gap of over 11,000 units. Any reduction in the State investment affordable housing will further widen the gap to the market demands for housing among low and moderate-income households. The economic impact report produced by the consulting firm out of Philadelphia, which is being considered the Commission, points out that many important factors are beyond the scope of the report in what they are addressing in the report to evaluate the state credit thoroughly. Among those critical factors includes, lowering the number of cost burden households who are attaining more than 30% of their income for rent every month; always one paycheck away from eviction.

Mr. Shinn pointed out that Eviction Land.org at Princeton University showed that Oklahoma has some of the highest eviction rates in the nation. Tulsa is ranked number 11 and Oklahoma City is ranked number 20. Increasing the number of affordable units that are available across the State is critical family and neighborhood stabilization. When families have access to housing that they can afford, they can consider purchasing healthcare, planning for college for their children or for planning for retirement. When you pay more than 50% of your income for rent, you worry about buying groceries, or whether you can pay the utility bills. The current rates of poverty in Oklahoma show that over 621,000 Oklahomans were below the poverty level in 2017, which is 15.8% of the State's population. The minimum wage in Oklahoma is \$7.25 hour, but you have to make \$15.41 an hour in order to afford a two-bedroom apartment.

The Coalition recently commissioned the Oklahoma Department of Commerce to do its own economic impact study and evaluate the State credit. Between 2015 and 2018, the State allocated \$15 million, 332 thousand dollars in credits, which provided funding for 36 developments in 27 communities, including 3,900 jobs during peak construction over \$200 million dollars in payroll, \$42 million dollars in economic activity, including indirect effects. The overall economic contribution from developing and leasing companies is over \$575 million dollars.

The solution is more affordable housing and that solution is an economic driver in the State. We need more investment in affordable housing and not less. The Coalition request that the Commission recommend full funding and the continuation of the Oklahoma Affordable Housing Act.

2. Lance Windell:

Mr. Windell, a homebuilder in Ardmore, Oklahoma stated when he builds in rural Oklahoma, he speaks with the economic development person in that town and the first thing they tell him is they cannot bring jobs to their town because of lack of housing. Mr. Windell said, the actual dollars spent might not bring dollars back to Oklahoma, but they bring housing so that the economic developers in that town can do their job. If you do not have the housing, you cannot bring in the jobs. The credit allows for builders like him to go into various rural towns to build the workforce housing that is needed to bring jobs, because without the housing you cannot bring the employers; they will not come. The perspective of this being an economic development tool, it is, but it is not the only economic development tool. It is laying the foundation for the other economic development that is going to go on in the town and he believes that if there is not a push in rural Oklahoma to make it happen, there will not be jobs brought to the rural areas of the State.

Written Comment:

Two written documents were submitted to the Commission from Scott Nixon, Manager of Sugar Creek Capital and Corey Bornemann, Housing Development Allocation Specialist, on a study commissioned by the Oklahoma Coalition for Affordable Housing, prepared by the Oklahoma Department of Commerce.

No action taken.

3. Discussion and public comment on Applied Research Support Program.

No speaker present. No action taken.

4. Discussion and public comment on Energy Efficient Residential Construction Tax Credit.

Speaker:

Lance Windell:

Mr. Windell recognized that the tax credit had been dead for over a year, but shared a story with the Commission on how the credit helped his business grow. In 2007, a person from OG&E said he could get him \$4,000 dollars a house if he started building houses better than what he was building then. At that time, he was building at a bare minimum of insulated energy efficiency homes, but when configuring the proposal from OG&E, he learned it was going to cost him \$3,000 dollars a house to get a \$4,000 dollar credit, which put him making \$600 dollars per house. He stepped up to the challenge of the incentive and was proud of the houses he was starting to build and continued the practice.

When the credit became no longer available two years ago, he refigured the cost without the tax credit and learned even though it cost him around \$1000 dollars, it was not costing him that much more. He made the decision to continue the practice, as he could stand by every house he built no matter the area, building OG&E tested energy efficient homes.

Today, he builds 300 plus units a year and now builds almost twice as energy efficient than what he was building back in 2006, because of the tax credit. Though the tax credit expired, he will continue the practice. He sees it as a success story for his company, because the tax credit did what it was supposed to do.

He would like to have the credit brought back, but make it harder than what it was, which will incentivize him to be an even builder today than what he already is.

No action taken.

5. Discussion and public comment on Health Research Program.

No speaker present. No action taken.

6. Discussion and public comment on Small Business Incubators (Tenants & Sponsors).

No speaker present. No action taken.

4. New Business [Lyle Roggow] None.

5. Adjourn. [Lyle Roggow]

There being no further business, Mr. Brown made the motion to adjourn. Mr. Denton seconded the motion. Seeing no opposition, the meeting adjourned at 10:35 a.m.

**INCENTIVE EVALUATION COMMISSION
REGULAR MEETING MINUTES**

Nov. 15, 2018

Oklahoma State Capitol

Rm. 419-C, 10:00 a.m.

Oklahoma City, Oklahoma

A meeting notice was filed with the Secretary of State and an agenda posted in accordance with the Open Meeting Act.

MEMBERS PRESENT: Ron Brown, Layperson
Jim Denton, CPA, Auditor of Private Firm
Carlos Johnson, Certified Public Accountant
Dr. Cynthia Rogers, Economist
Lyle Roggow, President of the OK Professional Economic
Development Council
Commissioner Burrage, Ex Officio; Non-voting (Tax Commission)

MEMBERS ABSENT: Secretary Snodgrass, Ex Officio; Non-voting (Dept. of Commerce)
Denise Northrup, Ex Officio; Non-voting (OMES)

STAFF/GUESTS:	Beverly Hicks, OMES	Mary Ann Roberts, OTC
	Randall Bauer, PFM	Shelley Zumwalt, OMES
	Susan Stout, OMES	David Oakley, Legis OK
	Michael Daves, ODFA	Leslie Blair, ODOC
	John Gilbert, OMES	Yuan Tian, OMES
	Jim Dunlap, Lobbyist	Seth Rott, MMR
	Andrea Frymire, Midwest Housing	Shawn Ashley, eCapitol
	Nicole Boyles, OEDC/State Chamber	

1. Call to order and establish a quorum. [Lyle Roggow, chairman]

Chairman Roggow called the meeting to order at 10:01 a.m. A roll call was taken and a quorum was established. Chairman Roggow was advised that notice of the meeting was given and an agenda posted in accordance with the Open Meeting Act.

2. Approval of minutes from the Nov. 1 meeting. [Lyle Roggow]

Mr. Denton moved to approve the November 1st meeting minutes. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, abstain; Mr. Roggow, aye.

3. Discussion and possible action on the 2018 Eleven Incentives. Possible action may include to approve, disapprove, modify or take no action. [Lyle Roggow]

1. Discussion and possible action on Investment /New Jobs Tax Credit.

Below are the nine changes PFM recommended to improve the program that the Commission voted on.

a) Award credits only in the year the investment is made or when new jobs are created:

Mr. Johnson moved to approve the recommendation as written. Dr. Rogers seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

b) Limit the credit carryforward period to five years:

Mr. Johnson moved to modify the recommendation from five years to seven years. Mr. Denton seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

c) Reduce the credit amount to equal four percent of capital investment or \$2,000 per new job:

Mr. Denton moved to approve the recommendation as written. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

d) Implement strict reporting requirements and claw-back provisions:

Dr. Rogers moved to approve the recommendation as written. Mr. Denton seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

e) Restrict credit eligibility to specific industries:

Mr. Denton moved to approve the recommendation as written. Dr. Rogers seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

f) Restrict the credit to only capital expenditures for new or expanding facilities, rather than capital replacement:

Mr. Denton moved to approve the recommendation as written. Dr. Rogers seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

g) Increase the wage requirement for new jobs:

Mr. Johnson moved to modify the recommendation to match the Quality Jobs Program. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

h) Maintain a cap of annual expenditures for tax credits awarded prior to implementation of credit changes:

Mr. Denton moved to approve the recommendation as written. Dr. Rogers seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

i) Improve Data Collection:

Dr. Rogers moved to approve the recommendation as written. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

Mr. Johnson moved to approve the PFM report with modifications made by the Commission. Mr. Denton seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

2. Discussion and possible action on Quick Action Closing Fund.

Mr. Johnson moved to approve to retain the program with the modification that the wage threshold be equal to that of the Quality Jobs Program. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

3. Discussion and possible action on New Products Development Income Tax Exemption (Incentives for Inventors).

Dr. Rogers moved to approve the recommendation to repeal the program as presented by PFM. Mr. Denton seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, no; Dr. Rogers, aye; Mr. Roggow, aye.

4. Discussion and possible action on Technology Business Finance Program.

The Commission voted on two recommended program changes made by PFM.

a) Require program participants to respond to annual surveys:

Dr. Rogers moved to approve the recommendation as written. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

b) Modify the annual survey to collect data determining the Oklahoma presence of program participants:

Mr. Denton moved to approve to modify the annual survey as stated in the recommendations made by PFM. Dr. Rogers seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

5. Discussion and possible action on Quality Jobs Investment Program.

Mr. Denton moved to accept PFM's report to approve the recommendation to repeal the program. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

6. Discussion and possible action on Technology Transfer Income Tax Exemption.

Mr. Denton moved to approve the report as written as it relates to recommendations made by PFM as detailed in the report. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

7. Discussion and possible action on Affordable Housing Tax Credit.

The Commission voted on the following three recommended program modifications made by PFM.

a) Shorten the 10 year credit period for future allocations:

Mr. Denton moved to change the 10-year credit period to a 5-year credit period for future allocations. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

b) Consider removing the statutory provision that precludes housing projects in Oklahoma's most populous counties from receiving funding:

Mr. Johnson moved to approve to the recommendation of PFM. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

c) Consider making the tax credits refundable instead of transferable:

Mr. Johnson moved to disapprove the recommendation made by PFM that the tax credits related to housing be nontransferable. Mr. Denton seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

8. Discussion and possible action on Applied Research Support Program.

Mr. Denton moved to approve the report of PFM with modifications identified on page 6 of the report. Dr. Rogers seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, nay; Mr. Roggow, aye.

9. Discussion and possible action on Energy Efficient Residential Construction Tax Credit.

Dr. Rogers moved to approve the report as presented to repeal the program. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

10. Discussion and possible action on Health Research Program.

Mr. Johnson moved to approve the recommendation of PMF with modification as stated on page 6 of the PFM report. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

11. Discussion and possible action on Small Business Incubators (Tenants & Sponsors).

The Commission voted on the following two recommendations made by PFM.

Mr. Johnson exited the meeting at 12:01 p.m.

a) Retain the Small Business Incubators Income Tax Exemption for Tenants:

Dr. Rogers moved to approve to retain as written. Mr. Brown seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Dr. Rogers, aye; Mr. Roggow, aye.

b) Repeal the Small Business Incubators Income Tax Exemption for Sponsors:

Mr. Brown moved to approve to repeal as written. Dr. Rogers seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Dr. Rogers, aye; Mr. Roggow, aye.

Mr. Johnson returned to the meeting at 12:06 p.m.

4. Discussion and possible action on the acceptance of the final report provided by PFM. [Lyle Roggow]

Mr. Denton moved to approve the final reports provided by PFM as modified by the members during their deliberations today. Such modified reports shall be the final report of the Commission and shall be posted on the website. Dr. Rogers seconded the motion. The following votes were recorded and the motion passed:

Mr. Brown, aye; Mr. Denton, aye; Mr. Johnson, aye; Dr. Rogers, aye; Mr. Roggow, aye.

IEC website; <http://iec.ok.gov>.

5. Adjourn. [Lyle Roggow]

There being no further business, Mr. Denton made the motion to adjourn. Mr. Brown seconded the motion. Seeing no opposition, the meeting adjourned at 12:12 p.m.

INCENTIVE EVALUATION COMMISSION TABLE OF CONTENTS

The following report can be navigated by using your cursor to select an incentive evaluation below. You also can go directly to commissioner comments after each evaluation. At the bottom of each comment page select the button to return to the table of contents.

[Investment/New Jobs Tax Credit](#)

[Quick Action Closing Fund](#)

[New Products Development Income Tax Exemption \(Incentive for Inventors\)](#)

[Technology Business Finance Program](#)

[Quality Jobs Investment Program](#)

[Technology Transfer Income Tax Exemption](#)

[Affordable Housing Tax Credit](#)

[Applied Research Support Program](#)

[Energy Efficient Residential Construction Tax Credit](#)

[Health Research Program](#)

[Small Business Incubators \(Tenants and Sponsors\)](#)

State of Oklahoma

Incentive Evaluation Commission

Investment/New Jobs Tax Credit Evaluation

November 9, 2018

PFM Group Consulting LLC
BNY Mellon Center
1735 Market Street
43rd Floor
Philadelphia, PA 19103



Key Findings and Recommendations



Overview

The State of Oklahoma began offering the Investment/New Jobs Tax Credit in 1980. The credit is available to manufacturers, aircraft maintenance facilities, and web search portal companies who either invest in depreciable property of at least \$50,000 or create new jobs in the State. The tax credit is equal to one percent of the cost of the depreciable property or \$500 per new employee, which may be claimed for five years. If a company makes an investment of at least \$40 million or is located in an Enterprise Zone, the credit is doubled.

Overall Recommendation: Based on its analysis of available data, the project team recommends reconfiguring the program.

Key Findings Related to Established Criteria for Evaluation

As of Tax Year 2015, there is \$557.4 million of unused carried forward credits. This represents the potential amount of credits that may be used in future tax years and creates a significant liability for the State. In response to this accumulation, a temporary cap has been applied to the program that devalues credits to restrict the annual cost to about \$25 million per year. To accomplish this, the Oklahoma Tax Commission (OTC) reduces the yearly claimed credits to a percentage of their original value, which is calculated by dividing \$25 million by the amount of credits used two years prior. For example, for 2017, \$25 million was divided by the amount used in 2015 (\$64.8 million) to arrive at 38.6 percent. This percentage is then applied to all credits used to reduce the total amount that can be used that year.

An analysis of 2016 returns claiming the credit shows 245 new claims reporting total capital investment of \$2.0 billion and 737 new jobs. The total value of these credits for 2016 is estimated to be \$38.9 million, of which \$38.2 million (98.3 percent) is for capital investment.

Capital investment associated with new 2016 credit claims accounts for about 87.8 percent of total manufacturing capital expenditures in the State that year.¹ This suggests almost all capital expenditures in the sector are receiving this incentive.

Almost half of all claims qualify for the doubled credit by locating in an Enterprise Zone or investing \$40 million or more. About 49.4 percent of all claims qualify for doubled credits, accounting for 91.4 percent of total capital investment and 80.0 percent of new jobs. Credits for investments of \$40 million or more account for 84.9 percent of all new 2016 claims.

The minimum annual salary requirement for new jobs to qualify for a tax credit is very low. The minimum requirement is an annual salary of \$7,000. A minimum wage worker (working 40 hours a week over 52 weeks) would earn \$15,080 annually. In essence, the existing salary requirement is no requirement at all and means that the State may be incenting low wage jobs. About 80 percent of new jobs (590 jobs) claimed in 2016 were located in Enterprise Zones, which qualifies them for \$1,000 in credits per job. Because of the low salary threshold, low quality jobs may be incented in the State's most economically distressed areas (at twice the value as elsewhere in the State).

The nominal tax benefit for a manufacturer receiving both the Investment Tax Credit and the Five Year Ad Valorem Exemption for manufacturers can equal more than 10 percent of the original value of a capital investment. As an example of how this works in practice, the following table shows the benefits a manufacturer would receive from both incentives for a \$1 million real property investment in Oklahoma County

¹ Total Oklahoma manufacturing capital expenditures were \$2.3 billion according to U.S. Census Bureau Annual Survey of Manufacturers, 2016



(a large urban county) and Dewey County (a more rural county), based on assessment rates and average millage rates in each county, assuming the investment is not made in an Enterprise Zone.

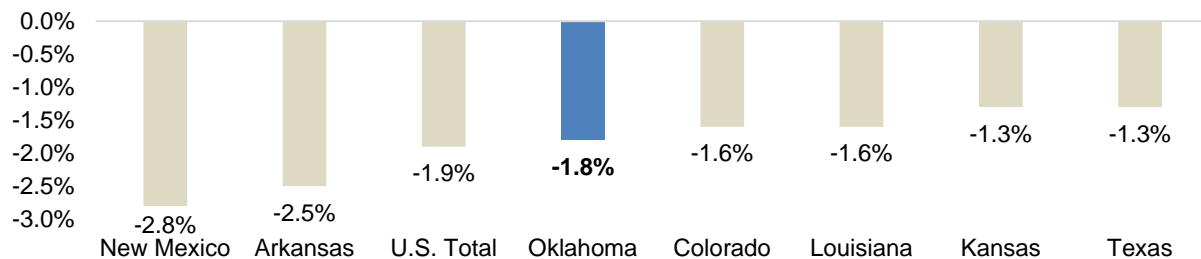
Table 1: Tax Benefit for \$1 Million Capital Investment²

	Oklahoma County			Dewey County		
	Average 2017 millage rate: 109.02 Assessment rate: 11.00%			Average 2017 millage rate: 71.60 Assessment rate: 11.00%		
	Ad Valorem Exemption Benefit	Investment Tax Credit Benefit	Total	Ad Valorem Exemption Benefit	Investment Tax Credit Benefit	Total
Year 1	\$11,851	\$10,000	\$21,851	\$7,783	\$10,000	\$17,783
Year 2	\$11,544	\$10,000	\$21,544	\$7,581	\$10,000	\$17,581
Year 3	\$11,237	\$10,000	\$21,237	\$7,380	\$10,000	\$17,380
Year 4	\$10,928	\$10,000	\$20,928	\$7,177	\$10,000	\$17,177
Year 5	\$10,621	\$10,000	\$20,621	\$6,976	\$10,000	\$16,976
Total	\$56,181	\$50,000	\$106,181	\$36,897	\$50,000	\$86,897

Data collected by the Oklahoma Tax Commission (OTC) is insufficient for economic impact analysis. The number of jobs and the amount of capital investment associated with the credits is not regularly processed for aggregate analysis by the OTC. The data collected by the OTC is also lacking important details (such as payroll for newly created jobs, industry codes, and the nature of capital investments made), which are necessary for accurately estimating economic impact.

Oklahoma's employment growth in manufacturing ranks fifth of seven nearby states, while on average annual pay in the sector, Oklahoma ranks third. The results show Oklahoma's manufacturing sector is generally following regional and national employment and wage trends.

Figure 1: 15-Year Manufacturing Employment CAGR (2001 - 2016)

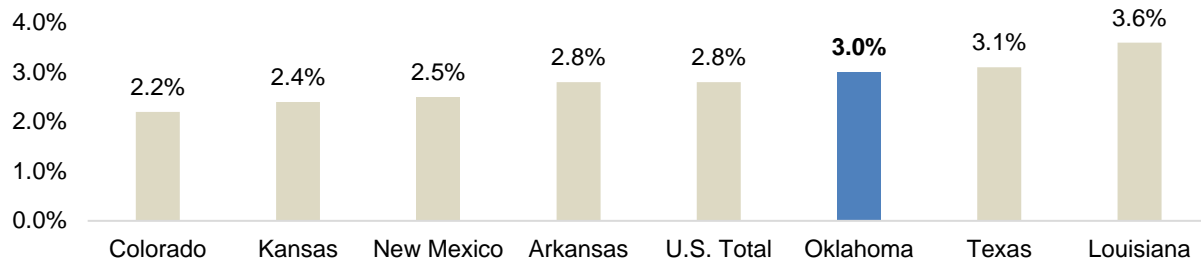


Source: U.S. Bureau of Labor Statistics

² A depreciation schedule for buildings, provided by the Department of Commerce, has been applied in the calculation of the ad valorem tax exemption benefit.



Figure 2: 15-Year Manufacturing Average Annual Pay CAGR (2001 - 2016)



Source: U.S. Bureau of Labor Statistics

Recommended Changes to improve the program

Control costs through changes in incentive design. The program to date has incurred a \$557.4 million potential liability for the State, and that liability is expected to continue to grow. There are several features of this incentive's design that have contributed to this significant future financial commitment, most notably the indefinite carryforward period for capital investment credits. The following recommendations address opportunities for incentive design changes intended to slow this trend in the future.

Recommendation 1: Award credits only in the year the investment is made or when new jobs are created. Credits are most valuable for companies in the year the investment is made. The goal of the program is to influence a company's decision to make a capital investment or create new jobs in the State. Tax credits would be most effective in meeting this goal if they are awarded as close as possible to when that decision is made.

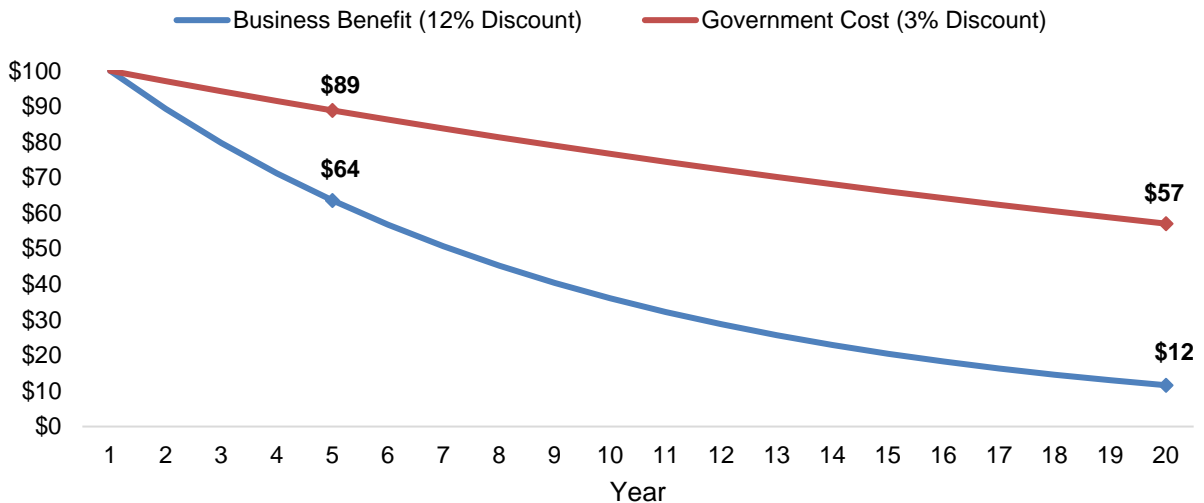
Due to the differences in how businesses and governments value money, when the State makes a commitment to award credits in equal amounts over the next five years, the State's payment in year five is worth 89 percent of its value in year one (the year the investment is made). Businesses generally apply a higher discount rate to future payments. Academic research estimates the average discount rate used by businesses is about 12 percent, while governments use a discount rate of about 3 percent.³

The following example illustrates the differences in the value of \$100 to businesses and governments at different points in the future. From a business perspective, \$100 five years from now has a present value of \$64. The State values the same \$100 five years from now at \$89, meaning the cost to the State of providing the tax credit is higher than the benefit the business is receiving. This difference becomes greater the further into the future a payment is received. By awarding credits only in the year the investment or new job is made, the State would be receiving better value for its foregone tax revenue.

³ Timothy J. Bartik, W.E. Upjohn Institute for Employment Research – A new Panel Database on Business Incentives for Economic Development (February 2017). Accessed electronically at <https://upjohn.org/models/bied/maps/ReportFinal.pdf>



Figure 3: Present Value of \$100 Tax Credit over Time



Recommendation 2: Limit the credit carryforward period to five years. Most benchmark states have a limit, ranging from 3 to 14 years, while Oklahoma's credit for capital investment may be carried forward indefinitely. Reducing the carryforward period would control the long term costs of the program for the State while improving its effectiveness. Under current rules, a company can claim a capital investment credit and use it indefinitely (which may be far into the future). As shown in the previous present value analysis, the value of the credit to businesses declines significantly in the years following the decision to make a capital investment. As time passes, it becomes less likely that the tax credit had an impact on the business decision it was intended to encourage.

According to Oklahoma Tax Commission data, each year from Tax Year 2008 through 2015, no more than 35.6 percent of the credits claimed in a year were used. This has generated the program's significant unused carryforward credit liability. By reducing the carryforward period, credits generated in any year moving forward would be cleared within five years rather than remaining an indefinite State liability.

Recommendation 3: Reduce the credit amount to equal four percent of capital investment or \$2,000 per new job. After the program is adjusted to award the full credit amount in the year the investment is made, the original credit amount of 5 percent of capital investment, or \$2,500 per job over 5 years, can be reduced while offering the same benefit to companies. Using a 12 percent discount rate, the present value of a 1 percent tax credit each year for 5 years is equal to about 4 percent. The present value of the new jobs credit equal to \$500 each year for 5 years is about \$2,000. This change can reduce the State's costs by 14 percent in present value terms. The following table shows the nominal savings of this adjustment, using new credit claims for 2016 as an example.

Table 2: Credit Reduction Savings

	Total Credits for 2016 Claims (Over 5 Years)	Total Credits for 2016 Claims (1 Year, Reduced Credit Amount)	Savings
Capital Credits	\$191.1 million	\$152.8 million	\$38.2 million
New Jobs Credits	\$3.3 million	\$2.7 million	\$0.7 million
Total Credits	\$194.4 million	\$155.5 million	\$38.9 million



Recommendation 4: Implement strict reporting requirements and claw-back provisions. One important feature of the current five-year credit period is its requirement that the jobs and investments associated with the tax credits be maintained in the State. In order to maintain this protection, claw-back provisions should be implemented, rescinding the tax credits if jobs or investments are not maintained over a five year period.

Recommendation 5: Restrict credit eligibility to specific industries. Adding more specific industry restrictions can help reduce costs by shrinking the eligible pool of claimants while better targeting the credit toward the State's economic development goals. Since the credit's creation in 1980, eligible industries have been expanded to include aircraft maintenance facilities and internet-related industries, but the program's original target of manufacturing firms generally has not been refined. By targeting the incentive to high wage and high multiplier industries within the manufacturing sector, the State can increase the likelihood that this incentive is a net economic benefit (and may reduce the cost of the program).

Recommendation 6: Restrict the credit to only capital expenditures for new or expanding facilities, rather than capital replacement. Expenditures to replace or update existing equipment provide little value in terms of economic activity and is not likely to influence firm location decisions. Instead, the program should focus on incenting expenditures on new or expanding facilities that increase economic activity and increase the likelihood that the program is a net economic benefit for the State.

Recommendation 7: Increase the wage requirement for new jobs. Statute currently requires new jobs qualifying for tax credits to pay at least \$7,000 per year. This extremely low threshold (a full time minimum wage job would result in a salary over twice the current wage requirement) results from a lack of updates to this part of the program's statutory requirements. While most of the use of the program is for capital investment, the State should update this requirement in order to ensure that any credits for job creation are incentivizing the creation of higher wage jobs. For example, the new threshold could match the Quality Jobs Program, which mandates that the average wage of jobs created by its beneficiaries is greater than or equal to the county average. This may reduce the pool of eligible claimants and also help control the cost of the program. Increasing this wage requirement should also increase the benefit to the State of any incented job creation through the multiplier effects of higher income workers.

Recommendation 8: Maintain a cap on annual expenditures for tax credits awarded prior to implementation of credit changes. The temporary cap currently in place is designed to keep annual expenditures close to \$25 million. This is a key cost control measure for the State as \$557 million in unused carryforward credits have accumulated as a potential liability.

Recommendation 9: Improve Data Collection. Data currently collected by the Oklahoma Tax Commission is insufficient for an accurate economic impact analysis. In order to make an accurate economic impact analysis possible in the future, the following data needs to be collected:

- Baseline employment and payroll data in the year the credit is claimed
- Updated employment and total payroll for each of the 5 years claiming the credit
- The nature of capital investments made – expanding new facilities, new projects, retooling existing facilities, etc.
- North American Industry Classification System (NAICS) code of companies claiming credits



Introduction



Incentive Evaluation Commission Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The Investment/New Jobs Tax Credit is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgement, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Incentive Background

Oklahoma's Investment/New Jobs Tax Credit (Credit) is an incentive offered to manufacturers, aircraft maintenance facilities, and web search portal companies who either invest in depreciable property or create new jobs in the State.⁴ Manufacturers may qualify for a tax credit equal to one percent of the cost of the depreciable property purchased, or \$500 per new employee. According to the Oklahoma Tax Commission, the credit is most often used for investment in depreciable property, rather than the creation of new jobs.

Manufacturing in Oklahoma

The Credit is part of an effort by the State to incentivize business activity in the manufacturing sector. Two of the State's other major incentives for manufacturers, the Five-Year Ad Valorem Tax Exemption and the Quality Jobs Program, have already been reviewed by the Incentive Evaluation Commission. While the Five-Year Ad Valorem Tax Exemption reduces overhead costs and the Quality Jobs Program reduces the cost of labor, this Credit primarily targets the cost of capital investment. It is likely that there is some overlap between the programs, particularly as it relates to the Investment Tax Credit and the Ad Valorem Tax Exemption.

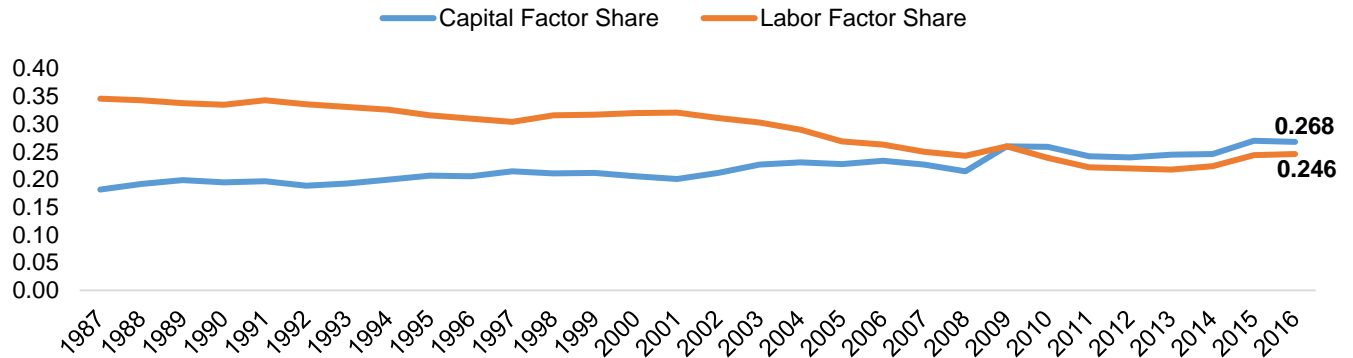
Since 1987, capital has grown as a factor of productivity in United States manufacturing, while labor's share has declined. Technological advancements leading to the reduction in the costs of capital, and the offshoring of labor in manufacturing have been suggested as explanations for this shift.⁵

⁴ A "web search portal" means an establishment classified under NAICS code 519130 which operates websites that use a search engine to generate and maintain extensive databases of Internet addresses and content in an easily searchable format

⁵ National Bureau of Economic Research – Trends in Factor Shares; Facts and Implications (2017). Accessed electronically at <http://www.nber.org/reporter/2017number4/karabarounis.html>
Brookings Institution - The Decline of the U.S. Labor Share (Fall 2013). Accessed electronically at https://www.brookings.edu/wp-content/uploads/2016/07/2013b_elsby_labor_share.pdf



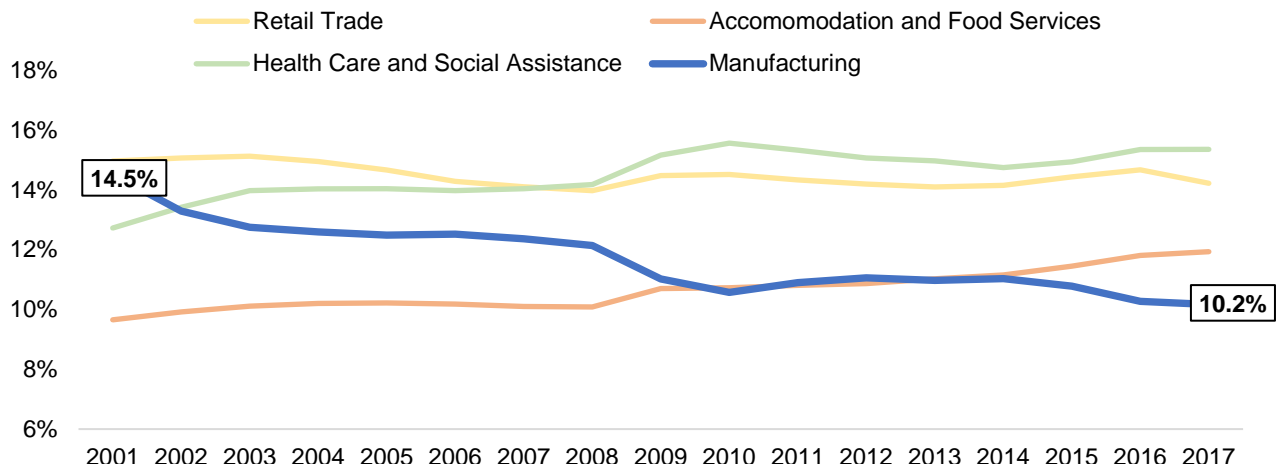
Figure 4: Capital and Labor Factor Shares in U.S. Manufacturing, 1987 to 2016



Source: U.S. Bureau of Labor Statistics

Employment has declined as manufacturing has become more capital-intensive, Oklahoma manufacturing employment has declined by 24.6 percent between 2001 and 2017. In 2001, manufacturing was the State's second-largest employment sector, with 14.5 percent of all private employment in the State. In 2017, its share was 10.2 percent, ranking as its fourth-highest employment sector, behind retail trade and the growing sectors of health care and social assistance, and accommodation and food services.

Figure 5: Share of Total Oklahoma Private Employment, 2001 to 2017

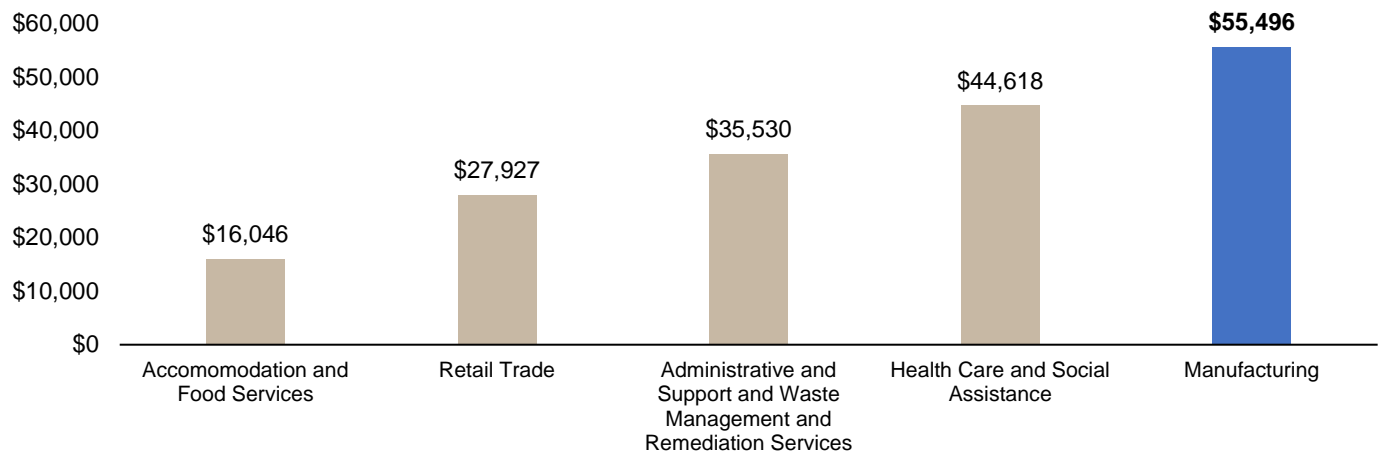


Source: U.S. Bureau of Labor Statistics

The manufacturing sector provides relatively high-paying jobs, with average annual pay 22.8 percent higher than the statewide average. Of the State's five largest employment sectors, manufacturing, the highest paying sector, has average annual pay that is more than 24 percent higher than health care and social assistance, the State's next highest pay sector.



Figure 6: Average Annual Pay in Oklahoma's Five Highest-Employment Sectors, 2017



Source: U.S. Bureau of Labor Statistics

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this program, while its goals are not clearly stated in statute, they appear to be to stimulate the formation of capital and create jobs in its targeted industries.

To assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

- Change in employment and payroll from qualified facilities
- Change in employment and payroll from qualified industries before/after program
- Change in employment and payroll in qualified industries in other states
- Return on investment analysis

The criteria focus on what are generally considered key goals of incentive programs (such as the generation of economic activity). Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

State of Oklahoma

Incentive Evaluation Commission

Quick Action Closing Fund Evaluation

November 9, 2018

PFM Group Consulting LLC
BNY Mellon Center
1735 Market Street
43rd Floor
Philadelphia, PA 19103

Access to the full report can be found on the IEC Website



Key Findings and Recommendations



Overview

The Quick Action Closing Fund was established in 2011. The fund provides resources for the Governor to make expenditures to attract high-impact businesses when they are likely to be the deciding factor in a business's location decision. These expenditures typically support infrastructure or capital improvements necessary for relocation of a company, but they can be used for a variety of business needs.

Overall Recommendation: Based on its review of available data, the project team recommends reconfiguring the program.

Key Findings Related to Established Criteria for Evaluation

Through FY2018, the Fund has been used sporadically and did not have a dedicated funding stream. As a result, the existing data on the program is based on a small sample of projects.

Projects receiving payments from the Quick Action Closing Fund were expected to create over 1,445 new jobs. If this number of jobs are created, the State's cost per job would be approximately \$6,500.

The overall average salary of projected jobs associated with awards is \$68,463 but one project receiving funds projected creating jobs with an average salary of \$33,000. This is significantly lower than the average annual pay in Oklahoma of \$45,121 per year, detracting from the program's goal of creating high quality employment opportunities in the State.¹

Capital investment made by projects receiving payments is over \$712 million. Capital investments will generally support additional economic activity within the State, although this will vary by the type of capital investment, the industry and its geographic location.

Three of five companies that have received Quick Action Closing Fund payments have also been awarded Quality Jobs Program contracts. While incentive 'layering' occurs in many instances, it makes it more difficult to determine the economic impact from any single incentive program.

There are strong administrative protections contained within the program. First, awards are required to be revenue neutral (based on a model maintained by the Department of Commerce), this requires that tax revenue is equal to or surpasses funds committed to businesses under the program. Second, there are strong claw-backs in place should the business not meet identified goals for capital investment and jobs, or if the business were to sell the capital investment obtained by the state funding.

Other Findings

Contributions to the fund from Quality Jobs and 21st Century Quality Jobs payments should provide more consistent funding and allow for increased use of the program. Beginning April 30, 2018, five percent of all Quality Jobs and 21st Century Quality Jobs payments made by the Oklahoma Tax Commission for contracts entered into on or after April 30, 2018 will be contributed to the Quick Action Closing Fund. If this policy was implemented in 2012, it would have added a total of \$5.6 million to the fund between 2012 and 2016.

¹ U.S. Bureau of Labor Statistics Quarterly Census of Employment and Wages, 2017.



Changes to improve the program

Recommendation 1: Implement a wage threshold for job creation to ensure incentivized jobs are paid higher than average wages. A stated goal of the program is to provide high quality employment opportunities, but at least one project that has received program funds projected annual salaries for new jobs lower than the statewide average. An official wage threshold would prevent this happening in the future and further the State's interests as high wage employment produces greater return to the State through economic multiplier effects. Benchmarking of similar programs in other states shows four of five comparable programs require wages to be at least equal to the average county wage, while two programs require wages to exceed these averages.



Introduction



Incentives Evaluation Commission Process Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The Quick Action Closing Fund is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Quick Action Closing Fund Incentive Background

In 2011, the Oklahoma Legislature passed House Bill 1953, creating the Quick Action Closing Fund. There was concern at the time that Oklahoma was at a competitive disadvantage with neighboring states because those states had a closing fund and Oklahoma did not. The fund was created as a way to attract and retain high-impact businesses. The fund provides resources to the Governor to make expenditures to attract high-impact businesses when the expenditures are likely to be the deciding factor in a business's location decision. These expenditures typically support infrastructure or capital improvements necessary for relocation of a company, but they can be used for a variety of business needs.

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this program, the specific goal included in legislation is to **attract or retain high-impact businesses to provide high-quality employment opportunities, capital investment, and net economic benefits to the State**. The establishing legislation also notes that without such a fund, the State is at a competitive disadvantage when seeking to attract high-impact businesses.

Additionally, to assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

- History of use of the program.
- Jobs/payroll associated with the program.
- Layering of the program with other incentives
- Comparison of job and payroll growth with/without use of this incentive
- Return on investment – economic activity versus financial net cost.

The criteria focus on what are generally considered key goals of incentive programs. Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

State of Oklahoma

Incentive Evaluation Commission

New Products Development Exemption Evaluation

November 9, 2018

PFM Group Consulting LLC
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Key Findings and Recommendations



Overview

The New Products Development Income Tax Exemption was established in 1987. The incentive offers an income tax exemption to both inventors and manufacturers of new products developed in Oklahoma. An inventor can exempt royalty payments for up to seven years, as long as the new product is manufactured in the State. The manufacturer producing the product in Oklahoma is able to exclude from state taxable income 65 percent of the cost of depreciable property purchased in order to manufacture the product, up to \$500,000.

Taxpayers claiming the royalty income tax exemption must register with the Oklahoma Center for the Advancement of Science and Technology (OCAST). Following registration with OCAST, the exemption is administered by the Oklahoma Tax Commission (OTC).

The program is heavily benefiting two companies, while available data regarding program outcomes shows a negative return on investment for the State. Meanwhile, there is little evidence to suggest the program is stimulating the development of new products in the State.

Recommendation: Based on its analysis of available data, the project team recommends repealing the program.

Key Findings Related to Established Criteria for Evaluation

Program cost, in terms of individual income tax exempted, has been increasing. From Tax Year 2011 through 2015, individual income tax expenditures increased from \$58,639 to \$344,000, and have averaged \$321,448 from Tax Year 2013 through 2015.

The OTC does not calculate the total amount of income excluded by manufacturers as part of this program. While this information is collected on corporate income tax forms for audit purposes, it is not compiled by the OTC for any aggregate analysis. Therefore, the OTC does not provide estimates of the use of these exemptions for corporate income tax.

Based on available data, the State's return on investment for the inventor royalty income tax exemption is negative. From FY 2011 through FY 2015, known tax expenditures associated with the program totaled \$1.2 million, while its economic activity generated \$0.7 million – resulting in a net loss of \$0.5 million for the State.

Two companies have been responsible for over 82 percent of total product registration applications from July 1, 1998 through July 1, 2017. Charles Machine Works and ThruTubing Solutions have submitted 267 and 95 registration applications, respectively, over that time period.

Of the companies registered with OCAST for the royalty tax exemption, 3 of the 24 companies have also received the Investment/New Jobs Tax Credit. Charles Machine Works, the company with the highest number of registration applications on file with OCAST, has also claimed over \$1.2 million in Investment/New Jobs Tax Credits from Tax Year 2011 through 2015.

Relative to comparable state programs, Oklahoma's New Products Development Income Tax Exemption is broad-based. Two of the three comparable programs target incentives for inventors in certain industries or to small businesses. Oklahoma does not restrict its program by industry or company size.



Other Findings

Since the start of the program in 1987 to 2015, Oklahoma has moved from the 16th to 33rd among the states in utility patents issued per year.¹ Despite the program's goal of stimulating product development in the State, Oklahoma's share of total utility patents issued has declined from 1.4 percent in 1987 to 0.4 percent in 2015.

Recommended Changes to Improve Future Evaluation

Recommendation 1: Improve data processing in order to collect and report the total cost of corporate tax exemptions. In order to improve future evaluations of this program and any other program associated with corporate tax exemptions, the OTC should improve its data processing to allow for the aggregation of the total cost of each corporate tax exemption. Without this data, it is not possible to evaluate the full impact of the program or understand its basic cost to the State.

¹ United States Patent Office data



Introduction



Incentive Evaluation Commission Process Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The New Products Development Income Tax Exemption is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

New Products Development Income Tax Exemption Incentive Background

The New Products Development Income Tax Exemption was established in 1987. The incentive offers an income tax exemption to inventors and manufacturers of new products developed in Oklahoma. An inventor can exempt royalty payments for up to seven years, as long as the new product is manufactured in the State. The manufacturer producing the product in Oklahoma may exclude 65 percent of the cost of depreciable property purchased in order to manufacture the product, up to \$500,000, from its Oklahoma taxable income.

Claimants of the exemption must register products with the Oklahoma Center for the Advancement of Science and Technology (OCAST). Following registration, the exemption is administered by the Oklahoma Tax Commission (OTC).

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this program, no stated goals are listed in its establishing statute. However, based on the characteristics of the program, its goals appear to be to stimulate innovation through the development of new products in the state and to leverage that innovation to create jobs in manufacturing.

To assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

- Use of the program.
- Comparison of Oklahoma incentive to other states
- Determination of the amount of layering with Investment/New Jobs Tax Credit

The criteria focus on what are generally considered key goals of incentive programs. Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

State of Oklahoma

Incentive Evaluation Commission

Technology Business Finance Program Evaluation

November 9, 2018

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Key Findings and Recommendations



Overview

The Technology Business Finance Program (TBFP) was established in 1999. The program is intended to assist qualified pre-seed or concept stage firms commercialize new products and processes and advance to the next stage of investment. It provides capital to qualified companies with repayment and private investment matching requirements.

To administer the program, the Oklahoma Center for the Advancement of Science and Technology (OCAST) has partnered with i2E, a not-for-profit corporation that invests in Oklahoma-based start-up companies. Qualifying start-ups may receive cash advances, generally between \$20,000 and \$50,000. The start-ups enter into contracts with i2E and agree to repay the advances with interest within 5 years.

TBFP has operated without appropriations since FY 2012. Based on current trends, the program is projected to be able to operate without appropriations for at least another decade, but it will eventually exhaust its funds. This is understandable, given the high-risk nature of its investments and its repayment structure. At that point, the State will need to decide whether to contribute more funding to the program.

Recommendation: Based on analysis of the available data, the project team recommends reconfiguring the program to improve data collection for future evaluation.

Key Findings Related to Established Criteria for Evaluation

There is insufficient data to determine the economic impact of the program. As the administrator of the program, the not-for-profit corporation i2E conducts annual surveys of program participants to collect the number of jobs, average salary and annual revenue that was made possible because of TBFP funding. However, due to fluctuations in the number of respondents to the annual survey, the best this data can offer is a year-to-year snapshot of a sampling of companies that have participated.

Lack of appropriations may be dampening the impact of the program. From FY 1999 through FY 2012, the TBFP was appropriated a total of \$10.7 million, averaging \$765,000 per year. Since FY 2012, the program has received no appropriations. In the meantime, there has been a significant decline in the dollar amount per advance. From FY 1999 through FY 2012, the average dollar amount per advance was \$100,885, while from FY 2012 through FY 2017, it declined to \$46,412.

Approximately half of the total amount of advances made have been repaid. Of the \$12.1 million in funding advanced, \$6.1 million has been repaid. Of the 140 advances, 79 (56.4 percent) have made no repayment. Repayment of advances is important, because absent additional appropriations, the program relies on repayments in order to make future advances.

TBFP portfolio companies have a four-year survival rate of 63.5 percent. The average four-year survival rate for Oklahoma establishments in general has been 54.4 percent since the inception of the program. This suggests the program is providing some advantage to participants.

Recommended Program Changes

Recommendation 1: Require program participants to respond to annual surveys. There is currently no requirement that companies receiving funding through the TBFP respond to i2E's annual survey. Requiring companies to respond to the survey, at least for a certain period of time after receiving funding, would allow for an analysis of employment and payroll growth from year to year.



Recommendation 2: Modify the annual survey to collect data determining the Oklahoma presence of program participants. The annual survey currently administered by i2E asks companies to report jobs and payroll made possible by TBFP funds, but does not ask specifically for payroll based in Oklahoma. Modifying the survey to collect data on Oklahoma activity specifically would improve the ability of future evaluators to determine the program's economic impact on the State.



Introduction



Incentive Evaluation Commission Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The Technology Business Finance Program (TBFP) is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Incentive Background

The TBFP was established in 1999 to address a shortage of capital for seed and start-up companies in the State. According to current guidelines, awards made to concept stage companies through the program are expected to range from \$20,000 to \$50,000. However, in previous years, the program has awarded amounts in the range of \$100,000. Funding recipients are required to repay this investment and raise matching private capital. The program was initially funded by State appropriations, but it has been self-sustaining since 2012.

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this program, the goal is to help new technology firms start up and get to the next stage of investment by private sources by providing pre-seed funding in incremental stages.

To assist in a determination of program effectiveness, the Commission has adopted the following criteria:

- Jobs/payroll associated with the program
- Use of the program over time
- Comparison of participant success rates to tech start-ups, generally
- Return on investment from an equity standpoint

The criteria focus on what are generally considered key goals of incentive programs. Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

State of Oklahoma

Incentive Evaluation Commission

Quality Jobs Investment Program Evaluation

November 9, 2018

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Key Findings and Recommendations



Overview

The Quality Jobs Investment Program (Program) was created in 1994. It authorizes the Oklahoma Development Finance Authority (ODFA) to provide funding to investment enterprises which subsequently invest in businesses relocating or expanding in Oklahoma. The Program is funded by bond issuances secured by the State's Credit Enhancement Reserve Fund. The Program is authorized to issue up to \$40 million in bonds to fund investments, but it has only issued one \$9.9 million 1996 series of variable rate bonds.

The Program's latest investment was made in 2007. The poor performance of the investments made by the Program has led to a declining fund balance and income levels that cannot cover the interest payments on the bonds that initially financed the Program. ODFA no longer views this Program as a useful tool for economic development and has no plans to make investments at any time in the future. The initial goals of the Program are currently being pursued by more recent State economic development investment efforts, including the Oklahoma Seed Capital Fund and the Technology Business Finance Program.

Recommendation: Based on its analysis of available data, the project team recommends repealing the program.

Key Findings Related to Established Criteria for Evaluation

The Program has a negative balance due to poor investment performance. As of June 30, 2017, the net balance of the Program was -\$3.4 million. This deficit is likely to grow as the return on its investments have not been sufficient to cover annual interest payments on bonds issued to fund the Program.

No Program investments have been made since 2007. The latest investment, totaling \$1.15 million, provided a compound return on investment of 0.8 percent. The ODFA has no plans to make further investments using the Program.

The variable interest rate on the outstanding bonds creates the potential for the costs of the Program to increase in the future. The interest rate was last adjusted in 2008, when it declined from 5.36 percent to 2.5 percent. This change decreased annual interest payments from \$535,696 to \$249,975. However, based on market conditions, the interest rate may rise in the near future (and continue to fluctuate), as these bonds do not mature until 2031. ODFA intends to use its assets to the extent possible to meet its obligations. However, if ODFA is unable to meet its obligation at the maturity date, the obligation may be met by issuing general obligation bonds from the Credit Enhancement Reserve Fund.

At the maturity date of the bonds, the Program is projected to have a balance of -\$6.2 million. With no active investments, the only income the fund will receive over the rest of the bonds duration will be from cash management interest equal to about \$35,000 per year. This interest is insufficient to cover the current annual debt service of \$249,975.



Introduction



Incentive Evaluation Commission Process Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The Quality Jobs Investment Program is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Quality Jobs Investment Program Incentive Background

The Quality Jobs Investment Program (Program) was created in 1994. It authorizes the Oklahoma Development Finance Authority (ODFA) to provide funding to an investment enterprise that invests in businesses relocating or expanding in Oklahoma. The program is funded by bond issuances secured by the Credit Enhancement Reserve Fund.

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this program, its statute describes its goal as to create **“a more comprehensive and efficient public and private financing infrastructure for businesses relocating or expanding in this state.”**¹

To assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

- History of use of the program
- Investment outcomes – businesses created or expanded, jobs and payroll as a result
- History of returns on investments

The criteria focus on what are generally considered key goals of incentive programs, in this case, businesses created or expanded and additional jobs and payroll that result. Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

¹ 74 O.S. § 70 5062.8a

State of Oklahoma

Incentive Evaluation Commission

Technology Transfer Income Tax Exemption Evaluation

November 9, 2018

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Key Findings and Recommendations



Overview

The Technology Transfer Income Tax Exemption was created in 1987. For tax years starting on or after January 1, 1988, it allows corporations to exempt from income 10 percent of gross proceeds from the transfer of technology to an Oklahoma small business for 10 years. While not specified in statute, the goals of the program are likely to provide support for the transfer of technology to Oklahoma small businesses that do not have the resources to produce technology that may provide operational efficiencies or provide innovative products to the market.

Based on the characteristics of the program and the lack of comparable programs in other states, it is unclear if this program is addressing a critical need for the State's economy. Many states make an effort to support technology transfers, but use methods that benefit small businesses directly. Many states also concentrate efforts to support technology transfer on public research universities where technology is developed. Due to a lack of data regarding the usage and cost of the tax exemption offered by the program, it is also unclear how often the program is used, which could be one indication of the need for this incentive.

Overall Recommendation: Based on the lack of comparable programs, and lack of data available to estimate its cost and benefit, the project team recommends reconfiguring the program by requiring additional data to be collected and evaluated prior to determining whether to retain or repeal the program.

Key Findings Related to Established Criteria for Evaluation

The Oklahoma Tax Commission (OTC) is unable to provide data on the use of the exemption. Corporate tax exemptions are reported as part of the calculation of Oklahoma taxable income for corporate income tax returns as part of Form 512. The OTC collects this information in order to review it in the case of an audit, but it does not process this information at an aggregate level for the determination of the total cost of the corporate income tax exemption. As a result, the OTC has not provided an estimate of the cost of this exemption, the number of returns claiming the exemption, or the trends in its usage over time. Without this data, it is not possible to determine the usage, fiscal impact, or economic impact of the program.

Other states seeking to support small business technology transfers use different methods. Arkansas has a program that offers grant funding in order to reduce transfer transaction costs. Many other states have programs that supplement the federal Small Business Technology Transfer program through technical training, funding of the application process, or grant funding matching federal funds.

Changes to Improve Future Evaluations

The following information should be collected by OTC in the future to improve evaluation of the program's impact:

- Amount of tax exemptions per year
- Number of tax exemptions per year
- Amount of gross proceeds from technology transfer associated with the exemption
- North American Industry Classification System (NAICS) codes associated with transferors and transferees
- Description of the technology being transferred



Introduction



Incentive Evaluation Commission Process Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The Technology Transfer Income Tax Exemption is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Technology Transfer Income Tax Exemption Incentive Background

The Technology Transfer Income Tax Exemption was created in 1987. For tax years starting on or after January 1, 1988, it allows corporations to exempt from income 10 percent of gross proceeds from the transfer of technology to an Oklahoma small business for 10 years.

Small businesses often do not have the resources to perform research and development activities in order to improve operational efficiency or create new products. Technology is often transferred to commercial businesses from research institutions. While research institutions are well equipped to perform the scientific research and development activities necessary to create new technology, they often lack the ability and resources to commercialize a product. As a result, the transfer of technology to commercial entities is often a critical step toward creating and marketing new technology.

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this program, its goals are not clearly stated in statute. However, based on the characteristics of the program, the intent appears to be to support the transfer of technology to businesses in Oklahoma that may not have the resources to perform research and development activities.

To assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

- Comparison of Oklahoma incentive to other states
- Number and amount of technology transfers
- Dollar value of benefit
- Employment and payroll associated with the technology transfer

The criteria focus on what are generally considered key goals of incentive programs – in this case, for example, employment and payroll associated with the technology transfer incented by this program. Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

State of Oklahoma

Incentive Evaluation Commission

Affordable Housing Tax Credit Program Evaluation

November 20, 2018

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Key Findings and Recommendations



Overview

The purpose of the Oklahoma Affordable Housing Tax Credit (AHTC) program is to expand the supply of new, affordable rental units and to rehabilitate existing rental housing for qualifying households by stimulating private investment. The tax credit is available for qualified projects¹ placed in service after July 1, 2015 in counties with a population of less than 150,000. The amount of the State credit is equal to the allocation of the federal Low Income Housing Tax Credit (LIHTC); the total allocated to all qualified new projects in an allocation year cannot exceed \$4 million.

Recommendation: Based on its analysis of available data, the project team recommends reconfiguring the Affordable Housing Tax Credit program.

Key Findings Related to Established Criteria for Evaluation

- **While the State has long received federal LIHTCs, State AHTC funding introduced an additional \$4 million for eligible projects each year beginning in 2015.** This new funding source effectively increased the total affordable housing tax credit allocation (state tax credits + federal LIHTCs) to more than \$13 million annually.
- **Since the introduction of the State tax credits, the number of new affordable housing projects funded in Oklahoma has increased.** Between 2010 and 2014, the State (via the federal LIHTCs) funded an average of 16 projects annually. Since 2015, the State has funded at least 20 new affordable housing projects per year.
- **By 2024, the State program will cost Oklahoma (in terms of foregone revenue) a total of \$40 million annually.²** While the total funding allocated to new projects in an allocation year cannot exceed \$4 million, the credit period is up to 10 years after a project is placed into service. This means that the projects funded in the initial \$4 million cohort in 2015 will collectively receive \$4 million annually each year through 2024, for a total State investment of \$40 million. The new projects funded in the second cohort in 2016 will also receive a total investment of \$40 million between 2016 and 2025, and so on. As a result, the total cost to the State will increase by \$4 million annually for the first ten years of the program until 2024, at which point it will level out at \$40 million per year. This concept is illustrated in the following table.

Table 1: Oklahoma Affordable Housing Tax Credit Program – Cost to State, 2015-2024 (in Millions)

Cohort	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
1	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0
2		\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0
3			\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0
4				\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0
5					\$4.0	\$4.0	\$4.0	\$4.0	\$4.0	\$4.0
6						\$4.0	\$4.0	\$4.0	\$4.0	\$4.0
7							\$4.0	\$4.0	\$4.0	\$4.0
8								\$4.0	\$4.0	\$4.0
9									\$4.0	\$4.0
10										\$4.0
State Cost	\$4.0	\$8.0	\$12.0	\$16.0	\$20.0	\$24.0	\$28.0	\$32.0	\$36.0	\$40.0

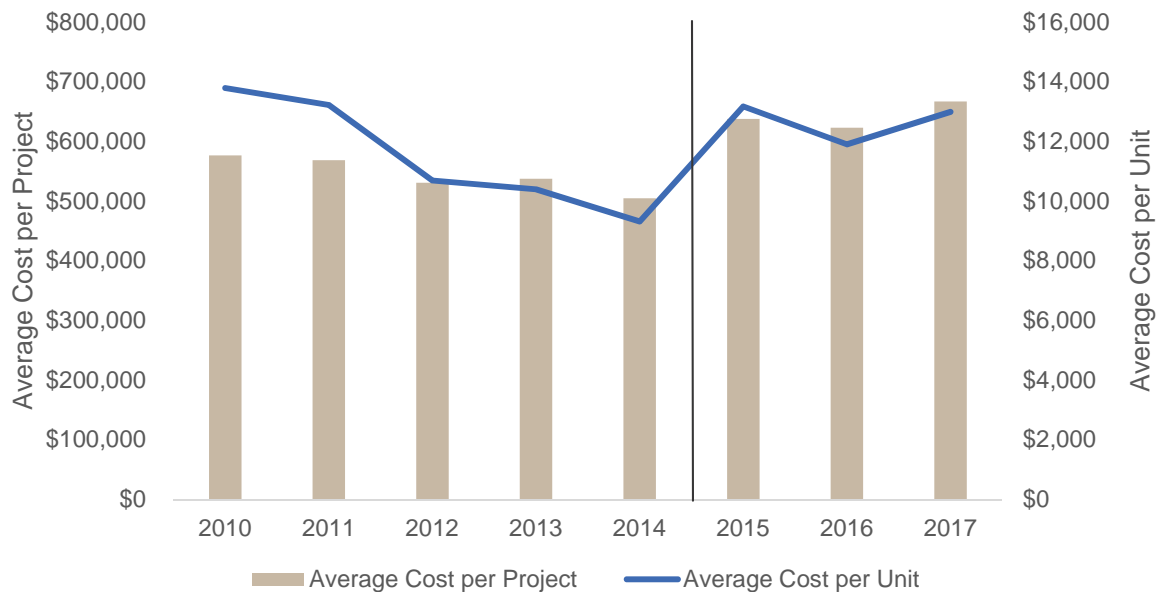
¹ "Qualified project" means a qualified low-income building as that term is defined in Section 42 of the IRC of 1986, as amended.

² In the event that a project is not ultimately completed or otherwise becomes ineligible for funding, the credits may be retracted or retracted and the cost to the State would be reduced.



- **Since the introduction of the State credits, the average per-project and per-unit cost of new projects have both increased.** Prior to 2015, the average cost per project was between \$500,000 and \$580,000; the average cost per unit ranged from \$9,300 to \$13,800.³ Both of these measures were generally trending downward over time. In each of the three years since the State credits were introduced (2015-2017), however, the average cost per project and cost per unit have increased, as shown in the following figure.

Figure 1: Average Per-Project and Per-Unit Affordable Housing Costs, 2010-2017



Source: OHFA

- **The Oklahoma AHTC program results in increased statewide economic activity, but it has a negative net economic impact.** Three years of project funding (2015-2017) generated an estimated \$10.4 million in State tax revenue related to construction spending. Over the 10-year incentive period for the projects (2015-2024), the State will provide \$116.5 million in tax credits, resulting in a net impact of -\$106.1 million.

Other Findings

- **The affordable housing shortage is less prominent in Oklahoma than in many other states.** In Oklahoma, 49 homes exist for every 100 extremely low income renter households, lower only than Maine, Alabama, West Virginia, Mississippi, Kentucky, South Dakota and Montana (and tied with Arkansas). Among the 50 largest metropolitan areas in the U.S., Oklahoma City has less severe shortages of rental homes affordable to extremely low income households (42 per 100) than most. Only the Providence-Warwick RI-MA, Louisville/Jefferson County, KY-IN, Boston-Cambridge-Newton, MA-NH and Pittsburgh, PA metropolitan areas have more available rental homes affordable to extremely low income households.⁴

³ Costs provided are based on annual award (as opposed to total cost over 10 years) and include the state and federal amounts.

⁴ Comparison made is meant to provide context. The AHTC is not available in Oklahoma City.



- **There still appears to be a need for increased affordable housing in Oklahoma.** A 2015 Statewide Affordable Housing Market Study commissioned by the Oklahoma Housing Finance Agency (OHFA) and the Oklahoma Department of Commerce found that of the nearly 23,000 housing units needed for rent through the year 2020, almost 12,000 (more than 50 percent) will be needed by households earning less than 60 percent of Area Median Income (AMI).⁵
- **Housing affordability is highly dependent on location.** In some areas, a family considered extremely low income would have little trouble finding affordable housing, while in another city, a family might have to pay much more for a similar home. The fair market rent (FMR) for an efficiency apartment ranges from \$442 in the Okmulgee County metropolitan area to \$569 in the Oklahoma County area; the FMR for a four bedroom apartment ranges from \$936 in the Okmulgee County area to \$1,358 in the Oklahoma County area.
- **Sixteen states (including Oklahoma) offer state-level affordable housing tax credit programs.** Most of these states base their programs on the federal LIHTC program. Among the states, there is some variation in criteria for state-specific project selection – such as the incorporation of environmental and energy efficiency standards, community impact and revitalization plans and projects with a ‘readiness to proceed.’
- **Oklahoma is unique in its limitation of State credits to projects in counties with a population of less than 150,000.** While several other states have location stipulations within their eligibility guidelines, all others reference the federal LIHTC program statute, which requires that properties be located in a Qualified Census Tract (as opposed to basing qualification on the population of a given area). It is notable, however, that some rural states (such as Wyoming, Montana and Vermont) have directed a large proportion of their federal LIHTC resources to rural counties. At nearly 37 percent, Oklahoma ranks sixth nationally in rural LIHTCs as a share of total LIHTC units. Among states immediately surrounding Oklahoma, only Arkansas ranks in the top ten amongst states.⁶
- **The Tax Cuts and Jobs Act is likely to have an impact on the attractiveness of the federal affordable housing tax credits.** Some industry experts believe that the reduction in the federal corporate tax rate from 35 percent to 21 percent will dilute the value of the federal credits, because affordable housing investors are likely to owe significantly less in taxes and will therefore have less of a need to obtain tax credits from developers. As a result, those developers may build fewer affordable rental units in the next decade.⁷
- **The decision by legislators to tie the State tax credit to the federal credit results in more efficient, streamlined and accountable program administration.** The administrative burdens to the State beyond those for administering the federal tax credit program are minimal.
- **Several evaluations of the federal LIHTC program and its state counterparts have found the impact of the program to be difficult to analyze, or inconclusive, while others have found a low return on investment.** For instance, an evaluation of Missouri’s LIHTC noted that inefficiencies result in a low return on the state’s investment; the estimated return on investment was \$0.12 for every \$1.00 invested in the program.⁸

⁵ Each year, the Department of Housing and Urban Development (HUD) calculates the median income for every metropolitan region in the county. HUD focuses on the region – rather than just the city – because families searching for housing are likely to look beyond the city itself to find a place to live.

⁶ Urban Institute – The Low Income Housing Tax Credit: Past Achievements, Future Challenges (July 2018). Accessed electronically at https://www.urban.org/sites/default/files/publication/98761/lihtc_past_achievements_future_challenges_final_2.pdf

⁷ Governing – Affordable Housing Shortage Expected to Worsen Under New Tax Law (February 21, 2018). Accessed electronically at <http://www.governing.com/topics/finance/gov-affordable-housing-tax-credit.html>

⁸ Office of Missouri State Auditor – Tax Credit Programs (June 2017). Accessed electronically at <https://app.auditor.mo.gov/Repository/Press/2017051896073.pdf>



- **The AHTC incentive is not a traditional economic development program.** The legislation that created the incentive evaluation process defines an incentive as a “tax credit, tax exemption, tax deduction, tax expenditure, rebate, grant or loan that is intended to encourage businesses to locate, expand, invest or remain in Oklahoma, or to hire or retain employees in the State.” The purpose of the AHTC program is to expand the supply of new and affordable rental units and rehabilitate existing rental housing for qualifying households by stimulating private investment. While outside the scope of this evaluation, there are claimed societal benefits from increasing the supply of affordable housing that may also be considered when analyzing the State’s return on investment.

Recommended Program Modifications

Given the State’s investment once the AHTC program is fully implemented, coupled with the sizeable negative net economic impact, the State may wish to explore modifying one or several aspects of the program to reduce the overall financial cost of the program to the State.

It is notable that the decision by legislators to tie the State tax credit to the federal process results in efficient, streamlined and accountable program administration. It is reasonable to assume that modifications to the program which would have the effect of making it less streamlined with the federal process would increase administrative burden – a point which should be taken into consideration.

The following are several options the State may consider for modifying future allocations of the AHTC program. Any changes should be “grandfathered” in so as to not impact those projects already under contract.

- **Reduce the \$4.0 million annual allocation for new projects.** This would reduce the overall State investment, but it would also likely decrease the number of affordable housing projects and decrease the level of generated economic activity. Among the 16 states with comparable programs, 10 (including Oklahoma) place a flat cap on annual appropriations; Oklahoma’s \$4.0 million investment is low, higher only than Vermont (\$0.4 million). Alternatively, Oklahoma could shift from a flat dollar cap to a percent of the federal allocation each year, though this would be less predictable than the current structure. Five states base their annual program caps on the federal funding available.
- **Shorten the 10 year credit period for future allocations.** Shortening the credit period for future allocations would decrease the State’s total investment. Like Oklahoma, the States of Arkansas, Connecticut, Missouri, New York and Utah provide their credits over a 10 year period. Colorado and Nebraska offer their credits for six years, while Hawaii, Massachusetts and Vermont offer theirs for five years, and California provides theirs for four years. Illinois’ credit period is one year. Georgia aligns its credit period with the federal program (currently 10 years), while New Mexico has a ten year credit period for multifamily projects and a five year period for single family projects.
- **Lower the annual State credit transaction cap.** This option would entail reducing the award amount on a per-project basis to some percentage less than 1-for-1 with the federal project allocation. It is possible this option would free up a portion of the state credits for additional housing projects, though it could be argued that these amounts would not be sufficient to warrant new projects. As currently constructed, state credits in Oklahoma, Georgia, Missouri and Nebraska are equal to 100 percent of the federal credits.⁹ Other states (Arkansas, Hawaii, Minnesota and New Mexico) offer a smaller percentage of the federal allocation.¹⁰ Still others (Connecticut, Massachusetts and Vermont) set the

⁹ In Missouri, bond developments are subject to \$700,000 cap in annual state LIHTCs.

¹⁰ Minnesota’s proposed plan, which has not been enacted, would provide one-sixth of the total federal LIHTC allowable under the 10-year federal period.



cap at a specific dollar value as opposed to a share of the federal credit.¹¹ Finally, other states (California and Colorado) have transaction caps based on a percentage of eligible costs or qualified basis.

Other Recommendations

- **Consider removing the statutory provision that precludes housing projects in Oklahoma's most populous counties from receiving funding.** The three counties precluded as a result of this provision (Cleveland, Oklahoma and Tulsa) comprise 43.0 percent of the state's population and 42.2 percent of the total housing units in the state. Further, while the State as a whole had 49 affordable and available rental homes per 100 renter households in 2016, the Oklahoma City metropolitan area had just 42, suggesting that the shortage in the more urban areas of the state may be more pronounced.
- **Consider making the tax credits refundable instead of transferable.** Critics of transferrable tax credits question whether it is good public policy for tax breaks to be sold to companies in industries the tax credits were not meant to incent. Additionally, selling the credits generally deflates their value, as they are typically sold by those companies at 85 to 90 cents on the dollar. Instead of making credits transferrable, it would be more impactful to make them refundable. Refundable credits provide a larger benefit to the original recipient at the same cost to the State, as these taxpayers would not sell them for less than full value.

¹¹ Massachusetts has a variable transaction cap, which ranges from \$0.4 million to \$1.0 million based on the number of units being built.



Introduction



Incentive Evaluation Commission Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The AHTC program is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Industry and Incentive Background

The United States has a long-standing shortage of rental homes affordable and available to low income renter households. While the shortage is not as significant in Oklahoma as in most other states, a 2015 Statewide Affordable Housing Market Study found that of the nearly 44,000 housing units needed for ownership through the year 2020, approximately 7,500 (17.0 percent) will be needed by households earning less than 60 percent of AMI. Of the nearly 23,000 housing units needed for rent through the year 2020, almost 12,000 (more than 50 percent) will be needed by households earning less than 60 percent of AMI.

The purpose of Oklahoma's AHTC program is to expand the supply of new and affordable rental units and rehabilitate existing rental housing for qualifying households by stimulating private investment. The tax credit is available for qualified projects¹² placed in service after July 1, 2015 in counties with a population of less than 150,000. The amount of the State credit is equal to the allocation of the federal LIHTC; the total allocated to all qualified projects in an allocation year cannot exceed \$4 million.

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this credit, the specific goal included in legislation is to expand the supply of new affordable rental units and rehabilitate existing rental housing for qualifying households by stimulating private investment.

Additionally, to assist in a determination of program effectiveness, the Commission has adopted the following criteria:

- Number of housing projects funded by the program;
- Number of housing units associated with the credit;
- Change in qualified housing projects before/after the credit;
- Comparison to other states with/without similar credits; and
- State return on investment – economic activity versus financial net cost.

In some respects, this credit falls outside the typical incentive evaluation criteria. It is notable that the statutory language for determining an incentive subject to review by the Commission identifies them as “a tax credit, tax exemption, tax deduction, tax expenditure, rebate, grant, or loan that is intended to encourage businesses to locate, expand, invest, or remain in Oklahoma, or to hire or retain employees in Oklahoma.” In this instance, the criteria do not focus on the business per se, but on other outcomes associated with use of the credit.

¹² “Qualified project” means a qualified low-income building as that term is defined in Section 42 of the IRC of 1986, as amended.



In this case, the criteria focus on influencing a specific activity – in this case, the construction of affordable housing. Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

State of Oklahoma

Incentive Evaluation Commission

Applied Research Support Program Evaluation

November 9, 2018

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Key Findings and Recommendations



Overview

Administered by the Oklahoma Center for the Advancement of Science and Technology (OCAST), the Oklahoma Applied Research Support (OARS) Program invests in research and development (R&D) of innovative technologies with commercial potential. Funding (which is made available through appropriation) totals \$2.5 million in FY2018 and is designed to increase investment in the research and development of new technologies that will ultimately bring value to the State of Oklahoma and help grow and diversify the State's economy.

The OARS program provides two distinct funding categories:

- **Proof of Concept Applied R&D funding** supports early stage applied R&D projects such as proof and concept research and technical development projects, exploratory development and product definition. Awards are made for up to \$45,000 per year for one or two years.
- **Accelerated Applied R&D funding** supports later stage applied R&D projects where the product is defined, the market opportunity is well assessed, commercial opportunities are clearly identified and a commercial entity is defined. Awards are made for up to \$300,000 and may be made for one to three years.

Recommendation: Based on its analysis of available data, the project team recommends retaining the Oklahoma Applied Research Support Program.

Key Findings Related to Established Criteria for Evaluation

- **Oklahoma surpasses most states on investment in R&D activities.** Investing \$33.5 million in R&D in FY2016, Oklahoma ranked 11th among all states and Washington D.C., both in total R&D expenditures and on a per capita basis (\$8.63). Among the states immediately surrounding Oklahoma, only Texas made a larger investment (equal to \$9.46 per resident).
- **Oklahoma R&D performed, as a share of State GDP, lags most states.** At 0.62 percent of state GDP, Oklahoma ranked 46th nationally, higher only than Wyoming, Louisiana, Alaska and Arkansas (and tied with South Dakota). Among its surrounding states, Oklahoma performed better only than Arkansas, which ranked 48th.
- **Statewide employment in the scientific R&D services industry decreased from 2,543 employees in 2001 to 1,586 in 2017 – an overall decline of 37.6 percent, or a compound annual growth rate (CAGR) of -2.6 percent.**¹ Nationwide, industry employment increased by 23.5 percent, or a CAGR of 1.3 percent, during this time. Additionally, across all private industries in Oklahoma, employment increased by 7.6 percent between 2001 and 2017 – a CAGR of 0.5 percent.
- **Utility patents granted in the State of Oklahoma between 1963 and 2015 peaked in 1966 at 937 and have trended downward over time (a CAGR of -0.3 percent during the time period).** A total of 532 utility patents were issued in the state in 2015. Relative to its surrounding states and the U.S. as a whole, Oklahoma's patent activity is lagging; all other states analyzed experienced an increase in patents over the time period, and the nation as a whole saw an increase of 2.1 percent annually.
- **Since the program's inception, OCAST has provided \$96.4 million in OARS awards.** Peaking at nearly \$8 million in 1990, funding has decreased over time; the number of projects funded peaked in

¹ Scientific R&D per North American Industry Classification System (NAICS) code 5417, scientific research and development services.



1990 at 57 but since that point has averaged just over 19. In 2017, 12 projects received OARS funding, for a total award of \$2.5 million.

- **Private companies currently account for more than half of all OARS awards made.** In the earliest years of the program (until around 2000), the primary recipients of funding were colleges and universities, accounting for an average of 77.4 percent of total award dollars and 78.5 percent of projects funded. Since that time, a shift has occurred, whereby more private companies are receiving funding. Between 2001 and 2017, private industry represented an average of 58.9 percent of funding and 56.1 percent of projects funded.
- **A total of 160 new or retained jobs are attributable to 53 OARS awards made between 2012 and 2016.** The average pay associated with those jobs is estimated to be nearly \$60,000. Including benefits, total compensation is estimated to be \$7.6 million.²
- **Other economic impacts appear to be significant.** Among 63 award recipients responding, 17 reported startups/spin-out companies attributable to the receipt of OARS funding; 28 reported developing new products, 5 reported that patents have been granted and 3 reported receiving royalties or licensing fees. Additional capital investment, gross sales and subsequent funding data is also provided in this evaluation.
- **The OARS program's matching requirement has leveraged significant additional funding.** A total of \$30.2 million in matching funds has been committed since 2001, with the bulk of the funds levered during the past six years.
- **Since the program's inception, it has provided funding to nearly 600 collaborative projects in 21 counties.** There have been more than 100 collaborative projects in Payne, Oklahoma and Cleveland Counties (likely due to the high concentration of colleges and universities), as well as private industry.

Other Findings

- **At \$10.1 million funding in 2016, OCAST was the second-largest contributor to State-funded R&D.**³ OCAST funding accounted for 30.1 percent of total state agency expenditures; only the Tobacco Settlement Endowment Trust (at \$11.7 million) made a larger investment.⁴
- **A total of eight states were found to have comparable applied research incentive programs.** None of the states with comparable programs border Oklahoma. With an appropriation of \$2.5 million in FY2018, Oklahoma's funding for OARS projects is comparable to – even competitive with – other states providing similar programs.
- **Grantees are required by contract to respond to a program survey for a period of five years.** While it is beneficial for OCAST to collect program information, certain issues exist. For instance, the fact that respondents are required to reply for five years and then can drop off can lead to fluctuations in the data over time as one grantee's impact data is removed from totals (despite the project still being in existence). Additionally, the fact that recipients self-report the data can lead to variances in the way information is reported. The 2017 OCAST Impact Survey is provided in **Appendix A**.

² Based on PFM analysis of OCAST annual survey data. It is possible that survey responses may contain errors. Figures do not include data for award recipients that did not respond to the survey.

³ \$10.1 million represents total OCAST investment and is not specific to the OARS program.

⁴ The Oklahoma Tobacco Settlement Endowment Trust (TSET) is a State grant-making trust devoted to preventing cancer and cardiovascular disease via grants to schools, communities, state agencies and partner organizations. It also funds research and emerging opportunities in the public and private sectors.



Recommended Program Modifications

- **OCAST should collect more detailed information from current and former grant recipients to allow for consistent analysis.** The collection of additional information, such as the NAICS code associated with each project and a more detailed accounting of the jobs created or retained (e.g. position titles) will likely enable supplemental analysis of the OARS program's impacts. Additionally, each respondent should fill out a separate survey for each project, rather than aggregating the impact into a single response.
- **For programs that invest in early stage firms or research activities, it is critical to track business activity and funding sources prior to obtaining the state financial support and after the state monies have been spent to measure the long-term effect of the program.** In addition, if a business has multiple products being sold and developed, the data collection should detail these different functional activities to isolate the program receiving state funds.
- **If a successful product or company is developed, the location for where the product is sold, supported, and manufactured should be identified.** Given the failure rate of early stage companies and associated research, evaluations for these types of incentive programs tend to focus on a few highly successful companies, rather than individual recipients. These success stories can often generate enough economic activity and tax revenue to justify a program.
- **In order to correctly and accurately perform an economic impact analysis, the following information would be required on an annual basis.** It is preferable that this information be collected by project funding year cohort, since the awards most often last for multiple years. This would enable the analysis of impact from year to year (which is not currently possible).
 - Jobs data (including how many jobs existed prior to OCAST funding and how much other funding has been raised);
 - Payroll data;
 - Economic activity data (including gross sales and additional funding raised as a direct result of OARS funding);
 - Success or failure rate of each recipient; and
 - Industry sector information.



Introduction



Incentive Evaluation Commission Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The Oklahoma Applied Research Support (OARS) Program is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Industry and Incentive Background

According to the National Science Foundation (NSF), applied research is “aimed at gaining knowledge or understanding to determine the means by which a specific, recognized need may be met. In the industry, applied research includes investigations oriented to discovering new scientific knowledge that has specific commercial objectives with respect to products, processes or services.”⁵ Because applied research is used to increase scientific knowledge and develop innovative technologies, it plays an important role in solving everyday problems that may have a positive impact for the State and its residents.

Administered by the Oklahoma Center for the Advancement of Science and Technology (OCAST), the OARS Program invests in R&D supporting innovative technologies with commercial potential. Funding is designed to increase investment in the R&D of new technologies that will ultimately bring value to the State and help grow and diversify its economy.

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this program, the goal is to assist in the accelerated development of technology in the State by supporting applied research activities in existing and emerging technical areas.

To assist in a determination of program effectiveness, the Commission has adopted the following criteria:

- Commercially successful products developed as a result of program funding;
- Economic activity associated with program funding;
- Number and types of collaborative projects associated with program funding;
- Comparison of collaborative projects before and after the program; and
- State return on investment.

The criteria focus on what are generally considered key goals of incentive programs (such as the generation of economic activity). Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

⁵ National Science Foundation – Directorate for Social, Behavioral and Economic Sciences, U.S. definitions and resource surveys, 1996. Accessed electronically at <https://www.nsf.gov/statistics/fedfunds/glossary/def.htm>

State of Oklahoma

Incentive Evaluation Commission

Energy Efficient Residential Construction Tax Credit Evaluation

November 9, 2018

PFM Group Consulting LLC
BNY Mellon Center
1735 Market Street
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Key Findings and Recommendations



Overview

In 2006, the State of Oklahoma began offering the Energy Efficient Residential Construction tax credit to promote the construction of energy efficient residential property. Contractors constructing residential property of 2,000 square feet or less could qualify for a tax credit equal to qualified expenditures of up to \$4,000, depending on the efficiency rating of the property.

During the 2016 Oklahoma legislative session, SB1603 was enacted, which provided a sunset of this tax credit effective July 1, 2016. While it could be argued that the evaluation of the incentive is no longer necessary, examining the impact is useful from a public policy perspective. It is also possible that the State may wish to revisit this incentive in the future.

Recommendation: Based on the analysis of available information, the project team concurs with the repeal of the program.

Key Findings Related to Established Criteria for Evaluation

- **The number of energy efficient residential properties in the State has declined over time.** The total number of Energy Star certified homes built in Oklahoma peaked in 2009 at more than 3,500 but has since declined – totaling just over 200 in 2017. This equates to a compound annual growth rate (CAGR) of -14.2 percent between 2006 and 2017.
- **Similar declines in the number of energy efficient residential properties built have occurred in half of the states surrounding Oklahoma, while the other half have experienced increases.** Among the six states immediately surrounding Oklahoma, three (Arkansas, New Mexico and Texas) experienced declines between 2006 and 2017 (-18.1 percent, -12.1 percent and -9.2 percent, respectively). However, the other three states experienced growth in the number of Energy Star certified homes built: Colorado grew by 6.3 percent annually, Kansas by 5.0 percent and Missouri by 14.7 percent. The U.S. as a whole declined by -6.3 percent annually between 2006 and 2017.
- **Since 2008, use of the credit has remained relatively stable.** During this time frame, the annual tax credit use has averaged \$5.0 million. However, this total does not include credits transferred to insurance companies to reduce insurance premiums tax liabilities. These amounts totaled nearly \$4.0 million in 2016 and \$2.6 million in 2017.
- **There are savings associated with each energy efficient home built.** According to the Environmental Protection Agency (EPA), the savings generated by the 206 Energy Star certified homes built in Oklahoma in 2017 is equal to annual electric savings of nearly 280,000 kWh; annual gas savings of more than 19,000 therms; total annual utility bill savings of nearly \$55,000; and a CO₂ emission reduction of 298 metric tons.¹
- **The Energy Efficient Residential Construction Tax Credit program results in increased statewide economic activity, but the net impact is negative.** Between 2014 and 2016, the Energy Efficient Residential Construction Tax Credit, through direct, indirect and induced economic effects, generated approximately \$1.3 million in State tax revenue. Over this same period, however, the State provided \$27.6 million in tax credits, resulting in a net impact over the three year period of -\$26.3 million, as shown in the following table.

¹ A therm is a unit of heat equivalent to 100,000 Btu or 1.055 x 10⁸ joules.



Table 1: Annual Tax Revenue Generated

	Credits Established During Tax Year	Estimated Oklahoma Tax Revenue	Net Impact
2014	\$11,021,922	\$532,879	(\$10,489,043)
2015	\$8,266,952	\$423,317	(\$7,843,635)
2016	\$8,360,604	\$389,713	(\$7,970,891)
Total	\$27,649,478	\$1,345,909	(\$26,303,569)

Other Findings

- **Other states with similar incentives have sunset their programs.** Illinois and Indiana both repealed their programs in 2016, and Oregon ended its incentive program in 2017. New Mexico's program has been extended several times and is currently scheduled to sunset in 2021. The federal programs have also been prolonged; the Residential Energy Efficient Property Credit is scheduled to be repealed in 2021, while the other two federal programs were sunset effective in 2017. Only New Jersey does not appear to have a sunset date.
- **Other state (and federal) evaluations suggest that similar programs are ineffective and/or inequitable.** A review of Indiana's home insulation tax deduction found that the majority of qualifying projects did not claim the deduction, and the deduction was ineffective in influencing behavior. One analysis of a similar federal program concluded that energy tax credits are inequitable, due to the fact that energy efficient tax credits are used by residents with tax liabilities and are exclusively for home owners, not renters (both suggesting use by higher-income individuals). Another analysis of the federal programs found that while the purpose of residential energy efficiency tax credits is to motivate additional energy efficiency investment, the amount of the investment resulting from these credits is unclear.
- **The State is not currently at risk of significant increases in tax expenditures associated with the program.** One of the statutory requirements of the Incentive Evaluation Act is that each evaluation should determine "whether adequate protections are in place to ensure the fiscal impact of the incentive does not increase substantially beyond the State's expectations in future years." Given the sunset of the program effective July 1, 2016, the State is not at risk of significant increases in expenditures related to this incentive.
- **There are concerns about tax data and reporting, but improvements are being made.** There exists a lack of high quality data, which makes it difficult for the State to accurately report on the impact of the incentive. Since 2014, the data collected and reported is more detailed. Additionally, the enactment of HB2335, which directs the Oklahoma Tax Commission (OTC) to make tax credit data available on its website no later than January 1, 2020, will likely improve data availability and reporting.²

² In May 2018, Governor Fallin signed into law HB3225. The information available on the website must be available free of charge, downloadable and offer users the ability to systematically sort and search the data. The bill also sets the minimum standards for what type of information must be disclosed about each tax credit, including a brief explanation of the credit and specific information for tax year 2013 and each tax year thereafter.



Changes to Improve Future Evaluations (if the Program were Re-enacted)

- **Continue to improve the data collection process.** Should the State seek to reinstate this (or a similar) tax credit in the future, it should require additional data from those who qualify for the tax credit in order to ensure a full cost-benefit analysis can be completed. Important components would include which eligible expenditures are being claimed and what level of energy reduction (i.e. between 20 and 30 percent or greater than 40 percent) is being achieved.
- **Consider making credits refundable instead of transferable.** Critics of transferrable tax credits question whether it is good public policy for tax breaks to be sold to companies in industries the tax credits were not meant to incent. Additionally, selling the credits generally deflates their value, as they are typically sold at 85 to 90 cents on the dollar. Instead of making credits transferrable, it would be more impactful to make them refundable. Refundable credits provide a larger benefit to the original recipient at the same cost to the State, as these taxpayers would not sell them for less than full value.
- **Alternatively, consider replacing tax credits with grants or rebates.** In its analysis of two federal energy efficiency credits, the Congressional Research Service notes that replacing tax credits with a grant or rebate program would make the benefit more widely available and not limited to those taxpayers with tax liabilities. Illinois' Energy Efficient Affordable Housing Construction Program operates this way, providing grants for the installation of eligible efficient technologies in low-income residences at or below 80 percent of area median income.



Introduction



Incentive Evaluation Commission Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The Energy Efficient Residential Construction Tax Credit is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

During the 2016 legislative session, SB1603 was enacted, which provided a sunset of this tax credit effective July 1, 2016. While it could be argued that the evaluation of the incentive is no longer necessary, examining the impact is useful from a public policy perspective. It is also possible that the State may wish to revisit this incentive in the future.

Incentive Background

Advances in energy efficiency have allowed per capita residential energy use to remain relatively constant since the 1970s, even as demand for energy-using technologies has increased. Experts believe that there is unrealized potential for further residential energy efficiency – and tax credits are one policy option to encourage consumers to invest in energy efficient technologies.³

In 2006, the State began offering the Energy Efficient Residential Construction tax credit to promote the construction of energy efficient residential property. Contractors constructing residential property of 2,000 square feet or less could qualify for a tax credit equal to qualified expenditures of up to \$4,000, depending on the efficiency rating of the property.

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. For this program, the goal is to promote the construction of energy efficient residential property. To assist in a determination of program effectiveness, the Commission has adopted the following criteria:

- Change in number of energy efficient residential properties;
- Change in program utilization;
- Comparison of number of qualified properties versus surrounding states;
- Energy savings/environmental impact from qualified properties; and
- State return on investment.

In some respects, this credit falls outside the typical incentive evaluation criteria. It is notable that the statutory language for determining an incentive subject to review by the Commission identifies it as “a tax credit, tax exemption, tax deduction, tax expenditure, rebate, grant or loan that is intended to encourage businesses to locate, expand, invest or remain in Oklahoma, or to hire or retain employees in Oklahoma.” In this instance, the criteria do not focus on the business per se, but on other outcomes associated with use of the credit.

³ Congressional Research Service – Residential Energy Tax Credits: Overview and Analysis. April 9, 2018. Accessed electronically at <https://fas.org/sfp/crs/misc/R42089.pdf>



Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the cost, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

State of Oklahoma

Incentive Evaluation Commission

Health Research Program Evaluation

November 9, 2018

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Access to the full report can be found on the IEC Website



Key Findings and Recommendations



Overview

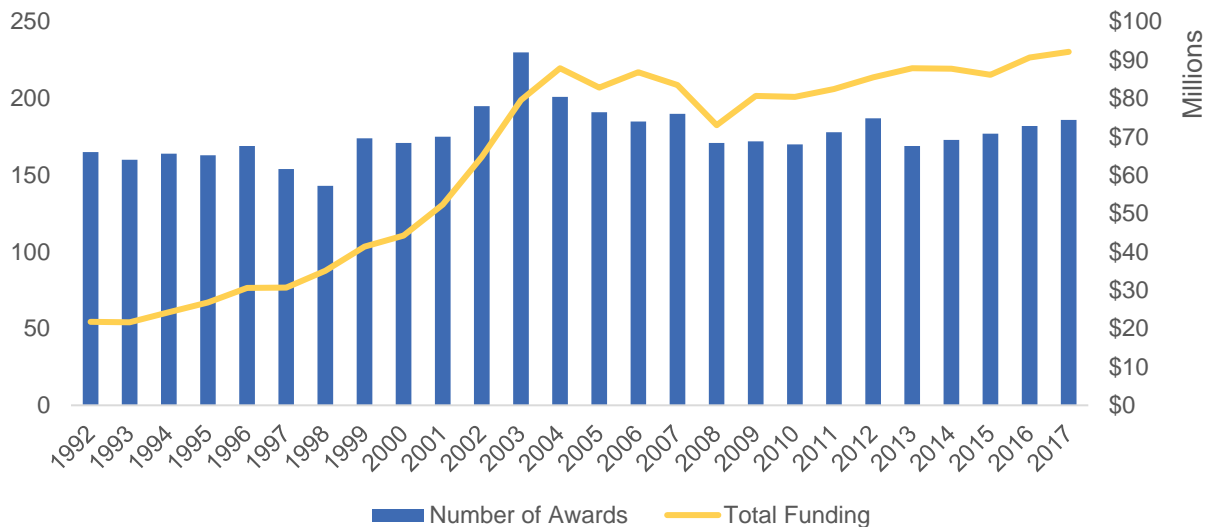
Administered by the Oklahoma Center for the Advancement of Science and Technology (OCAST), the Oklahoma Health Research Program funds basic research projects related to human health for one to three years at a maximum level of \$45,000 per year. The awards (which are funded by an appropriation of \$2.5 million in FY2018) enable researchers to gain the expertise and produce the data needed to obtain larger grants from federal agencies and other national funding organizations. Research funded by this program investigates the causes, diagnosis, treatment and prevention of human diseases and disabilities and facilitates the development of health care products and services.

Recommendation: Based on its analysis of available data, the project team recommends retaining the Oklahoma Health Research Program.

Key Findings Related to Established Criteria for Evaluation

- **Total National Institutes of Health (NIH) funding in Oklahoma has increased steadily over the past 25 years.** In 1992, NIH funding totaled \$21.7 million; by 2017, that total was \$92.1 million (a compound annual growth rate of 5.9 percent). Data for the years prior to the program's inception was not available.

Figure 1: NIH Award Activity in Oklahoma, 1992-2017



Source: NIH Reporting Portfolio – Awards by Location and Organization

- **Relative to other states, Oklahoma's per capita NIH funding is lagging.** Oklahoma ranked 39th in 1992 (at \$7) among the 50 states and Washington, D.C. Despite the state's per capita amount increasing to \$23 by 2017, its rank had fallen to 44th. Among Oklahoma's six surrounding states, (none of which were found to have comparable programs), Oklahoma's per capita NIH funding in 1992 ranked higher only than Arkansas (\$6 per capita), and this was also the case in 2017.
- **While trailing other states in NIH funding rankings, the State's direct investment in health-related research and development (R&D) is significant.** Of the \$15.7 million the State spent on health-related R&D in 2016, \$11.7 million was attributable to the Tobacco Settlement Endowment Trust, \$4.0 million to OCAST and approximately \$10,000 to the Department of Human Services. The State's



2016 investment in health-related R&D ranked 10th among 35 states for which data was provided. Further, among immediately surrounding states, Oklahoma's investment was smaller only than Texas (\$212 million) and, at \$4.04 per capita, Oklahoma was second only to Texas (\$7.87 per capita).¹

- **Statewide employment in R&D in the Physical, Engineering and Life Sciences industry decreased between 2001 and 2016 while average industry pay has increased.**² Further, the average industry pay (\$70,000 in 2016) is significantly higher than the average wage for all industries in Oklahoma (\$44,000) – and the average industry pay is increasing more rapidly than the average wage across all industries.
- **Medical patents awarded in Oklahoma peaked in 1998 at 42.**³ In 2012, the most recent year for which detailed data is available, 26 medical patents were issued in the state. Oklahoma's patent activity is comparable to surrounding states and those states with incentives comparable to the Health Research program.
- **Since the program's inception, OCAST has provided more than \$85 million in Health Research awards.** While there has been some variance in the value of contracts awarded annually over the past several decades, awards have remained relatively stable. Between 1988 (the first year a grant was funded) and 2017, annual grant disbursements averaged \$2.8 million.
- **The program's recipients are primarily public colleges and universities; these entities have accounted for between 70 and 89 percent of annual program funding since its inception.** With a total of \$67 million in awards received, these colleges and universities comprise 79 percent of total funding over the life of the program. Non-profit research institutions are the second largest recipients, receiving \$16 million since 1987. Private colleges and universities have received nearly \$2 million.
- **A total of 277.5 new or retained jobs are attributable to 128 Health Research awards made between 2010 and 2016.** The average pay associated with those jobs is estimated to be approximately \$45,000, equal to the average annual wage across all private industries (\$45,169 in 2017). Including benefits, total compensation is estimated to be \$9.1 million.⁴
- **Other economic impacts appear to be significant.** Among 151 Health Research award recipients responding to OCAST's annual survey, representatives of 81 projects (53.6 percent) indicated that a total of \$51.1 million in additional funding was obtained as a result of the initial Health Research funding. In addition, 12 reported developing new products and five reported that patents have been granted.

Other Findings

- **Few states have programs similar to the Health Research Program.** Only Connecticut, Pennsylvania and Virginia were found to have state-level grant programs geared toward health-related research. With an appropriation of \$2.5 million in FY2018, Oklahoma's program investment was comparable to that of Virginia, which awarded \$3.4 million. While both Oklahoma and Virginia fund their programs through an annual appropriation, Virginia's program also receives contributions from six

¹ National Science Foundation, National Center for Science and Engineering Statistics – Survey of State Government Research and Development. Accessed electronically at <https://ncesdata.nsf.gov/sgrd/2016/>

² Data based on North American Industry Classification System (NAICS) code 54171 – Research and Development in the Physical, Engineering and Life Sciences

³ Data per U.S. Patent and Trademark Office. Two major industry subcategories – pharmaceuticals and medicines (NAICS code 3254) and medical equipment and supplies (NAICS code 3391) are used to serve as a proxy for health research patents.

⁴ Based on PFM analysis of OCAST annual survey data. It is possible that survey responses may contain errors. Figures do not include data for award recipients that did not respond to the survey.



partnering universities. Virginia also has a matching requirement that ranges from one-to-one to six-to-one.

- **Grantees are required by contract to respond to a program survey for a period of five years.** While it is beneficial for OCAST to collect program information, certain issues exist. For instance, the fact that respondents are required to reply for five years and then can drop off can lead to fluctuations in the data over time as one grantee's impact data is removed from totals (despite the project still being in existence). Additionally, the fact that recipients self-report the data can lead to variances in the way information is reported. The 2017 OCAST Impact Survey is provided in **Appendix A**.

Recommended Program Modifications

- **OCAST should collect more detailed information from current and former grant recipients to allow for consistent analysis.** The collection of additional information, such as the NAICS code associated with each project and a more detailed accounting of the jobs created or retained (e.g. position titles) will likely enable supplemental analysis of the Health Research program's impacts. Additionally, each respondent should fill out a separate survey for each project, rather than aggregating the impact into a single response.
- **For programs that invest in early stage firms or research activities, it is critical to track business activity and funding sources prior to obtaining the state financial support and after the state monies have been spent to measure the long-term effect of the program.** In addition, if a business has multiple products being sold and developed, the data collection should detail these different functional activities to isolate the program receiving state funds.
- **If a successful product or company is developed, the location for where the product is sold, supported, and manufactured should be identified.** Given the failure rate of early stage companies and associated research, evaluations for these types of incentive programs tend to focus on a few highly successful companies, rather than individual recipients. These success stories can often generate enough economic activity and tax revenue to justify a program.
- **In order to correctly and accurately perform an economic impact analysis, the following information would be required on an annual basis.** It is preferable that this information be collected by project funding year cohort, since the awards most often last for multiple years. This would enable the analysis of impact from year to year (which is not currently possible).
 - Jobs data (including how many jobs existed prior to OCAST funding and how much other funding has been raised);
 - Payroll data;
 - Economic activity data (including gross sales and additional funding raised as a direct result of OARS funding);
 - Success or failure rate of each recipient; and
 - Industry sector information.



Introduction



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In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The Oklahoma Health Research Program is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Industry and Incentive Background

Citing Oklahoma's "need for an institution which combines the resources of public and private sectors to encourage the development of new products, new processes and whole new industries," the Economic Development Act of 1987 authorized the creation of OCAST. The Economic Development Act both created and incorporated a variety of mechanisms to increase the quantity and quality of research in Oklahoma in order to increase the rate of knowledge transfer and technological innovation and, thereby, improve economic competitiveness and spur economic growth. Originally created by the Oklahoma Health Research Act, the Oklahoma Health Research Program administered by OCAST is one of these mechanisms.

The Oklahoma Health Research Program funds basic research projects related to human health for one to three years at a maximum level of \$45,000 per year. The awards enable researchers to gain the expertise and produce the data needed to obtain larger grants from federal agencies and other national funding organizations. Research funded under this program investigates the causes, diagnosis, treatment and prevention of human diseases and disabilities and facilitates the development of health care products and services.

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this program, the goals are to help recruit and retain well-qualified health research scientists for the State, improve the competitiveness of Oklahoma-based investigators for national research funds, improve health care for the citizens of Oklahoma, and strengthen the State's health care industry.

In some respects, the goals of this program do not readily align with the legislative definition of incentives subject to review by the Commission. The enabling statute indicates that these incentives are "a tax credit, tax exemption, tax deduction, tax expenditure, rebate, grant, or loan that is intended to encourage businesses to locate, expand, invest, or remain in Oklahoma, or to hire or retain employees in Oklahoma." While it could be argued that improving research scientist competitiveness and strengthening the health care industry may encourage businesses to locate, expand, invest, or remain in Oklahoma, or to hire or retain employees in Oklahoma, these appear to be secondary or spin-off benefits rather than the primary purpose of the program.

To assist in a determination of program effectiveness, the Commission adopted the following criteria:

- Number of health research scientists recruited/retained through the program;
- National research funding obtained as a result of the program;
- Comparison of national research funding before/after program initiation;
- Comparison of national research funding for state without similar programs;
- Health care products and services developed as a result of funding; and
- Return on investment.



The criteria, particularly around health care products and services developed as a result of the funding, seek to focus on what are generally considered key goals of incentive programs, such as job recruitment and retention. Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

State of Oklahoma

Incentive Evaluation Commission

Small Business Incubators Evaluation

November 9, 2018

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Key Findings and Recommendations



Overview

In 1988, the Oklahoma Legislature passed the Oklahoma Small Business Incubators Incentives Act to “promote, encourage and advance economic prosperity and employment throughout the state” by offering income tax exemptions to both organizations qualifying as sponsors of small business incubators and the tenants of those incubators.¹ Sponsors are exempt from state income taxes on income earned from rental fees or other incubator-related income; tenants are exempt from state tax liability on income earned as a result of tenancy for up to 10 years, even after the tenant leaves the incubator.

Recommendation: The project team recommends retaining the Small Business Incubator Income Tax Exemption for Tenants and repealing the Small Business Incubator Income Tax Exemption for Sponsors.

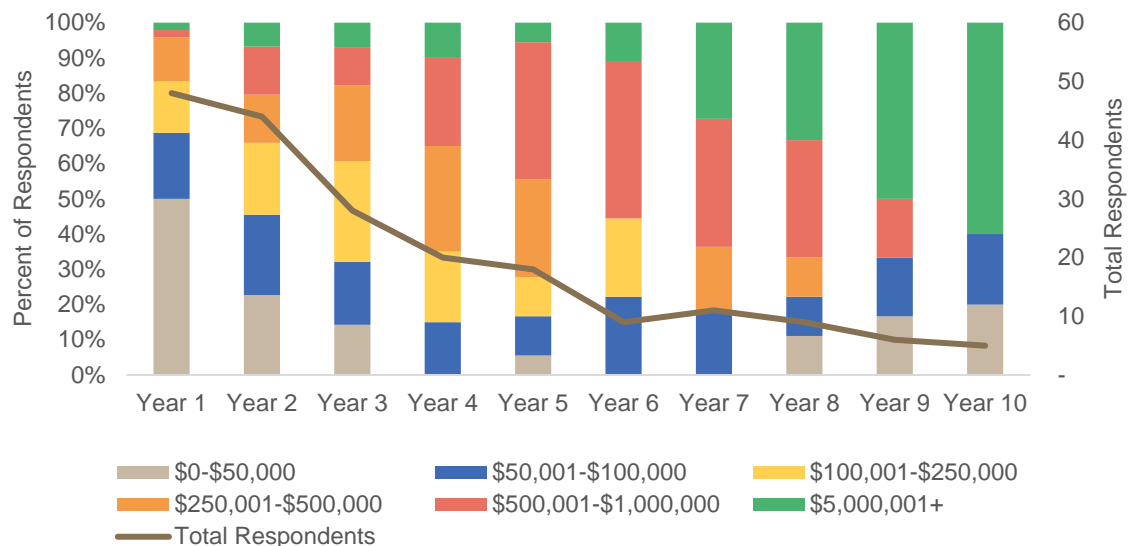
Key Findings

- **Since 2008, the number of certified incubators operating in the State has declined.** In recent years, the number of new incubators established has not kept pace with the number of incubator closures, resulting in a decline in the total number of incubators in the State. By the end of 2017, there were 17 fewer incubators in Oklahoma than in 2008.
- **While the number of incubators has declined over time, the total number of small businesses located in Oklahoma incubators each year has increased by 2.5 percent annually.** As a result, the average number of small businesses per incubator (5.3 in 2017) has nearly doubled since 2008. Since the program’s inception, a total of 943 small Oklahoma businesses have located in a small business incubator.
- **Current incubator tenants are primarily manufacturing firms but range from small service companies to high-tech research and development operations.** Of 31 current incubators, 13 (42 percent) target manufacturing and mixed use, while 5 (16 percent) are solely mixed use and 3 (10 percent) focus on manufacturing alone. An additional 2 focus on technology-based businesses, and the remainder cater to a specific industry (e.g. artists, student-led ventures, aerospace and defense, etc.) or a combination of industries.
- **The State’s small business incubators have aided in the creation of more than 3,000 Oklahoma jobs over the lifetime of the program.** A total of 2,147 jobs have been created by incubator graduates still located in the State. In 2017, 862 full-time jobs were provided by the 163 tenants of the State’s 31 certified incubators.
- **Payroll of incubator tenants appears to increase over time.** In response to a PFM-administered survey of current and former incubator tenants, half of all survey respondents indicated that, in year one of incubator tenancy, total payroll was less than \$50,000. Among those still qualifying in year 10, three of five survey respondents reported total payroll of \$5.0 million or greater annually, as shown in the following figure.

¹ Oklahoma Statutes §74-5072.



Figure 1: Total Payroll Range, Incubator Program Year 1-10



Source: PFM-administered incubator tenant survey

- **It is likely the return on investment to the State of Oklahoma for this program is breakeven or positive.** Based on the statewide average wage for the manufacturing sector (the primarily industry targeted by the current incubators), over \$142.5 million in wages is supported by current or former incubator tenants. At the same time, the State's associated tax expenditures are minimal, totaling approximately \$300,000 annually in 2014 and 2015.
- **Given the data limitations associated with this program, however, it is difficult to document the annual economic and tax impact of the incubators.** In the short-term, startup companies that may be attracted to incubators may not generate sufficient revenue and profits to necessitate the payment of income tax in Oklahoma. In addition, these companies may not satisfy the requirement of at least 75 percent of gross sales to buyers located outside the state, the federal government, or buyers in the state if the product or service is resold to an out-of-state customer or buyer for ultimate use in order to qualify for the exemption in years 6 to 10. That does not necessarily mean the tenants do not have employees, pay wages and buy local goods and services, as it is not uncommon for small business owners to reinvest all profits in the business.

Other Findings

- **The income tax exemption appears to be a key factor for incubator tenants in their business location decisions.** Nearly three quarters of respondents to the PFM-administered incubator tenant survey indicated that the availability of the exemption was an "important" consideration in their decision to locate in the incubator, and more than half of all respondents indicated that it was "very important."
- **Including Oklahoma, nine states were found to have incentive programs related to small business and/or small business incubators.** There are significant nuances that distinguish each program, and Oklahoma is unique in the structure of its incentive.



- **Some degree of taxpayer confusion exists regarding how to accurately claim the income tax exemption for incubator tenants.** To claim the exemption, taxpayers report associated income on the “Miscellaneous: Other Subtractions” line of Schedule 511-A, Oklahoma Subtractions. This line item is intended to be used for claiming various allowed subtractions that are not specifically enumerated on other lines of the Schedule. This line item is subject to error, as it is not unusual for the taxpayer to put an entry on that line that could (and perhaps should) have been claimed on one of the other lines on the Schedule.
- **It is difficult to estimate the tax expenditure amounts of the individual components of the “Miscellaneous: Other Subtractions” line item.** This is primarily because six subtractions are reported on the line, each with a code linked to that subtraction:
 1. Royalty income;
 2. Manufacturer’s exclusion;
 3. Small business incubator;
 4. Payments as a result of a military member combat zone death;
 5. Payments to a spouse of a military member killed in combat zone;
 6. Allowable deductions not included in items 1-5;

In reviewing claims for tax year 2015, for example, the Oklahoma Tax Commission (OTC) found that 7.0 percent of the returns claiming a subtraction on this line were lacking a code linked to a specific subtraction. Roughly 85.0 percent of the returns claiming this subtraction used the ‘99’ code, which is the catch-all for “other” miscellaneous subtractions. Aggregating the returns that used the ‘3’ code for business incubator exclusions may or may not accurately reflect the number of returns and the amount being claimed.

Changes to Improve Future Evaluations

- **Improve the exemptions claims process.** The aggregation of small business incubator-related claims with several other deductions and exemptions makes it difficult to determine which claims are related to which deduction or exemption. Additionally, it is common for taxpayers to fill out the form incorrectly, which raises data reliability concerns. In order to avoid confusion on the subtraction being claimed, each deduction and exemption should have its own line item on Schedule 511-A.
- **Eliminate the income tax exemption for sponsors.** While the Small Business Incubators program by statute offers tax benefits to both incubator tenants and the incubators themselves, the sole beneficiaries of the tax incentive are and have been incubator tenants. This is because nearly all of Oklahoma’s incubators operate as non-profits and are not required to pay income taxes. In fact, very few for-profit incubators have been operated in the State.
- **Eliminate the requirement that tenants make at least 75 percent of gross sales out of state in order to qualify for years 6 to 10 of the tax exemption.** According to the Department of Commerce (Department), most tenants do not fulfill this requirement, and do not remain in the program after the fifth year.



Introduction



Incentive Evaluation Commission Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The Small Business Incubator Income Tax Exemption is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Industry and Incentive Background

Small businesses represent the majority of businesses in the U.S. and play a significant role in job creation. In 2015, the U.S. Small Business Administration (SBA) estimated that the country's 30.2 million small businesses (which include employers with fewer than 500 employees and nonemployer firms²) accounted for 99.9 percent of total U.S. businesses; the 58.9 million people employed by small businesses accounted for 47.5 percent of the country's private workforce. Given the important economic role played by small businesses, many states – including Oklahoma – have taken steps in recent decades to provide support to small businesses. One common method is the establishment of startup assistance organizations, such as business incubators. These entities provide a variety of services (including a physical location) for new small businesses.

In 1988, the Oklahoma Legislature passed the Oklahoma Small Business Incubators Incentives Act to “promote, encourage and advance economic prosperity and employment throughout the state” by offering income tax exemptions to both organizations qualifying as sponsors of small business incubators and the tenants of those incubators.³ According to Oklahoma Statutes (O.S. §74-5073), incubators are defined as “facilities in which small units of space may be leased by a tenant and in which management maintains or provides access to business development services for use by tenants” and the term tenant refers to a “sole proprietorship, business partnership or corporation operating a business for profit and leasing or otherwise occupying space in an incubator.”

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of these programs, the goals are to promote, encourage and advance economic prosperity and employment throughout the state. To assist in a determination of program effectiveness, the Commission has adopted the following criteria, which focus on the tenants of the program:

- Employment and payroll associated with qualified small businesses;
- Change in small business employment before/after the incentive;
- Change in small business employment in cities/counties within close proximity;
- Change in small business employment for Oklahoma versus surrounding states; and
- State return on investment.

The criteria focus on what are generally considered key goals of incentive programs (such as increased employment and payroll). Ultimately, incentive programs have to weigh both the benefits (outcomes related to

² The SBA defines a nonemployer firm as one that has no paid employees, has annual business receipts of \$1,000 or more and is subject to federal income taxes. Nonemployers account for about three percent of business receipts but make up an estimated 75 percent of all businesses.

³ Oklahoma Statutes §74-5072.



achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.