INCENTIVE EVALUATION COMMISSION
REGULAR MEETING MINUTES
OCT. 13, 2021; 10 a.m.
OKLAHOMA STATE CAPITOL
SENATE CONFERENCE ROOM 4S.9
OKLAHOMA CITY, OK 73105

MEMBERS PRESENT:
Lyle Roggow, President, Designee of the OK Professional Economic Development Council
Mandy Fuller, CPA, Auditor of Private Company
Earl Sears, Bartlesville, OK
Dr. Robert Dauffenbach, Economist
Mark Wood, Chairman, Tax Commission, Ex-Officio; Non-Voting
Dana Webb, OMES designee, Ex-Officio; Non-Voting

MEMBERS ABSENT:
Carlos Johnson, Certified Public Accountant
Brent Kisling, Director, Department of Commerce, Ex-Officio; Non-Voting

STAFF/GUESTS:
Beverly Hicks, OMES
Trace Jones, ODOC
Randall Bauer, PFM
Lyle Walters, OCAST
Amanda Hall, State Chamber
Andrea Frymire, Midwest Housing
David Oakley, LegisOK
Megan Holden, OTC
John Riesenberg, Governor’s Office
Jim Dunlap, American Airlines

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

   Chairman Roggow called this regular meeting to order at 10:03 a.m. A roll call was taken, and a quorum was established. A meeting notice was filed with the Secretary of State, and the agenda was posted in accordance with the Open Meeting Act.

2. **Approval of minutes from the August 25, 2022, Commission meeting:**

   Mandy Fuller moved to approve the meeting minutes for August. Rep. Earl Sears seconded the motion. The following votes were recorded, and the motion passed:

   Ms. Fuller, aye; Mr. Roggow, aye; Mr. Sears, aye; Dr. Dauffenbach, aye.

3. Presentation and discussion of draft evaluation reports for Year 7, 2021 incentives given by PFM Consultant Randall Bauer:

1. **Oklahoma Affordable Housing Tax Credit**
2. **Small Business Incubators Incentives**
3. **Applied Research Support Program**
4. **Health Research Support Program**
5. **Quick Action Closing Fund**
6. **Investment/New Jobs Tax Credit**
7. **New Products Development Exemption**
8. **Seed Capital Fund**
9. **Technology Business Financing Program**
10. **Technology Transfer Income Tax Exemption**

Affordable Housing Tax Credit – *Recommendation: Retain*. As in 2018, the project team recommends making the credit refundable rather than transferable so as not to dilute the resources dedicated to affordable housing.
***Findings*:** Between 2015 and 2021, a total of $27.9 million in state credits was issued. These helped create more than 3,700 affordable housing units in Oklahoma. The population restriction was eliminated in 2019, and eight newly eligible projects have been funded. These projects supported the development of 794 low-income units with $5.3 million in state tax credits. There has been little change in the availability of affordable housing in recent years. Oklahoma faces a shortage of 71,160 rental homes affordable and available for extremely low-income renters. Between 2015 and 2021, the program helped fund 57 projects – equal to 0.1 percent of the need.

Small Business Incubators – ***Recommendation: Retain, with modifications.*** Establish Standards for tenant occupancy to qualify for tax exemption. The program statute does not require businesses to be tenants in an incubator for a designated amount of time or performance before becoming eligible for the exemption. A business could establish tenancy then immediately depart the incubator while becoming eligible for the exemption. A business could establish tenancy then immediately depart the incubator while becoming eligible for the ten-year exemption. Increase data collection and require participation in the annual survey as a condition of occupancy in State-certified incubators.
Findings: On average, incubators collectively have 149 tenants per year. Because the number of incubators has slightly declined while the number of tenants has remained unchanged, the average number of tenants per incubator has increased by a compound annual growth rate (CAGR) of 2.4 percent. 16 of the 36 incubators categorize themselves as mixed-use, 16 focus on manufacturing/distribution, and seven target technology-centered businesses. There has been an increase in key indicators of incubator 'graduating' firms.

Applied Research Support (OARS) Program – ***Recommendation: Retain, with modifications.*** Further refine and improve data collection and reporting processes. While OCAST has begun collecting additional data points from its OARS grantees in recent years, evaluating the program's effectiveness effectively remains challenging due to data collection and reporting process issues. OCAST should collect additional information from grant recipients as part of its data collection and reporting processes, including jobs, payroll, economic activity, and success or failure rate. OCAST should conduct longitudinal case studies over a meaningful period of time for select companies. This would track the advance and development of the effects and benefits of applied research funded by the program, showing the synergy between grants, follow-on funding, and capital investment. OCAST should obtain data on when funds are spent and the purpose for fund expenditures for follow-on funding attained.

Findings**:** Between 2009 and 2021, there have been $36.8 million in OARS grant awards (an average of $2.8 million per year). On a year-over-year basis, total grants awarded have declined, decreasing by a compound annual growth rate (CAGR) of -7.1 percent. Recent OARs awards attracted $3.6 million in follow-on funds between 2016 and 2021. Recent OARS recipients reported filing 26 patent applications and having 27 granted; the reported value of the patents is estimated to be $136.0 million. In 2020 and 2021, prior OARS grant recipients formed 17 new companies, developed 115 new products or innovations, and filed 29 patents. Between 2016 and 2021, $16.0 million in OARS grants resulted in an estimated total economic impact of $178.5 million but $5.9 million of net revenue to the State. As a grant award program, 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.

Health Research Support Program – ***Recommendation: Retain with modifications.*** Further refine and improve data collection and reporting processes. While OCAST has begun collecting additional data points from its health research grantees in recent years, evaluating the program's effectiveness effectively remains challenging due to data collection and reporting process issues. OCAST should collect additional information from grant recipients as part of its data collection and reporting processes, including jobs, payroll, economic activity, success or failure rate, and industry sector formation. OCAST should conduct longitudinal case studies over a meaningful period of time for select grant recipients. This would track the advance and development of the effects and benefits of health research funded by the program, showing the synergy between grants, follow-on funding, and capital investment. OCAST should obtain data on when funds are spent and the purpose for fund expenditures for follow-on funding attained.

Findings: Between 2011 and 2021, $37.9 million Health Research grants were awarded, totaling $37.9 million (an average of $3.4 million per year). On a year-over-year basis, total grants awarded have declined, decreasing by a compound annual growth rate (CAGR) of -5.3 percent over that time period. In 2021, Health Research award payments totaled $2.5 million, representing approximately $1.8 million decrease from 2011. The total number of federal National Institutes of Health (NIH) awards funded annually in Oklahoma remained relatively stable: between 1992 and 2017, total awards increased by a CAGR of 0.5 percent. Recently, the state has seen a significant increase: between 2017 and 2021, growth was a CAGR of 10.6 percent. Total NIH funding in the State available under these awards has grown relatively steadily over time, increasing from $21.7 million in 1992 to $128.3 million in 2021, CAGR of 6.3 percent. From 2016-2021, Health Research Program grant recipients attracted approximately $84.3 million in follow-on funds, representing a significant benefit of the program. Recent Health Research Program grant recipients reported having ten patent applications granted; the value of the patents is estimated to be $2.0 million. Based on information collected by OCAST, in 2020 and 2021, prior Health Research Program grant recipients formed six new companies, developed 32 new products or innovations, and filed eight patents. Economic activity associated with program funding: In the aggregate, OCAST awarded approximately $18.5 million in Health Research Program grants between 2016 and 2021. OCAST reported a total financial impact of $183.4 million during the time period. Accounting for the direct, indirect, and induced impacts of the Health Research funds awarded, the Health Research program generated approximately $5.9 million in state tax revenue between 2016 and 2021, well less than the $18.5 million in awards granted over the time period. As a grant program with declining funding, adequate financial protections are in place.

Quick Action Closing Fund – ***Recommendation: Retain, with modifications.*** **Require more robust reporting on awards.** Oklahoma publicly reports only the award amount, the company name, award date, and a brief description of how the award will be used. Nearly all comparable programs have more detailed public reporting on projects that have received awards. Include an explanation of why each awarded project was considered "high-impact." The statute dictates that the QACF may be used when the award would "likely be a determining factor in locating a high-impact business project or facility in Oklahoma." However, no definition of "high-impact" is provided in the statute.

Findings*:* The Fund's unreserved fund balance has tripled since 2018, up to $18.6 million from $4.3 million. Legislative appropriations drove this increase, rather than the statutory five percent of all new Quality Jobs Program rebate payments the Fund started receiving in FY 2019. The Fund has made $36.9 million in awards, and two-thirds of the total award was made between FY 2021 and FY 2022. As more funding has been made available, more awards have been made. A total of $24.5 million was awarded between FY 2021 and FY 2022, but only $7.3 million of those have been paid as these projects continue to work toward performance thresholds. Fund award contracts are structured, so payment is not issued until performance thresholds related to jobs, payroll, and capital investment are met. Projects receiving awards were projected to create 6,752 new jobs at an average salary of $63,000. Projects that have received payments were projected to create 4,081 jobs. In comparison, another 2,681 projected jobs are associated with projects awarded in FY 2020 or later that are still working toward meeting performance thresholds. An analysis of companies awarded funds found as of 2022, these companies have a total of 7,470 employees in the State with an average salary of $83,818. The average projected capital investment per project is $151.4 million. Projects associated with awards that have been paid average $86.0 million, while projects in progress (with award payments pending) average $308.2 million. Assuming projections are achieved, for each $1.00 spent through the program award payments from FY 2018 through FY 2022, the economic impacts of participating companies generate $2.55 of new state tax revenue. Projected economic activity associated with companies receiving a total of $10.9 million in payments during this period would generate $1,602.6 million in economic impacts, creating $27.9 million in state tax revenue from employment, payroll, and investment activity. Nine of 12 companies that have completed QACF projects have also been awarded Quality Jobs Program contracts. Effective cost controls are in place. All awards are required to be revenue neutral as determined by a detailed analysis by the Department of Commerce. Claw back provisions are included in award agreements to return funds to the State if performance thresholds are not met. The award agreements are structured so that awards are not paid until performance goals are met.

Investment/New Jobs Tax Credit – ***Recommendation: Reconfigure***. Limit the carryforward period to seven years. The carryforward period for capital investment credits is indefinite, contributing to the continued growth in the State's unused tax credit liability. This is in line with the Commission's recommendation following the last evaluation of this credit. Require claims to be filed with the Tax Commission each year of the carry forward period, regardless of whether the credit is used to offset tax liability. Regular annual claims can require claimants to attest that the capital investment is still in use, and, in aggregate, these annual claims would provide the State a clearer picture of how much credit is still available to be used. Require an application and approval before allowing claims. The application would be submitted within 30 days of the capital investment being placed in service and would need to be approved before the taxpayer could claim the credit on a tax return. Applying in a timely manner would increase the likelihood that firms would have to plan on taking the credit when making a qualifying investment. Eliminate the new jobs credit in favor of incenting manufacturing job creation through the Quality Jobs Program. The Investment-New Jobs Tax Credit needs significant updates to its job creation requirements. As noted in critical findings, the minimum annual pay required of $7,000 is equal to 11.2 percent of the manufacturing's average annual pay in Oklahoma. There is also no requirement related to benefits provided to new jobs. Only one new job is required to receive a new job tax credit. Amend the statute to require data collection for incentive evaluation and usage tracking purposes. The OTC currently collects useful information for incentive evaluation purposes on its Form 506. However, this information is not stored in a way that is easily accessible for evaluators and legislators to understand who is claiming the credit and why. The statute should be amended to require the OTC to store this information for program evaluation purposes.
Findings: Use of the credit to offset tax liability has generally decreased over time, while unused carried forward credit has increased to $734.1 million as of TY2020. The OTC is not statutorily required to and does not collect data to analyze program effectiveness or track program use in detail. OTC provided more detailed information for one tax year upon special request. Without this information for each program year, evaluations will continue to be limited. An analysis of a set of claims submitted for investments or jobs placed in service during Tax Year 2019 showed the

following. Based on the economic activity associated with the claims, the credit generates $0.73 in new State tax revenue for each $1.00 of foregone State revenue. Nearly all the credits claimed were for capital investment, which accounted for 99.7 percent of new credits; less than one percent of credit claims were related to new jobs. This is in line with the previous evaluation of this credit that found 98.3 percent of new credit claims in Tax Year 2016 were for capital investment. New credit claims made in Tax Year 2019 were associated with $1,300 million in capital investment. Of this investment, 86 percent was in an Enterprise Zone in Oklahoma. Oklahoma's tax benefit ranks 9th of 11 among comparable state programs. Because Oklahoma's one percent credit is claimed over five years, the present value of the capital investment tax credit is four percent of the total investment cost, despite its nominal total benefit of five percent. In general, it is unlikely that the credit significantly influences business decisions: From TY 2008 through 2019, excluding years a cap was in effect, an average of 21.1 percent of the total reported value of credits claimed was used to reduce tax liability. The State's corporate and top individual income tax rate declined from 6.0 to 4.0 percent and 5.0 to 4.75 percent, respectively, starting in Tax Year 2022 and is likely to increase the amount of carried forward credit. The Investment-New Jobs tax credit does not require an application or advanced notice to receive benefits. The credit is claimed on tax returns, so firms may claim it regardless of whether it played a role in the investment decision. While the capital investment tax credit has been able to keep up with inflation and cost growth because it is a percentage of total investment, the new jobs tax credit as a fixed dollar amount has fallen behind. From 2001 to 2021, the value of the $500 tax credit per new job has declined from 1.5 percent to 0.8 percent of Oklahoma's average annual pay in manufacturing.
Key program requirements expressed as dollar amounts in the statute have not been updated since the credit was created in 1980. The minimum salary required to qualify for the new jobs tax credit is extremely low, at $7,000. This equates to 11.2 percent of Oklahoma's average annual pay for manufacturing in 2021. The minimum required investment amount of $50,000 has also not been changed since 1980. Adjusted for inflation, this is equivalent to about $170,000 in 2022.

New Products Development Exemption – ***Recommendation: Repeal.*** Improve data processing to collect and report the total cost of corporate tax exemptions. 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 disaggregation of the total cost of each corporate tax exemption. Modify program requirements to require companies to provide key data annually to be eligible for tax exemption. Currently, those wishing to take the tax exemption must register with OCAST. Still, there is no requirement that the inventor or manufacturer provide additional information that would be useful in determining the effectiveness or efficacy of the program. The inventor or manufacturer should be required to provide information on annual revenues, annual payroll, and FTEs, both the total number and the number located in Oklahoma, to be eligible for the tax exemption.
Findings: Royalty Income Tax Exemptions have declined from $452,462 in TY 2015 to $181,719 in TY 2020. The OTC does not calculate the total income excluded by manufacturers as part of

this program. While firms need to be approved through the OCAST registration process, the corresponding OTC data is only available in the aggregate. Based on data from 2015 to 2020, the New Products Development Income Tax Exemption may have a negative return on investment. Estimated tax expenditures were approximately $1.6 million, with an estimated tax revenue increase of roughly $0.5 million, for a total loss of $1.1 million. However, data limitations for the depreciable property exemption mean this is likely understating the impact. Two firms represent 93 percent of registration applications from July 2017 to July 2022, with one firm 91 percent of the total. This follows a similar pattern identified in the 2018 incentive evaluation of this program. Of the companies registered with OCAST for the royalty tax exemption, 3 of the 30 companies have also received the Investment/New Jobs Tax Credit. The company with the highest number of registration applications on file has also received nearly $1.4 million in Investment/New Jobs Tax Credits over TYs 2014 through 2016. Oklahoma's New Products Development Income Tax Exemption is broad-based relative to comparable state programs. Two of the three similar programs in other states target incentives for inventors in specific industries or small businesses. Oklahoma does not restrict its program by industry or company size.

Seed Capital Fund – ***Recommendation: Retain, with modifications.*** A current focus in software and biotech firms could be shifted over time to align with other statewide programs and incentives. Given the maturation of the venture capital industry in Oklahoma, it could be valuable to reexamine OSCF's role and mission in the market. Implementing the new pre-seed capital program in FY23 solves a significant challenge for firms accessing the TBFP. Additional research – in the form of surveys, in-depth interviews, and/or focus groups – should be conducted to identify remaining gaps for entrepreneurs that can be supported through the OSCF and its associated programs. Improve data collection and reporting. Annual data collection and reporting should be modified to collect data that better ties business performance to the initial investment made by the fund. This would improve future evaluations and more accurately describe the program's benefits. The annual survey should collect growth in employment, wages, revenue, and profitability measures.

Findings: From 2008 to Q3 2022, OSCF closed 83 investments totaling $31 million in 44 companies. Companies receiving funding have made repayments totaling more than $9 million to the fund. From 2008 to Q2 2022, total capital investment in Oklahoma by companies receiving OSCF funding reached $272 million. The capital investment amount is approximately 8.8 times the initial investments made over that period. Since establishing the first fund Series in 2007, the OSCF has leveraged more than $700 million of private capital. This represents an approximate 23:1 leverage ratio. From 2008 to 2021, for the economic impact that can be measured, the OSCF has a negative internal ROI. However, this does not include impacts from additional capital invested in Oklahoma due to these early, strategic investments in seed-stage companies. The fund is also revolving so that future repayments and investment returns can be recycled. The most common OSCF investment recipients are companies operating in the biopharmaceutical or computer software industries. These industries account for 68 percent of the total number of investments and 70 percent of the total dollar amount of investments made. According to data from the National Venture Capital Association, Oklahoma ranks 46th among all states in the number of companies receiving investment, venture capital deals, and total dollars invested. After making up ground compared to nearby states in the last evaluation, Oklahoma has continued to grow, but not as quickly as states such as Kansas and Arkansas. Data collection and reporting improvements are needed. Data reported by i2e is collected via an annual survey of all participating firms. The response rate of firms varies yearly, so there can be no time-series trend drawn from the data. There is also no information collected that identifies the sector where each job is created or at what stage in the investment's lifecycle it was made.

Technology Business Financing Program – ***Recommendation: Retain, with modifications.*** Require program participants to respond to annual surveys. There is 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.
Findings: The data is insufficient to determine the program's economic impact. i2E, the program administrator, conducts annual surveys of the number of jobs, average salary, and annual revenue of program participants. Fluctuations in responses mean the data can only offer a snapshot of a sampling of participating companies. Of the $12.9 million in funding advanced, $6.3 million has been repaid. With no new appropriations planned for the TBFP, current projections estimate the program will run out of funds between 2036 and 2058. TBFP portfolio companies have a four-year survival rate of 66.2 percent. The average four-year survival rate for Oklahoma establishments, in general, has been 54.5 percent since the program's inception. This suggests the program may be providing some advantages to participants. The most common OSCF investment recipients are companies operating in the biopharmaceutical or computer software industries. These industries account for 68 percent of the total number and 70 percent of the dollar amount of investments made.

Technology Transfer Income Tax Exemption – ***Recommendation: Retain, with modifications.*** Enhance data collection through changes to current corporate tax forms. OTC staff expressed the opinion that the contemporary tax forms are viewed as burdensome for taxpayers, and the OTC seeks to streamline and reduce the required data rather than increase it. Their general perspective is that increased complexity leads to more significant taxpayer reporting errors. While this is an understandable perspective, there is also a public policy need for data and information associated with tax expenditures. Given that digital tax preparation software is widely used, and many impacted taxpayers probably retain tax preparation professionals, the OTC should consider targeted, high-value additions to these forms to improve data quality. Shift administration of the program to a contract-based agreement with the Department of Commerce. The authorizing statute could require that the Department approve those wishing to take the exemption of Commerce. The Department of Commerce could then make data reporting an annual requirement for program approval. Consider reconfiguring the program to incorporate best practices from benchmark programs. This might include converting the income tax exemption to a grant, as has been successful in the Arkansas example. Specifically, the program could be altered to reduce costs for entities generating technology that can be transferred, as opposed to the corporations that acquire the technology. Funding can also be diverted to support services such as technical assistance for small businesses applying for STTR awards or connecting small businesses and entities such as colleges and universities that frequently develop these desirable technologies to generate additional opportunities to commercialize these products and services.

Findings: The OTC is unable to provide data on the use of the exemption. Corporate tax exemptions are claimed through Form 512 as part of the calculation of Oklahoma taxable income for corporate income tax returns. The OTC collects this information through a "Miscellaneous Other" exemptions form box – the Technology Transfer program represents one of five possible exemptions that can be listed in that space. Despite many other states having similar goals, Oklahoma is the only example of this particular strategy to incentivize the relevant activities. The state offers grant funding in Arkansas to reduce business technology transfer costs. Other states supplement federal programs, including the Small Business Technology Transfer (SBTT) program, by offering technical training, funding to complete the SBTT application process, or matching grants for federal funds received.

The ten evaluations from PFM were recommendations only. No action was taken.

4. **Overview of Public Hearing Guidelines for meeting on October 27, 2022:**

   Chairman Roggow gave an overview of the guidelines for public hearing.

5. **Announcements:**

   Chairman Roggow announced that the public hearing is on Thursday, October 28, 2021, at 10:00 a.m., in Senate Conference Room 4S.9.

6. **Adjourn**

   There being no further business, Mr. Sears made the motion to adjourn. Mandy Fuller seconded the motion. Seeing no opposition, the meeting adjourned at 11:43 a.m.