

Memorandum

To: Economic Development Committee

From: Elizabeth Lynam, and Tammy Pels

Date: February 19, 2010

**RE: Overview of Economic Development Programs in the Governor's
2010-11 Executive Budget**

Dennis Mullen, the CEO of Empire State Development (ESD), will be joining us at our next Committee meeting on February 24, 2010 to discuss the Governor's new program proposals. After his talk we would like to discuss with the Committee whether CBC should support the proposals as they are considered this session by the Legislature. Staff has prepared this memo to brief Committee members for the meeting. Part I summarizes the proposals and Part II evaluates them against key criteria and similar programs in select states. An appendix summarizes comparable programs in New York's neighboring states.

I. Overview

With the Executive Budget the Governor proposed five new economic development programs, the most significant of which is a jobs credit program to replace the Empire Zones, to be called the "Excelsior" jobs program. The Empire Zone program is slated to sunset this coming June. Current beneficiaries will continue to get tax breaks for the remainder of the approved period but no new applicants will be accepted. Current beneficiaries have the option to apply for the new Excelsior program but will be accepted only if they meet the new criteria and rescind their participation in an Empire Zone. Other smaller programs include a matching grants program to provide research funds to universities, a small business revolving loan fund to provide credit for ventures that might otherwise have limited access to capital, a technology seed fund to help tech entrepreneurs avoid early stage burnout from lack of financing, and a manufacturing legacy program that would help create business partnerships to re-purpose vacant manufacturing facilities.

Excelsior Jobs Program – This is by far the most significant new program proposed in terms of funding and potential participation. It is meant to replace the Empire Zones program, which sunsets in June of this year. The program has three refundable components.

1. A new jobs tax credit of between \$2,500 and \$10,000 per job. The exact value of the credit will be determined by regulations to be promulgated after the program is approved. The intention of ESD is that the formula for the credit includes weightings for 1) the quality of the jobs created, with higher salaried positions carrying higher value, and 2) the economic

distress of the location, perhaps based on unemployment figures. To be eligible firms must create and maintain at least 50 jobs. The credits are refundable, with a payout to the firm if the credit exceeds its tax liability.

2. The Excelsior Investment Tax Credit (ITC) valued at two percent of total qualified investments, as defined by the IRS.
3. A Research and Development (R&D) Tax Credit designed to match the federal R&D credit at 10 percent of new eligible investments. The program has one small difference from the federal program—it would apply the credit only to capital, not operating expenses.

To be eligible for the Excelsior program a firm would apply to ESD using a uniform application. If approved the firm would receive a five year commitment to participate in the program. Upon creating and maintaining the jobs in any year of the five, the firm would receive the tax benefits. The first application year would be fiscal year 2010-11, and the first year for benefit pay-outs would be fiscal year 2011-12 for the prior year's results. The program is capped at \$50 million in each year of the five-year statutorily-authorized period. Targeted industry areas would include high-, bio-, clean-, and green-tech, and pharmaceutical, financial services, and manufacturing.

Innovation Economy Matching Grants Program – Grants would be given to universities at a 10 percent matching rate to private funds through a competitive bidding process prioritizing scientific and economic benefits to the State. The program will be funded over five years from the American Recovery and Reinvestment Act stimulus money and would be authorized by statute to spend up to \$100 million over that period.

Small Business Revolving Loan Fund – The program would provide business development loans to small business owners that have traditionally had difficulty accessing the capital markets. Funds in the amount of \$25 million would be turned over to local lenders that have relationships with business owners in the community. Women- and minority-owned businesses would be targeted. The concept is that these loans would be made by local financial institutions and paid back so that the program becomes self-funding.

New Technology Seed Fund – This fund would be for technology entrepreneurs working in university-sponsored facilities. The intent of the program is to help avoid “the valley of death” that challenges the arrival of new tech products in the marketplace because their developers lacked capital at the critical middle phase of the R&D continuum. Consequently, start-up and early stage small business would be targeted to receive these funds. Universities would administer the funds and would theoretically be able to select the most promising new companies from their satellite R&D communities. The fund would have \$25 million.

Manufacturing Legacy Program – This program would seek to develop local-State-business alliances to redevelop physical plant no longer needed for

manufacturing. The alliances would identify sites and commit to plans to repurpose abandoned space for other more productive community uses. Local Industrial Development Agencies could participate should incentives be necessary. No legislation is required for this program.

II. Evaluation

The CBC staff conducted a preliminary evaluation of the program proposals for the Committee’s consideration using three criteria: 1) budgetary impact; 2) design improvements over earlier economic development programs; and 3) improvement of New York’s competitive position and efforts to attract innovation enterprise relative to other states.

Budgetary Impact

The budgetary impact of the new program proposals is negligible in the short run but grows in the out years. The largest expense will be the Excelsior program which, although capped annually at \$50 million, will cover five years for a total program cost of \$1,250 million. (See Table 1.)

Table 1
Excelsior Jobs Program
Expected Spending, Fiscal Years 2010-11 to 2020-21
(Dollars in millions)

<u>Award Year</u>	<u>Annual Commitment</u>	<u>Cash Payment Schedule</u> <u>(Fiscal year based on prior year results)</u>											<u>Cumulative Total</u>
		<u>2010-11</u>	<u>2011-12</u>	<u>2012-13</u>	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>	<u>2018-19</u>	<u>2019-20</u>	<u>2020-21</u>	
2010-11	\$ 250	-	-	50	50	50	50	50	-	-	-	-	\$ 250
2011-12	250	-	-	-	50	50	50	50	50	-	-	-	250
2012-13	250	-	-	-	-	50	50	50	50	50	-	-	250
2013-14	250	-	-	-	-	-	50	50	50	50	50	-	250
2014-15	250	-	-	-	-	-	-	50	50	50	50	50	250
Total	\$ 1,250	\$ -	\$ -	\$ 50	\$ 100	\$ 150	\$ 200	\$ 250	\$ 200	\$ 150	\$ 100	\$ 50	\$ 1,250

Source: Empire State Development.

Two of the proposed new programs—Innovation Economy Matching Grants and Small Business Revolving Loan Fund—are not funded by ESD. The matching grants will be supported with \$100 million in federal stimulus aid and the New York Power Authority will contribute \$25 million to seed the small business loan fund. The \$25 million New Technology Seed Fund will be paid for by ESD and accounts for the lion’s share of the planned \$34 million increase in the authority’s budget. No funds are to be made available for the Manufacturing Legacy program.

Design Improvements Over Prior Programs

The work of CBC and others helped to identify serious accountability and design flaws in New York's existing portfolio of economic development programs. In developing the Excelsior program proposal ESD addressed some of these flaws expressly in the authorizing statute and has indicated that it will address others in regulatory oversight guidelines to be developed after the program is enacted. The argument for the separation is that some items are more appropriate for statute and others for regulation. Regulations require a labor intensive six-month process that arguably would not be an appropriate use of staff time at ESD unless the program is enacted by the Legislature. Some critiques have been left unaddressed in the current slate of proposals.

The statutory provisions include:

- Retroactive payment – Firms will only be paid for the prior year's results. Program credits will be based on actual rather than projected performance. This will be the case for all three components of the program -- jobs creation, investment, and R&D tax credits. No payments will be made to firms failing to meet performance targets.
- Local administration no longer – The complicated dual administration of the Empire Zones will end as the pay-outs from that program end. Administration of the new program will be by ESD alone, although it is hoped there will be local participation in the selection of promising firms to apply for the new credits.
- Verifiable by external data – ESD will be authorized to use external databases from the Department of Labor and Tax and Finance to validate firm claims. This is an accountability tool currently employed by the New York City Economic Development Corporation.
- Standard job creation definitions will be used – To get credit jobs created must be full-time and at least six months in duration. Firms must create at least 50 jobs to be eligible for the program, a feature that ESD claims will let in only “going” concerns that have a better chance of success.
- Eligible industries to some degree specified – The statute contains specific definitions of the types of firms that could receive credits. These include financial services, manufacturing, and high tech. However, there is also an “other” category for applicants to be deemed worthy at the discretion of the head of ESD. The definitions do seem to rule out a retail applicant, which was not the case in the Empire Zones, but there is a degree of administrative discretion allowed. At this point ESD estimates that about 3,000 of the 9,000 firms currently in the Empire Zones program would be eligible for Excelsior consideration. Note that manufacturing and financial services are included among the selected industries, perhaps to ensure that the upper-left and lower-right-hand corners of the State can be enthusiastic about the program.

Regulatory provisions to be drafted later include:

- Targeting – Degrees of need and quality to be measured – The amount of the credits per job will vary. Areas in dire economic straits could receive greater credit per job. Officials at ESD indicate that they would use unemployment or a similar tangible metric of economic hardship in the formula that will generate the value of the credit to be awarded to any one eligible firm. According to ESD, the caliber—wages and benefits—of the jobs created will also be a factor in determining the award size, an improvement over the Empire Zones’ treatment of all jobs as equally meritorious of credit. The formula that varies the award could be used to limit the spread of the program to well-to-do areas of the State and to prompt the creation of higher quality jobs.
- Selection criteria and application process – The metrics and process to be used in selecting firms for the program will be determined later. This means that the complexity of the process firms now encounter as they seek assistance from the State may or may not be addressed. In addition, questions remain about whether firms could apply for just one of the programs or must qualify for all three. The Business Council, for example, argues that capital investment alone should be considered meritorious even if in some cases jobs are replaced by capital, if it helps the firms in question become more profitable.

Not addressed in ESD’s new agenda is the fragmentation of programs and subsidies identified in CBC’s reports. Power subsidies will continue under separate governance (unless the legislature moves to change those programs, several of which are due to sunset during this year.) The new programs are not integrated under a strategic plan that is coordinated with other efforts to meet specific goals. In addition, it is unclear what reporting requirements, if any, will be placed on ESD so that the new metrics and the actual results of the new slate of programs can be examined by the public.

Improvement of New York’s Competitive Position

Two questions related to improving New York’s position were considered. These are:

1. Were the recommendations of the recent report by the Task Force on Diversifying the New York State Economy through Industry-Higher Education Partnerships followed?
2. How do the depth, design, and accountability measures associated with the program compare with programs of immediate neighbor states?

Findings and Recommendations of the Task Force and Others

In the past year several organizations have identified difficulties in New York’s strategies to increase economic activity by supporting innovation sector firms. The Governor convened his own Task Force chaired by the President of Cornell University. The Center for an Urban Future completed a study of New York City’s climate for innovation and

the Business Council also released recommendations recently. Their findings are summarized below.

1. New York lacks a fully functioning innovation ecosystem (as defined as communication and collaboration between business, government, academia and investment community).
2. New York places too little emphasis on new business creation and entrepreneurial activity and too much emphasis on large business retention and expansion.
3. New York is not recognized as an innovation hub or as friendly to new business start-ups.
4. State policies are driven by political and geographic concerns.
5. New York businesses invest heavily in research and development but not all within New York's boundaries.
6. New York's academic institutions are more focused on producing revenue from patents and royalties than working with outside industry partners.
7. New York has little capital available for early-stage companies developing through the "valley of death," from technology maturity to profitability.
8. Professional investors are not sufficiently aware of investment opportunities at New York's universities.

In addition, the Industry-Higher Education Task Force recommended the adoption of a research and development tax credit that is based on eligibility requirements for the existing Federal R&D tax credit and provides a deeper tax credit for companies collaborating with institutions of higher education located in New York State. The R&D recommendation was incorporated. However, the design could have been more explicit in providing incentives for collaborative partnerships as some other states do and the Task Force itself recommended.

The impetus for the Excelsior and the other programs in part stems from the work of the Task Force. Although Excelsior is not as much for start-ups because of its relatively high 50-job requirement, the other loan, seed capital, and matching fund will help.

2) Findings from Other States

Among the neighboring states of New Jersey, Connecticut, and Pennsylvania, job credit programs appear to be smaller in total cost and much less per job than is proposed for Excelsior. For example, New Jersey and Pennsylvania provide about \$1,000 per job. However, their job creation thresholds are lower—25 jobs with some preferential treatment for small businesses. Connecticut's credits are nonrefundable and only available for new businesses. New Jersey's program costs \$7 million and Connecticut's is capped at \$10 million.

New Jersey and Pennsylvania's other innovation economy programs have favored an innovation zone approach, and do more to specify the nature of the collaborative relationships required than what is being proposed in New York. This may help to spur the growth of the kinds of communities New York's Task Force report advocates. New

Jersey has a dozen differentiated programs, presumably to meet a variety of needs of start-up and emerging high-tech firms. Pennsylvania's Ben Franklin Partners invests alongside angel investors and guarantees up to 25 percent of private investments to attract private capital to support new businesses.

The proposal to increase New York's R&D tax credit to 10 percent to conform to federal thresholds appears to put New York on competitive ground. New York's proposal is superior to Pennsylvania and Connecticut's and on par with New Jersey's. In addition, New York's would be more favorable than those of Colorado, North Carolina, and Texas. (See Table 2.)

Table 2: Research & Development Tax Credit Comparison (with new NY proposal)

	Effective Tax Rate	Applies to			Carry Forward	Refundable	Transferable
		Incremental Expense	Non-Incremental Expense	Capital Investment			
CA	13.7%	✓			✓		
CO	3% (only if in Enterprise Zone)	✓					
CT	6.0%	✓	✓		✓	✓ (partial refund for small biz)	
MA	10.0%	✓					
NJ	10.0%	✓					✓(operating losses also transferable)
NY	10.0%			✓		✓	
NC	5.0%	✓			✓		
PA	0.9%	✓					✓
TX	5.0%	✓			✓		

APPENDIX: Comparable Programs in Neighboring States

New Jersey - The New Jersey Economic Development Authority selects award recipients to participate in the Business Employment Incentive Program (BEIP) and administers the program.

- Eligible businesses must create 25 jobs within two years. However, emerging high technology and biotech companies are only required to create 10 jobs. Eligible businesses must demonstrate that the incentives are a critical component of the firm's expansion plans. Once eligibility is confirmed, businesses can receive benefits for up to 10 years.
- Benefits equal between 10 percent and 80 percent of the withholding taxes paid by new company employees. The exact award amount is based on several criteria, including wages, number of new jobs, industry, private sector investment, capital investment, location in distressed area, links to housing development or community redevelopment, transportation benefits, and research and development connection to a university.
- Program recipients must adhere to several transparency and accountability regulations: 1) allow the NJ EDA full access to company records for audits, 2) retain new jobs for 1.5 times the number of years of the award life, and 3) submit annual reports with state and federal tax returns. The Division of Taxation is empowered to compare annual report data with state tax records for consistency.
- The total cost of BEIP in fiscal year 2006 was \$6.9 million and the program generated an estimated 6,397 new jobs. This translates into an annual commitment per job of \$1,085. The BEIP is based solely on withheld payroll taxes.

In addition to a 10 percent research and development tax credit, New Jersey maintains a host of different niche programs.

- Unprofitable technology companies with less than 225 U.S. employees are eligible to sell net operating losses and R&D credits to unrelated corporations.
- Early-stage life sciences or technology companies that have received a grant for applied research may receive financing equal to 20 percent of approved New Jersey Commission on Science & Technology grants for indirect costs, up to a maximum of \$100,000. Life science or technology companies that have not yet achieved proof of concept can apply for financing of up to \$200,000 for beta testing. Life science or technology companies that *have* achieved proof of concept and need capital to support revenue generation can apply for financing of \$200,000 to \$1 million.
- Manufacturers of clean energy can apply for up to \$3.3 million in grants and interest-free loans.
- Technology companies involved in the production of digital media content can apply for a corporate tax credit equal to 20 percent of expenses.
- Companies can access new talent and expertise by being sponsored for fellowships to employ recent doctoral graduates of New Jersey universities. Award amount is \$65,000 salary for the first year and \$75,000 for the second,

with an additional \$10,000 each year to be spent on career development expenses for the postdoctoral fellow.

- The Incubator Seed Program provides awards ranging from \$20,000 to \$50,000 in competitive funding to assist emerging businesses achieve milestones in their commercialization path. Eligible projects involve: marketing, sales, or distribution strategies; prototyping; patent applications, searches or strategies; product development, and manufacturing and customer trials. Business must be located within one of the 14 State-supported incubators.

New Jersey has also created three Innovation Zones that encompass state universities, research institutions and related businesses. The zones include areas within the cities of Camden, Newark and the Greater New Brunswick areas to encourage collaboration and the transfer of scientific research to business. Enhanced financial incentives are available to eligible technology and life sciences businesses locating there. Each Zone also has an existing or planned state-of-the-art technology center, offering companies opportunities to lease office, wet and dry laboratory, and production space.

Pennsylvania - The Pennsylvania jobs program is called the New Job Creation Tax Credit.

- To be eligible, a business must create at least 25 new full-time jobs or increase its number of full-time employees by at least 20 percent within three years of the start date.
- The credit equals \$1,000 per full-time employee.
- In any year, 25 percent of the allocated credits must go to businesses with fewer than 100 employees.

Pennsylvania runs the Keystone Innovation Zones (KIZ) that require certain types of partnerships likely to make market introduction of new products more likely. In order to qualify for KIZ designation, partnerships must include an institution of higher education and a combination of the following types of entities: economic development organizations, private sector businesses, business support organizations, commercial lending institutions, venture capital, and foundations. Recommended partners include local government organizations and workforce development organizations.

- Companies located in a KIZ in operation for fewer than eight years may claim a credit equal to 50 percent of the increase in the company's gross revenues in the prior year. Unused credits may be carried forward for four years or, with State approval, can be sold or assigned.
- Annual statewide allocation is capped at \$25 million; the maximum credit per company is \$100,000.

Pennsylvania's Ben Franklin Technology Partners (BFTP) focuses on technology-driven enterprises in sectors such as information technology, life sciences, communications, advanced manufacturing, advanced materials and environmental technology.

- BFTP invests alongside angel investors and requires a 1:1 match.

- The Fund makes seed, early-stage, and growth capital investments ranging from \$100,000 to \$500,000. The fund provides a direct guarantee of up to 25 percent of the investment made by investors.

Pennsylvania also runs the New PA Venture Capital Investment Program. At least 50 percent of the funds must be made available to VC partnerships with senior partners in smaller Pennsylvania counties.

Connecticut – The New Jobs Creation Tax Credit, is available only to *new-to*-Connecticut businesses that create at least 10 jobs. The tax credit equals 60 percent of state withholding taxes from new employees. A credit may be granted for 5 successive years for each new job. Credits are non-refundable and not permitted to be carried forward. The cap on the program is \$10 million.

The innovation fund run by Connecticut is called Connecticut Innovations (CI.) CI finances investments solely through its own investment returns. CI focuses on the following sectors: bioscience, information technology, photonics/applied optics and energy/environmental systems.

- Since 1995, CI has invested \$133 million in Connecticut companies.
- CI also manages two targeted funds, CT BioSeed Fund and CT Clean Energy Fund. The BioSeed Fund has \$5 million available to help accelerate the growth of early-stage biotech enterprises in CT that are working to solve unmet medical needs. Initial investments range up to \$500,000. The Clean Energy Fund is overseen by the 15-member Connecticut Clean Energy Fund Board and funded by a surcharge on residential and commercial electric bills