

Approved: January 15, 1999
Date

MINUTES OF THE SENATE COMMERCE COMMITTEE.

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on January 14, 1999 in Room 123-S of the Capitol.

All members were present except:

Committee staff present: Lynne Holt, Legislative Research Department
Jerry Donaldson, Legislative Research Department
Bob Nugent, Revisor of Statutes
Betty Bomar, Committee Secretary

Conferees appearing before the committee:
Mikel Miller, Director of Research, Kansas, Inc.
Gary Sherrer, Lieutenant Governor/Secretary, Department of Commerce and Housing

Others attending: See attached list

Ms. Mikel Miller, Director of Research, Kansas, Inc., presented a report on *Evaluation of the High Performance Firms Incentives Program (HPIP), Kansas Department of Commerce & Housing, May 1998*, (A copy is on file in the office of the Legislative Research Department). Ms. Miller stated the High Performance Firms Incentives Program (HPIP) statute was passed by the Kansas Legislature in 1993, and requires Kansas, Inc., perform a study of the programs effectiveness and report the findings, along with recommendations for its continuation, discontinuation, or alteration to the Kansas Legislature during FY 1998. (Attachment 1)

HPIP was designed to offer incentives to accomplish three goals: 1) Encourage the retention and expansion of existing "high performance" firms; 2) Encourage the attraction of "high performance" firms to Kansas; and 3) Encourage other Kansas firms to move toward becoming "high performance" firms. The incentives offered to achieve these goals are: Kansas Income Tax Credit equal to 10% of capital investment that exceeds \$50,000, Sales Tax Exemptions on certain purchases, Workforce Training Income Tax Credits; Matching Funds up to \$12,500 for consulting services; and Priority Consideration for certain business assistance programs. Ms. Miller stated in order to receive HPIP incentives, a firm must be certified annually through the Kansas Department of Commerce & Housing (KDOCH) and pass the following three basic tests:

- 1) Firm type: a. Manufacturing,
b. Transportation/Communications/Utilities, Finance/Insurance/Real Estate, and
c. Business Services;
- 2) Workforce training expenditures, in excess of 2% of total payroll in one of the KDOCH programs; and
- 3) Firms must demonstrate they pay above average wages for firms of like type and size in similar areas.

Ms. Miller stated Kansas, Inc., found the program to be effective and is recommended for continuation with consideration of 7 modification, 5 of which are related to internal program administration. One recommendation would amend the HPIP statute to include warehousing, wholesale trade and distribution sectors among those firms eligible for certification. Inclusion of the wholesale trade and distribution sectors will complement the targeted industrial recruitment plan adopted by the KDOCH and is in keeping with sound economic theory.

Lt. Governor Sherrer, Secretary of the Department of Commerce and Housing responded to recommendations made in the Report. The Chair asked Lt. Governor Sherrer to provide the Committee a clarification of his position on the recommendation regarding the audit process as well as a report

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on the number of certifications given to insurance companies and financial institutions since the passage of SB 416 in the 1998 Legislative session.

Gary Sherrer, Lt. Governor/Secretary, KDOCH, stated the Department uses one-third of the EDIF money, which is less than 25% of the agency's budget. The general fund provides about 2% of their budget, and the remainder of their budget is federal money.

Lt. Governor Sherrer addressed three issues: 1) Accountability; 2) Changes made in the Department; and 3) Return on investment in FY 1998.

Lt. Governor Sherrer stated a review is made periodically by Kansas, Inc., of the various agency programs. Each division of KDOCH prepares a plan which is measurable and specific as to objectives, job creation, extension of services and trade and number of new business who will get involved in trade. The plans are up-dated quarterly. The budget submitted is a performance based budget. Internal quality measurements are maintained and the Annual Report is program specific.

Lt. Governor Sherrer reported the following changes made within the Department: eliminated the position of librarian and the library; added the IMPACT program as a result of legislative action; enhanced the KEIEP, HPIP programs; expanded the Enterprise Zone; insurance and privilege tax issues; and created incentives without walls, which has impacted the Main Street communities. The Department has initiated a consolidated plan which sets aside certain housing tax credit monies, federal monies in community development, sewer, water programs, etc., economic development monies, and tourism development monies to utilize these monies in communities to permit completion of a whole program rather than a doing a program piece-meal. The STEP program, a matching grant program which allows communities to utilize in-kind labor as their matching fund requirement was initiated. Training equipment grants have been tied to the businesses that need the work force, and two of the four Travel Information Centers have been privatized. The Department has reduced its staff five percent.

Lt. Governor Sherrer stated some of the achievements are: From an initial investment of \$20 million in EDIF, 1100 jobs were created in Wyandotte County, with the lowest pay being \$8.50 per hour with fringe benefits and day care facility, with a \$50 million payroll. In Topeka, 775 jobs were created with a \$26 million payroll. The State created 1785 jobs with a total payroll of \$70 million with a \$20 million investment. Lt. Governor Sherrer provided additional examples of economic development activities throughout the state, where jobs have been created as a result of the incentives and programs the state has initiated over the last four years.

Lt. Governor Sherrer advised there has been a 1.1% population growth in Kansas, which is the highest the state has experienced in the last 37 years.

Upon motion by Senator Ranson, seconded by Senator Steineger, the Minutes of the January 13, 1999 meeting were unanimously approved.

The meeting was adjourned at 9:00 a.m.

The next meeting is scheduled for January 15, 1999.

Kansas, Inc. Testimony
Presented to Senate Commerce Committee
January 13, 1999

Evaluation of High Performance Firm Incentives Program (HPIP)

Purpose of the Report.

In 1993, the Kansas Legislature passed KSA 74-50,131 which instituted the High Performance Firms Incentives Program (HPIP) in Kansas. The statute also required that Kansas, Inc. perform a study of the program's effectiveness and report the findings, along with a recommendation for its continuation, discontinuation, or alteration to the Kansas Legislature during FY 1998.

That study was completed and published in May, 1998. Copies of the completed report were disseminated to all members of the Kansas legislature at that time. The report was also presented to the Joint Committee on Economic Development in October of last year.

Program Background

The High Performance Firms Incentives Program (HPIP) was conceived by Kansas, Inc. and proposed as SB 73 to the 1993 Legislature as part of a series of initiatives aimed at implementing "A Kansas Vision," the state's new strategic plan for economic development. The designers of HPIP hoped to offer incentives significant enough to accomplish three distinct goals:

- 1) Encourage the retention and expansion of existing "high performance" firms;
- 2) encourage the attraction of "high performance" firms to Kansas; and
- 3) encourage other Kansas firms to move toward becoming "high performance" firms.

Incentives Offered

To achieve these goals, the Legislature saw fit to provide HPIP certified firms the following incentives:

- **Kansas Income Tax Credit** equal to 10% of capital investment that exceeds \$50,000. The credit may offset 100% of the annual tax obligation and has a ten-year carryover provision. Credits may be used in any year during the ten-year carryover period in which the firm meets program requirements.
- **Sales Tax Exemption** on purchases of all materials and labor related to a capital investment.
- **Workforce Training Income Tax Credit** of up to \$50,000 for investment in employee training and education that exceeds 2% of payroll costs. There is no carryover provision for these credits.
- **Matching Funds** of up to \$12,500 to reimburse the firm for up to 50% of the costs of approved consulting services aimed at improving business operati

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Attachment #1-1 thru 1-5

- **Priority Consideration** for business assistance programs administered by the Kansas Department of Commerce & Housing (KDOC&H), the Kansas Technology Enterprise Corporation (KTEC), or the Mid-America Manufacturing Technology Center (MAMTC).

Firm Eligibility

To receive HPIP incentives, a firm must first be certified through the Kansas Department of Commerce & Housing. The enabling statute requires a firm to pass three basic tests to become eligible for certification as an HPIP firm. These basic tests involve 1) firm type, 2) workforce training expenditures, and 3) wage rates. Appendix B of the report provides a diagram illustrating the discussion to follow.

Firm Type. Currently, to be eligible for HPIP certification a firm must be within one of the three following categories:

- 1) Manufacturing (SIC Codes 20-39);
- 2) Transportation/Communications/Utilities (SIC Codes 40-49)
Finance/Insurance/Real Estate (SIC Codes 60-67)
Services (SIC Codes 70-89);
- 3) Corporate or Regional Headquarters or Ancillary Support (back office) Operations of a national or multinational corporation regardless of SIC Code.

An additional test is required for any business in category two above. Firms in this category must demonstrate that more than 50% of their gross revenues are the result of sales to 1) Kansas manufacturers, or 2) commercial or governmental customers outside the state, or 3) a combination of both. (See Recommendation #2)

Workforce Training Expenditures. In addition to being the right type of firm, companies wishing to qualify for HPIP certification must either spend at least 2% of total payroll on worker training or participate in one of the Department of Commerce & Housing's workforce training programs. Those would include the Kansas Industrial Training (KIT) program, the Kansas Industrial Retraining (KIR) program, and the Kansas Investment in Major Projects and Comprehensive Training (IMPACT) program.

Wage Rates. A firm must also demonstrate that it pays above average wages for firms of like type and size in similar areas of the state.

Program Funding

The program receives a direct line item EDIF allocation which is used to fund matching grants for approved private consulting services. Program administration is funded through the operations budget of the Business Development Division of KDOC&H.

A total of \$300,000 has been appropriated for reimbursement of consulting fees between FY 1994 and FY 1998. The FY 1999 Governor's Budget did not include funding for this portion of the

HPIP program. A complete accounting of historical line item EDIF funding and usage is contained in Figure 11 of this report.

Kansas, Inc.'s evaluation methodology

Kansas, Inc. used a number of research techniques in the accomplishment of this evaluation. Among them were:

- A confidential survey of HPIP firms certified between FY 1994 and FY 1997. A 92% response rate was achieved.
- Analysis of program records and materials
- Extensive interviews with program manager
- Program's economic impact as measured by Kansas, Inc.'s economic modeling software

Major Findings of Evaluation

- ▶ Overall, the HPIP program was found to be effectively meeting its statutory goals and is recommended for continuation with consideration of the following modifications.
- A total of 64 firms have been certified for HPIP benefits by KDOC&H between FY 1994 and FY 1997. A total of 95 certifications have been granted these 64 firms.
- ▶ The average HPIP certified firm is a manufacturing company with less than 300 workers located either the Northeast or South Central region of the state.
- ▶ A total of \$645.3 million in investment was reported in connection with HPIP certified firms between FY 1994 and FY 1997.
- ▶ A total of 3,430 jobs were created in connection with HPIP certified projects between FY 1994 and FY 1997.
- ▶ The 64 HPIP firms earned an estimated \$66.0 million in state income tax credits between FY 1994 and FY 1997. According to the Kansas Department of Revenue, a total of only \$1,008,698 in income tax credits (\$1 of every \$66 earned) has actually been claimed by these firms as of September 1997.
- ▶ Eleven of the 64 HPIP firms received an estimated \$2.9 million in state sales tax exemption between FY 1994 and FY 1997 that may not have been available except through the HPIP program. This amount represents approximately 6.5% of the sales tax exemption granted through the Kansas Enterprise Zone in FY 1997 alone.
- ▶ Overall, HPIP incentives had a greater impact on recruitment efforts than on the retention of existing Kansas firms.
- ▶ 41% of existing Kansas firms said the HPIP program had a "significant impact" on their decision to invest in new machinery and equipment or facility.

- ▶ 47% of existing Kansas firms that had seriously considered leaving the state to undertake their projects, said the HPIP incentives “contributed significantly” to their ultimate decision to remain and invest in Kansas.
- ▶ 41% of existing Kansas firms that had seriously considered leaving the state to undertake their projects, said that had it not been for the HPIP incentives, they would have taken the project to another state.
- ▶ HPIP incentives had less impact on existing Kansas firms that had not seriously considered moving from the state. In a confidential survey, 38% of those firms said they would have proceeded with the project as planned with or without the HPIP incentives. Fifty-three percent (53%) said they would have proceeded on a smaller scale.
- ▶ 40% of out-of-state firms said that HPIP incentives “contributed significantly” to their firm’s decision to locate their facility in Kansas.
- ▶ 40% of out-of-state firms said that had it not been for the the HPIP program, they would have located in another state.
- ▶ 23% of HPIP firms said they had increased worker training to meet HPIP requirements. There is no way of knowing how many firms are currently in the process of increasing investment in worker training to meet HPIP requirements.
- ▶ None of the HPIP firms said they had increased wages to meet HPIP requirements. However, there is no way of knowing how many firms are currently in the process of increasing wages to meet HPIP requirements.
- ▶ 13% of service sector firms said they had increased sales outside the state to meet HPIP requirements. There is no way of knowing how many firms are currently in the process of increasing sales outside the state to meet HPIP requirements.
- Overall, HPIP firms are satisfied with the services they received throughout the certification process and with the administration of the program itself. With the exception of the amount of paperwork and documentation required, firms gave all areas ratings which indicated no particular need for improvement.

Recommendations

A total of 7 recommendations were made as part of the study. Among those recommendations, 5 were related to internal program administration. One recommendation, which endorsed legislation to amend the HPIP statute to include credits against premium, privilege fees and privilege taxes paid by insurance companies and financial institutions was passed with SB 416 during the 1998 Legislative session. The remaining recommendation would require legislative action to initiate. In the interest of time, I will expand on that recommendation only. A full report of all 7 recommendations can be found beginning on page 3 of the report.

Amend the HPIP statute to include the warehousing, wholesale trade and distribution sectors among those firms eligible for HPIP certification.

The wholesale trade sector of the economy is designated as Major SIC Code Group 50 and 51 and includes warehousing, wholesale trade, and distribution. Firms within this sector act much like service sector firms, in that many are export-oriented and bring new dollars into the state by selling their product outside Kansas. Currently, the HPIP statute requires that non-manufacturing firms (SIC codes 40-49, 60-67, and 70-89) sell more than 50% of their gross revenues to Kansas manufacturers or commercial or governmental customers outside the state to qualify. If the HPIP statute is amended to allow wholesale firms eligibility, those firms should be required to meet this export-oriented test as well.

Inclusion of the wholesale trade and distribution sectors will complement the targeted industrial recruitment plan recently adopted by the Department of Commerce & Housing (KDOC&H) and, provided these firms meet the same standards required of service sector firms, is in keeping with sound economic theory.