

State of Oklahoma Incentive Evaluation Commission Historic Rehabilitation Tax Credit Draft Report



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Prepared by



Table of Contents

At A Glance	1
Executive Summary	1
Introduction.....	4
Program Background and Benchmarking.....	6
Fiscal Impact	15
Economic Impact.....	15
Technical and Administrative Issues.....	14
Outcomes	19
Recommendation	27

At a Glance: Historic Rehabilitation Tax Credit

Statute: O.S. 68 Section 2357.41

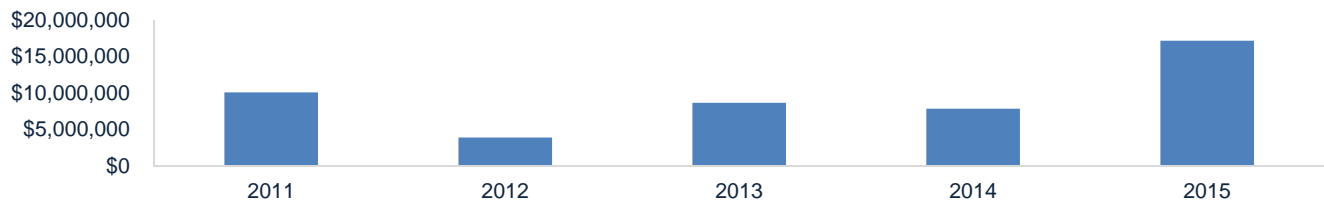
Program Goals

- Increase Historic Rehabilitation Activity

Fiscal Impact

	2011	2012	2013	2014	2015
Dollar Amount	\$10,091,775	\$3,918,729	\$8,666,174	\$7,847,800	\$17,162,851
Claimants	7	6	5	8	13

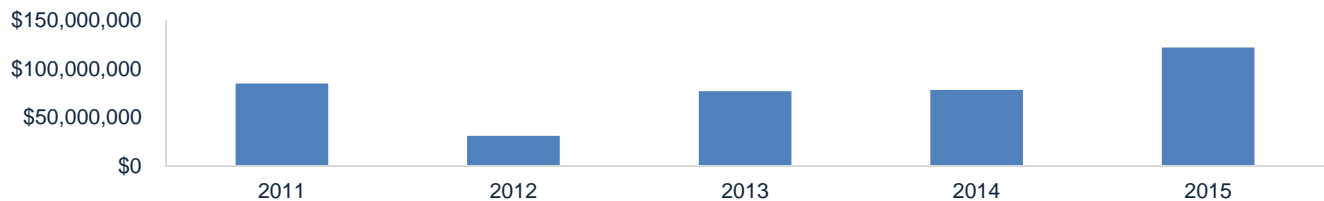
Dollar Amount of Tax Credits Claimed by Year



Economic Impact

	2011	2012	2013	2014	2015
Output	\$84,709,102	\$31,044,069	\$76,822,052	\$78,184,082	\$121,777,262
Labor Income	\$29,737,729	\$10,898,240	\$26,968,925	\$27,447,075	\$42,750,770
Employment	620	227	563	572	892
Total Tax Revenue	\$2,060,753	\$744,166	\$1,881,973	\$1,861,635	\$2,895,507

Economic Output by Year



Adequate Protections for Future Fiscal Impact?

- No. Without an annual cap in place, the cost burden on the State could grow beyond the point of desirability.

Effective Administration?

- Yes. The Oklahoma program is among the most efficient nationwide because it is directly tied to the federal program with not additional administrative burdens or costs. The policies and procedures in place are timely, transparent, and accountable.

Achieving its Goals?

- Yes. Since 2005, the year that the program was tied to the federal process, the average number of historical rehabilitation projects has quadrupled and total development investment has increased by 82 times. This level of growth far exceeds that of most other states.

Retain, Reconfigure, Repeal?

- The project team recommends that Oklahoma retain the program and adopt an annual cap to ensure some measure of future budget predictability.

Changes to Improve Future Evaluation?

- None

Executive Summary

More than 30 states have historic preservation incentives in place. The growth of these programs has been driven in part by interest in leveraging the Federal Historic Preservation Tax Credit, which allows developers to claim 20 percent income tax credits for the rehabilitation expenses incurred while restoring income-producing buildings that are listed on the National Register of Historic Places or certified by the National Parks Service.

Program Requirements, Eligibility, and Administration

In 1992, in the Local Development Act, the Oklahoma Legislature enacted a rehabilitation tax credit available to historic hotels and newspaper plants. In 2005, HB 3024 expanded the program to income-producing historic buildings, and allowed projects that qualify for the federal 20 percent credit to automatically qualify for the same amount of State tax credit without additional paperwork. The State tax credit mirrors the Federal Historic Preservation Tax Credit, and the program is administered by the State Historic Preservation Office (SHPO) in partnership with the National Park Service (NPS). Historic rehabilitation tax credits earned but not used may be carried forward for up to ten years. The credits are also transferrable, if not used, for up to five years after being earned.

Every state bordering Oklahoma has a historic rehabilitation tax credit program in place. Compared to this benchmark group, Oklahoma's credit amount of 20 percent is smaller than most. Oklahoma is also one of the few states to restrict the credit to income-producing structures, a choice that limits the Oklahoma's exposure to some of the program abuses and unintended loopholes that other states have struggled with, such as state-subsidized rehabilitation of luxury private residences.

Without an annual cap or a program cap in place, the cost burden on the State could continue to grow beyond the point of desirability. Other states, such as Missouri, have experienced growth in this program far beyond the initial predicted utilization levels. At present, more than half of all states have an annual cap in place.

Because Oklahoma's program is directly tied to the federal program with no additional administrative burdens or costs, it is among the most efficient nationwide. Each project is vetted and screened by SHPO and the NPS, and the credit is granted only after completion and certification of compliance with the U.S. Secretary of Interior Standards. The incremental burdens to the State above and beyond those involved in the administration of the federal tax credit program are minimal. The policies and procedures in place are timely, transparent, and accountable.

Program Impacts

The 2005 legislative changes – including both the expansion of eligibility and the alignment of administrative procedures with federal requirements – have led to a substantial increase in tax credit utilization. Since 2005 (the year of that the program was tied to the federal process), the average annual historic rehabilitation projects has quadrupled and the total development investment has increased 82 times, from just over \$1.0 million in 2005 to \$85.9 million in 2015. In FY2009, Oklahoma ranked 41st out of 47 states in the number of certified expenses; in FY2015, the state came in at 16th. The program has been exceptionally successful at increasing investment in historic rehabilitation in Oklahoma.

Though not specifically articulated as program goals in Oklahoma State statute, evidence indicates that that historic rehabilitation activities lead to additional economic development benefits at the local level, such as preserving and restoring historic landmarks, restoring vacant building to active and productive use, creating construction-related jobs and bringing long-term jobs to underutilized corridors and neighborhoods, and revitalizing older urban core areas. State program evaluations and academic research have demonstrated a significant and positive effect on property tax values, business attraction, population regrowth, and higher employment. Though not readily quantifiable, the impact on place-making, heritage, and local identity is generally recognized to be significant and of intangible value. As such, historic rehabilitation tax credits are proven tools that help to drive local revitalization and promote more cost effective infill development patterns.

On a statewide level, however, the aggregate benefits of the program are less readily quantifiable. The total effect on job growth is limited to fewer than 900 jobs per year, and the estimated impact on State revenues is less than \$3 million per year, only 17 percent of the cost incurred by the State. This finding is consistent with those reported by other program analyses, largely because new jobs created by the program are limited to temporary construction work. The long-term fiscal impacts are experienced at the local level, through growth in assessed value.

Recommendations

The project team recommends that Oklahoma adopt an annual cap to ensure some measure of future budget predictability. Further, in order to keep administration burdens to a minimum once a cap is in place, the team recommends that projects be accepted on a first-come-first-served basis in lieu of a supplementary assessment procedure.

Introduction

Overview

The Oklahoma Incentive Evaluation Commission (the Commission) was established in HB2182, which was enacted and became law in 2015. 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 Historic Rehabilitation Tax Credit is one of the incentives reviewed in 2016 by the Commission with recommendations to the Governor and the State Legislature.

Introduction

More than 30 states have historic preservation incentives in place. The growth of these programs has been driven in part by interest in leveraging the Federal Historic Preservation Tax Credit, which allows developers to claim 20 percent income tax credits for the rehabilitation expenses incurred while restoring income-producing buildings that are listed on the National Register of Historic Places or certified by the National Parks Service.

In 1992, in the Local Development Act, the Oklahoma Legislature enacted a rehabilitation tax credit available to historic hotels and newspaper plants. In 2005, HB3024 expanded the program to income-producing historic buildings, and allowed projects that qualify for the federal 20 percent credit to automatically qualify for the same amount of State tax credit without additional paperwork.¹ The State tax credit mirrors the Federal Historic Preservation Tax Credit, and the program is administered by the State Historic Preservation Office (SHPO) in partnership with the National Park Service.

Historic rehabilitation tax credits earned but not used may be carried forward for up to ten years. The credits are also transferrable, if not used, for up to five years after being earned.

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 goals were not included in the legislation that established it. In other states, articulated goals have included preserving and restoring historic landmarks, restoring vacant building to active and productive use, creating construction-related jobs and bringing long-term jobs to underutilized corridors and neighborhoods, and revitalizing older urban core areas.

There are other criteria that may be used to evaluate this program. To assist in a determination of the effectiveness of the program, the Incentive Evaluation Commission has adopted the following criteria:

- Total amount of rehabilitation expenditures and number of qualified projects
- State tax credit as a percent of total rehabilitation improvement for qualified projects
- Change in assessed value for rehabilitation projects approved for credit.
- Percent of qualified structures on the national registry of historic places that receive assistance

¹ 68 O.S. Section 2357.41

- Economic impact related to tourism, sales tax generated, etc.
- Connection with other related business incentives
- Return on investment (economic impact versus financial impact)

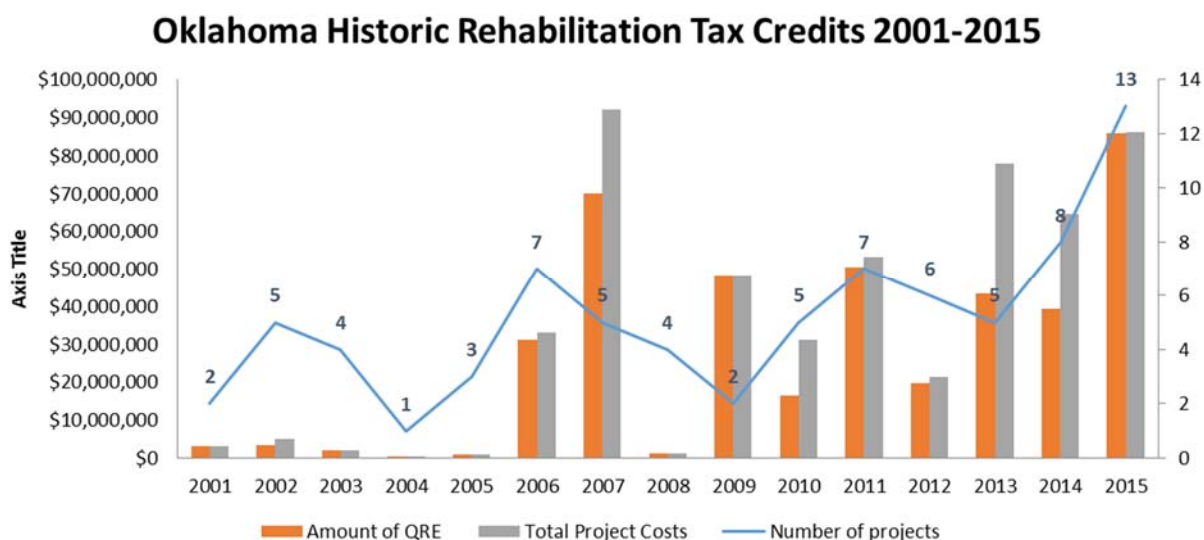
In the course of conducting this analysis, it became clear that local data availability constrained analysis of criteria 3, 5, and 6, though findings pertaining to these criteria produced by other academic research studies are reported in the benchmarking section below. In addition, it was determined that criterion 4 would not provide insight into the percentage of eligible buildings that have utilized the tax credit , as the National Registry of Historic Places is not the sole determination of eligibility.

Program Background and Benchmarking

Background

In 1992, the Oklahoma legislature enacted a rehabilitation tax credit available to historic hotels and newspaper plants in the Local Development Act. In 2005, House Bill 3024 expanded the program to income-producing historic buildings, creating a 20 percent income tax credit incentive for qualified rehabilitation of Oklahoma's certified historic buildings. Additionally, these 2005 amendments allowed projects that qualify for the federal 20 percent credit to automatically qualify for the same amount of state tax credit without additional paperwork.

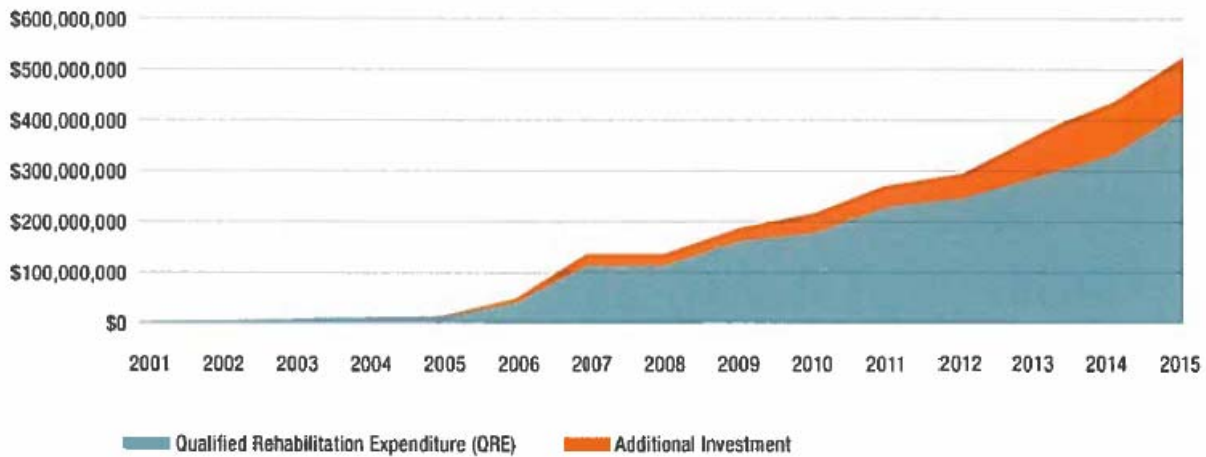
After these changes, the number of tax credit projects expanded significantly until 2008, when development projects of all kinds halted due to the recession. In 2010-2012, the legislature instituted a deferral of the tax credits, which allowed certified projects to move forward but not to claim credits until the deferral was lifted. In 2013, the first year of the reinstated tax credits, the number of completed projects more than doubled. As developers' access to credit has continued to improve and market rents are strengthening, the number of tax credits claimed has grown to \$15.4 million in 2015. There is no cap in place to limit future expenditure growth.



Source: State Historic Preservation Office, 2016

Since 2001, over 77 historic buildings have been rehabilitated using state historic tax credits, for a cumulative total of \$415 million in rehabilitation expenditures and total project investment reaching \$520 million.

Cumulative Investment in Tax Credit Project: FY2011 – FY2015

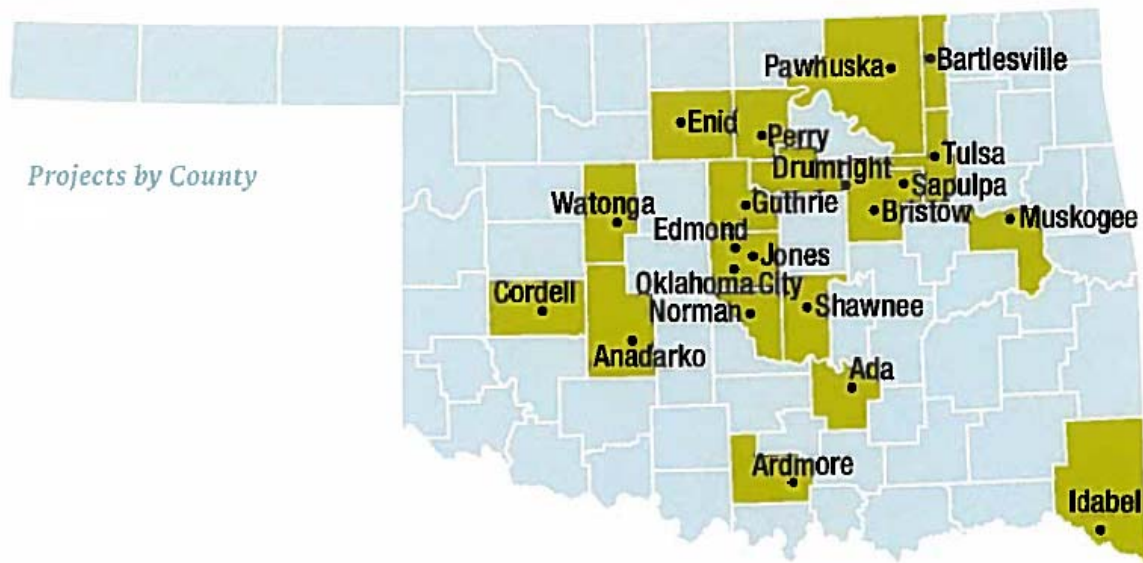


Source: Place Economics 2016

The State tax credit supports the redevelopment of buildings of all sizes and uses. While the average project investment was \$6.8 million, approximately 60 percent of tax credit monies invested to date have supported large projects in excess of \$20.0 million. Examples include the Tulsa Paper Company, Mayo Hotel, and Shawnee's Aldridge Hotel. Though only two percent of all tax credit monies have supported small projects under \$1.0 million, these projects represent 44 percent of all buildings that benefitted from the program. As a result, the program has supported both the redevelopment of market-leader projects that demonstrate the market viability of redevelopment in a particular area and are likely to generate spinoff activity, as well as a significant volume of smaller scale projects.

Approximately 70 percent of rehabilitation projects have been located in Oklahoma City and Tulsa, largely because market rate rents are sufficient to cover the rehabilitation investment, and these cities include the largest number of National Register-listed buildings. Because these projects are typically larger in scale, these two cities account for more than 90 percent of investment dollars (\$242.0 million to Oklahoma City and \$230.0 million to Tulsa). Muskogee, Oklahoma's 11th largest City, comes in third with \$11.0 million in total investment. Since 2001, cities in an additional 15 counties have benefitted from historic rehabilitation tax credit projects.

The following map details these locations across the state:



Source: *Place Economics 2016*

Benchmarking

Over half the states in the U.S. have tax credit programs that supplement federal historic preservation tax credits. In 2014, it was estimated that 48 percent of the completed projects that benefitted from the federal tax credit also received a state historic tax credit.² Every state bordering Oklahoma has a historic rehabilitation tax credit program in place. A review of these states provides insight into the different incentives regional developers weigh when pursuing projects.

Among the group of comparison states, differentiating program characteristics include the credit amount, credit caps, and eligibility that exceed federal limits.

Credit Amount: Oklahoma's credit amount of 20 percent of eligible expenses is low among the comparison group. Arkansas, Kansas, Missouri, and Texas each offer credits of 25 percent of eligible expenses. Colorado's credit is 20 to 30 percent. New Mexico offers up to 50 percent of eligible expenses, but this is limited to \$50,000, which indicates a focus on smaller projects. Looking beyond the region, Connecticut encourages the historic rehabilitation of affordable housing developments by offering a higher (30 percent) credit exclusively for this use.

Credit Caps: Oklahoma is one of 12 (out of 30) states that have chosen not to establish an overall annual program limit. While surrounding states may offer higher levels of subsidies to individual projects, the number of projects that can benefit from these incentives are often limited by a cap. Arkansas, for example has a limit of \$125,000 per project. New Mexico has a cap of the lower of 50

² National Park Services. 2015. Annual Tax Incentive Report. Available at: <https://www.nps.gov/tps/tax-incentives/taxdocs/tax-incentives-2015annual.pdf>

percent of eligible expenses and five years of tax liability. Maryland directly appropriates the aggregate amount of available credits.³

States with caps must decide whether to review applications on a first-come-first-served basis or institute a supplementary review process in order to determine which qualified applicants will receive the state credit. The State of Ohio, for example, conducts a cost-benefit analysis as part of the application process, using a 100-point scoring system measuring a project's economic impact, community benefit and return on investment to state and local governments. The analysis uses estimates of the future, post-rehabilitation property value, anticipated construction and permanent jobs and anticipated economic activity at the project site to estimate future tax revenue to both state and local governments. This additional step creates additional administrative burdens on both the applicant and the state, but it does result in greater available data to document economic impacts.

Carry Forward. To avoid budget challenges, states not only need to know how much incentives will cost over the long-term but also need to be able anticipate how much the programs will cost from year to year. States are more likely to face difficulties predicting the timing if companies are allowed to carry forward unused credits to future years. The Pew Charitable Trust has conducted extensive research on the use of incentives and has found that the longer a business can carry forward an incentive, the harder it generally will be for state officials to predict the timing of the costs to the state. Oklahoma's historic preservation program allows 10-year carryforwards, which is comparable to many other states—though some states allow carryforwards of only five (or fewer) years.

Transferability: All states adjacent to Oklahoma allow for the transferability of tax credits.

Eligibility: Texas is the only bordering state to limit the credit to only income-producing structures. Other states allow private residences to access the tax credit. However, as will be discussed later, an audit of Missouri's state tax credit program found that greater care should be used in extending the program to owner-occupied structures to ensure that the tax credits make a tangible difference to project feasibility.

Given the popularity of the historic rehabilitation tax credit program, several academic studies and programmatic analysis have examined their effectiveness. Some of the overarching findings are summarized below.

Several research studies conducted at the national and state level have found that historic preservation has a positive impact on property values.⁴ The Center for Urban Policy Research at Rutgers University

³ Stennis Institute of Government. The Economic and Fiscal Effects of the Mississippi Historic Preservation Tax Incentives Program: An Overview for Decision-Makers. Mississippi State University. Prepared at the Request of Philip Gunn, Speaker of the House. Available at: <http://www.preservationnation.org/take-action/advocacy-center/additional-resources/The-Economic-and-Fiscal-Effects-of-the-Mississippi-Historic-Preservation-Tax-Incentives-Program.pdf>

⁴ Zahirovic-Herbert, Velma and Chatterjee, Swarn. "Historic Preservation and Residential Property Values: Evidence from Quantile Regression." *Urban Studies* 49.2 (2012): 369-382; Clark, D.E. and Herrin, W.E. "Historical preservation and home sale prices: evidence from the Sacramento housing market." *Journal of Real Estate Finance and Economics* 27 (1997): 29-48.

has found that historic designation is associated with average property value increases ranging between 5 to 20 percent of the total property value.⁵ Based on a review of county auditor and treasurer records, Cleveland State University (CSU) found that the property values of completed historic preservation tax credit projects rose more than 250.0 percent, and parcels adjacent to projects increased an average of 12.1 percent.⁶ These increases in property values lead to additional local tax revenue to help local communities grow and provide services. The CSU study found that taxes collected from properties on project parcels increased by about \$7.2 million overall, or about 355 percent, while taxes rose by about 55 percent on adjacent parcels and by 30 percent on radial parcels.

By linking the addresses of project buildings to granular state employment and business data,⁷ the CSU study also found that the use of the historic rehabilitation led to an increase in employment, in the number of business establishments, and in the wages earned by people working for businesses registered in renovated buildings. From 2008 to 2014 (a period which includes the national recession), total employment of businesses registered at project buildings increased by 3,612 jobs (a 58.3 percent growth) and generated 70 more business establishments (a 50 percent increase), while adding \$201.4 million in total wages (a 57.5 percent increase, accounting for inflation). Similar results were found in a study conducted by the Iowa Department of Revenue, which additionally documented a 352.7 percent increase in total annual sales revenues associated with businesses located in tax credit projects.⁸ In other words, the tax credit has been found to be an important tool in attracting higher quality jobs and businesses to otherwise underutilized neighborhoods and business districts. It is not clear how much of these substantial local benefits translate into an aggregate impact on the statewide economy, though the Iowa Department of Revenue survey did find that an average of 84.3 percent of tax-credit supported project expenditures are spent on in-state goods and services.

Another theme evident in state tax credit assessments is that the historic rehabilitation tax credit program has intangible benefits that are difficult to quantify. Through interviews, case studies, and before/after documentation, many reports attempt to convey that these buildings, while useful economic engines, are also intricately intertwined with the identity, meaning and heritage of the state's neighborhoods, towns and cities. A programmatic assessment conducted by the State of Connecticut directly asserts that any job growth or increase in tax revenue spurred by the tax credit is incidental to

⁵ Leichenko, R., Coulson, E. and Listokin, D. "Historic preservation and residential property values: an analysis of Texas cities." *Urban Studies* 38.11 (2001): 1973-1987.

⁶ Cleveland State University, Center for Economic Development. October 2015. [Ohio Historic Preservation Tax Credit Economic Impact Study](https://development.ohio.gov/files/redev/2015OHPTCComprehensiveReport.pdf). Prepared for the Ohio Development Services Agency. Available at: <https://development.ohio.gov/files/redev/2015OHPTCComprehensiveReport.pdf>

⁷ A government program that publishes a quarterly count of employment and wages reported by employers

⁸ Zhong Jin. December 2014. [Iowa Historic Preservation and Cultural and Entertainment District Tax Credit: Tax Credits Program Evaluation Study](https://tax.iowa.gov/sites/files/idr/Historic%20Preservation%20Tax%20Credit%20Evaluation%20Study.pdf). Iowa Department of Revenue, Tax Research and Program Analysis Section. Available at:

<https://tax.iowa.gov/sites/files/idr/Historic%20Preservation%20Tax%20Credit%20Evaluation%20Study.pdf>

the program's primary purpose, which is to stimulate and support the preservation of historically important buildings.⁹

State assessments generally agree that state tax credit programs that are administered in tandem with the Federal tax credit are the most streamlined, transparent, and easy-to-use. Only one of the state historic tax credit programmatic audits reviewed – that issued by the State of Missouri – issued specific recommendations for improved program administration. These included:¹⁰

- Minimizing the time that passes between project completion and tax credit certificate issuance, which interest costs incurred by developers and reduces equity going toward construction.
- Modifying transferability regulations to increase the proportion of the tax credit dollars allocated specifically towards rehabilitation. Options include: making the tax credit refundable to make the credit more attractive to investors and reduce the incentive to sell the certificates at a discount; requiring credits be assigned to a state agency, local political subdivision or other not-for-profit organization that would sell the credits in the market and grant the proceeds to the project; or eliminating the use of the state tax credits in favor of direct appropriations through a state agency to fund historical rehabilitation projects.
- Disallowing the use of tax credits on high value owner-occupied residences. The Missouri audit found that their credit has been used for renovations to homes with high property values and high renovation costs. Because the tax credits represented a small percentage of total renovation costs, the credits may not have been a significant determining factor in the decision to redevelop the properties. The Audit recommended limiting the maximum tax credit allowed for owner-occupied residences to \$50,000 and prohibiting the tax credit for owner-occupied residences if the home was purchased for more than \$150,000.
- Improving state oversight by conducting site visits, monitoring project approval time, maintaining accurate program activity projections, and ensuring consistency in determining the eligibility of certain costs.

It is worth noting that the Oklahoma administrative processes already incorporate these recommendations, as noted in the administrative process section below.

The Missouri audit is also the only reviewed program assessment that recommends a reduction in the state historic rehabilitation tax credit program. The State of Missouri has led the nation in qualified rehabilitation expenses for historic preservation purposes, with approximately \$80 million in

⁹ Department of Economic and Community Development. September 2014. [An Assessment of Connecticut's Tax Credit and Abatement Programs](http://www.ct.gov/ecd/lib/ecd/decd_sb_501_sec_27_report_revised_2013_final.pdf). Available at:

http://www.ct.gov/ecd/lib/ecd/decd_sb_501_sec_27_report_revised_2013_final.pdf

¹⁰ Missouri State Auditor. March 2014. [Historic Preservation Tax Credit Program](http://app.auditor.mo.gov/Repository/Press/2014018370056.pdf). Report No. 2014-018. Available at: <http://app.auditor.mo.gov/Repository/Press/2014018370056.pdf>

redemptions annually. The state imposed a \$140 million annual program limit in 2010; and the Governor's Tax Credit Review Commission recommended a further reduction of this limit to \$75 million.

The following tables summarize program characteristics for neighboring states, as well as project caps for all state programs currently in place nationwide.

	Credit Amount	Cap	Minimum Investment	Private Residence Eligible	Carry Forward	Transferrable
Oklahoma	20%	No Cap	Greater of \$5,000 or the structure's book value	No	10 Years	Yes
Arkansas	25%	\$125,000 per project, \$4 million state aggregate cap per year	\$25,000	Yes	5 years	Yes
Colorado	20 to 30%	\$1 million annually, per property	25% of the structure's book value	Yes	10 years	Yes
Kansas	25%	No Cap	\$5,000	Yes	10 years	Yes
Missouri	25%	No Cap	None Specified	Yes	10 years	Yes
New Mexico	50%	Lower of \$25,000 or five years of tax liability per project	None Specified	Yes	4 years	Yes
Texas	25%	No Cap	None Specified	No	5 years	Yes

Aggregate and Project Caps on State Historic Tax Credits for Commercial Properties¹¹

State	Aggregate	Per Project Cap	Comments
Alabama	\$20 million	\$5 million	Starts May 15, 2016
Arkansas	\$4 million	\$125,000 in credits	
Colorado	None	\$50,000	
Connecticut	\$50 million over 3 years	\$5 million per project	
Delaware	\$5 million	None	For both homeowners and commercial
Georgia	None	\$300,000	
Illinois	None	None	River Edge Redevelopment Zone only
Indiana	\$450,000	None	
Iowa	\$45 million	None	
Kansas	None	None	
Kentucky	\$5 million	None	For both homeowners and commercial
Louisiana	None	\$5 million per taxpayer	In development district
Maine	None	\$5 million per project	
Maryland	Annual appropriation	\$3 million per project	Approximately \$10 million annual average appropriation
Massachusetts	\$50 million	None	
Minnesota	None	None	
Mississippi	\$60 million	None	
Missouri	\$140 million	None	Projects with eligible costs less than \$1,100,000 are not subject to cap
Montana	None	None	5% add-on to federal
Nebraska	\$15 million	\$1 million in credits	
New Mexico	None	\$25,000 outside \$50,000 in Arts & Cultural District	
New York	None	\$5 million	only in designated distressed areas
North Carolina	None	None	
North Dakota	None	\$250,000	In a "renaissance zone" only
Ohio	\$60 million	\$5 million	
Oklahoma	None	None	
Pennsylvania	\$3 million	\$500,000	Started 2012
Rhode Island	\$34.5 million	None	Cap currently set by legislature
South Carolina	None	None	10% add-on to federal; 25% for other eligible properties
Texas	None	None	Started Jan 1, 2015
Utah	None	None	limited to owner-occupied and residential property
Vermont	\$1.5 million	None	10% add-on to federal
Virginia	None	None	
West Virginia	None	None	10% add-on to federal
Wisconsin	None	None	20% credit

Source: National Trust for Historic Preservation

¹¹ Stennis Institute of Government. The Economic and Fiscal Effects of the Mississippi Historic Preservation Tax Incentives Program: An Overview for Decision-Makers. Mississippi State University. Prepared at the Request of Philip Gunn, Speaker of the House. Available at: <http://www.preservationnation.org/take-action/advocacy-center/additional-resources/The-Economic-and-Fiscal-Effects-of-the-Mississippi-Historic-Preservation-Tax-Incentives-Program.pdf>

Fiscal Impact

For this evaluation, fiscal impact is considered to be the directly attributable impact of the credit on State revenues and expenditures. The evaluation will discuss but not quantify revenue and expenditure impacts on local governments; as noted in the benchmarking section above, research indicates that significant benefits will accrue to local governments related to increased property value and increasing the economic use of formerly underutilized historic properties. However, there is far less attenuation from these local impacts for a discussion of a state incentive program – for a variety of reasons (including the impact of local decision making outside the state’s control on local revenues and expenditures and the widely divergent impacts throughout the state).

The following table identifies the tax credits associated with this program, by year of project completion and final certification. As already noted, the developers may carry forward the tax credits for up to 10 years and transfer them for up to five years.

Year	No. of Projects	Total Development Investment	Eligible Expenses	OK Tax Credits	Annual Growth
2001	2	\$3,191,081	\$3,191,081	\$638,216	
2002	5	\$5,004,763	\$3,275,015	\$655,003	2.6%
2003	4	\$2,152,971	\$2,130,646	\$426,129	-34.9%
2004	1	\$352,480	\$352,480	\$70,496	-83.5%
2005	3	\$1,044,270	\$1,042,724	\$208,545	195.8%
2006	7	\$32,943,797	\$31,188,899	\$6,237,780	2891.1%
2007	5	\$92,002,882	\$70,079,366	\$14,015,873	124.7%
2008	4	\$1,221,769	\$1,157,269	\$231,454	-98.3%
2009	2	\$48,358,427	\$48,342,527	\$9,668,505	4077.3%
2010	5	\$31,177,962	\$16,567,171	\$3,313,434	-65.7%
2011	7	\$53,129,592	\$50,458,876	\$10,091,775	204.6%
2012	6	\$21,364,103	\$19,593,647	\$3,918,729	-61.2%
2013	5	\$77,991,394	\$43,330,869	\$8,666,174	121.1%
2014	8	\$64,477,895	\$39,239,000	\$7,847,800	-9.4%
2015	13	\$85,908,755	\$85,814,255	\$17,162,851	118.7%
Total	77	\$520,322,141	\$415,763,825	\$83,152,765	

There is, of course, some additional revenue that would be generated from economic activity associated with this credit, which will be discussed in the following chapter. Note that the costs of program administration are born by the SHPO and are neither disaggregated from the rest of the Office’s annual expenditures nor included in the table.

One of the requirements of HB2182 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.” As illustrated in the table, the financial impacts

associated with this program are growing and will impact the revenue structure for an additional ten years thereafter. Several states have struggled when historic rehabilitation tax credits prove more popular than anticipated. As noted previously, the Missouri tax credit program has averaged \$123.0 million for the past five years, almost 10 times larger than the estimated annual cost of \$14.3 million projected at the time that the program was created.¹² This trend led the State Legislature to introduce an annual cap in 2010, and an additional lowering of the cap has been recommended. Oklahoma may find that a similar modification to the historic rehabilitation program may be a necessary and appropriate step to help ensure that the fiscal impact does not exceed the State's expectation in future years.

¹² Missouri State Auditor. March 2014. Historic Preservation Tax Credit Program. Report No. 2014-018. <http://app.auditor.mo.gov/repository/press/2014018832873.pdf>

Economic Impact

Economic Impact of Methodology

Economists use a number of statistics to describe regional economic activity. Four common measures are “Output” which describes total economic activity and is generally equivalent to a firm’s gross sales; “Value Added” which equals gross output of an industry or a sector less its intermediate inputs; “Labor Income” which corresponds to wages and benefits; and “Employment” which refers to jobs that have been created in the local economy.

In an input-output analysis of new economic activity, it is useful to distinguish three types of expenditure effects: direct, indirect, and induced.

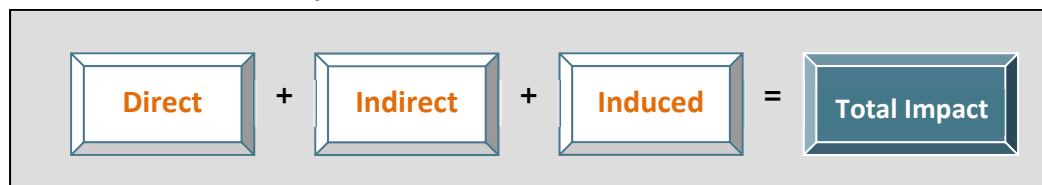
Direct effects are production changes associated with the immediate effects or final demand changes. The payment made by an out-of-town visitor to a hotel operator or the taxi fare paid for transportation while in town are examples of direct effects.

Indirect effects are production changes in backward-linked industries caused by the changing input needs of directly affected industries – typically, additional purchases to produce additional output. Satisfying the demand for an overnight stay will require the hotel operator to purchase additional cleaning supplies and services. The taxi driver will have to replace the gasoline consumed during the trip from the airport. These downstream purchases affect the economic output of other local merchants.

Induced effects are the changes in regional household spending patterns caused by changes in household income generated from the direct and indirect effects. Both the hotel operator and taxi driver experience increased income from the visitor’s stay, as do the cleaning supplies outlet and the gas station proprietor. Induced effects capture the way in which increased income is spent in the local economy.

A multiplier reflects the interaction between different sectors of the economy. An output multiplier of 1.4, for example, means that for every \$1,000 injected into the economy, all other sectors produce an additional \$400 in output. The larger the multiplier, the greater the impact will be in the regional economy.

The Flow of Economic Impacts



For this analysis, the project team used the IMPLAN online economic impact model with the dataset for the State of Oklahoma (2014 Model).

State of Oklahoma Tax Revenue Estimate Methodology

To provide an “order of magnitude” estimate for state tax revenue attributable to the incentive being evaluated, the project team focused on the ratio of state government tax collections to Oklahoma Gross Domestic Product (GDP). Two datasets were used to derive the ratio: 1) U.S. Department of Commerce Bureau of Economic Analysis GDP estimates by state;¹³ and 2) the Oklahoma Tax Commission’s *Annual Report of the Oklahoma Tax Commission* reports.¹⁴ Over the past ten years, the state tax revenue as a percent of state GDP was 5.5 percent.

State of Oklahoma Tax Revenue as a Percent of State GDP

Year	Oklahoma Tax Revenue*	Oklahoma GDP	Ratio
2005-06	\$8,435,214,025	\$136,804,000,000	6.2%
2006-07	\$8,685,842,682	\$144,171,000,000	6.0%
2007-08	\$9,008,981,280	\$155,015,000,000	5.8%
2008-09	\$8,783,165,581	\$143,380,000,000	6.1%
2009-10	\$7,774,910,000	\$151,318,000,000	5.1%
2010-11	\$8,367,871,162	\$165,278,000,000	5.1%
2011-12	\$8,998,362,975	\$173,911,000,000	5.2%
2012-13	\$9,175,334,979	\$182,447,000,000	5.0%
2013-14	\$9,550,183,790	\$190,171,000,000	5.0%
2014-15	\$9,778,654,182	\$180,425,000,000	5.4%
Average	\$8,855,852,065	\$162,292,000,000	5.5%

Source: U.S. Department of Commerce Bureau of Economic Analysis and Oklahoma Tax Commission

* Gross collections from state-levied taxes, licenses and fees, exclusive of city/county sales and use taxes and county lodging taxes

The value added of an industry, also referred to as gross domestic product (GDP)-by-industry, is the contribution of a private industry or government sector to overall GDP. The components of value added consist of compensation of employees, taxes on production and imports less subsidies, and gross operating surplus. Changes in value added components such as employee compensation have a direct impact on taxes such as income and sales tax. Other tax revenues such as alcoholic beverage and cigarette taxes are also positively correlated to changes in income.

Because of the highly correlated relationship between changes in the GDP by industry and most taxes collected by the state, the ratio of government tax collections to Oklahoma GDP forms the evaluation basis of the fiscal implications of different incentive programs offered by the State. The broader the basis of taxation (i.e., income and sales taxes) the stronger the correlation; with certain taxes on specific activity, such as the gross production (severance) tax, there may be some variation in the ratio year-to-year, although these fluctuations tend to smooth out over a period of several years. This ratio approach is

¹³ <http://www.bea.gov/regional/>

¹⁴ https://www.ok.gov/tax/Forms_&_Publications/Publications/Annual_Reports/index.html

somewhat standard practice, and is consistent with what IMPLAN and other economic modeling software programs use to estimate changes in tax revenue.

Data Collection, Model Inputs, and Other Issues

The project team performed the following steps to derive the economic and tax revenue impact:

1. The project team collected existing data and studies from State of Oklahoma agencies including the Oklahoma Tax Commission and Oklahoma Department of Commerce.
2. The project team collected and analyzed studies performed or commissioned by other organizations such as the Tulsa Foundation for Architecture and the National Park Service.
3. Data on Oklahoma annual estimated qualified rehabilitation expenditures (QRE) was obtained from the National Park Service – U.S. Department of the Interior¹⁵ for the years 2011 to 2015.
4. The certified rehabilitation costs, reported on the Part 3 application form, represent the estimated amount reported by the applicant to be claimed as qualifying costs associated with the rehabilitation. These costs do not include new construction and other work ineligible for the credit.
5. IMPLAN sector 57 Construction of New Commercial Structures was used to model the economic impact.
6. There was not sufficient detail available to model the economic impact of new construction and other work ineligible for the credit.
7. It was not possible to determine if the project developer would have constructed a new facility in Oklahoma instead of rehabilitating the historic facility. In some situations, the historic building and the tax credit was critical to the project success. In other circumstances, a project developer might have chosen a different building to renovate.
8. Total expenditures (also referred to as “economic activity”) are not the same as the tax historic tax credit. It is common, but not accurate, in economic impact studies to compare economic activity against the incentives offered. This comparison does not provide any insights into if the public sector is making a net profit or loss on the incentive program.

¹⁵ <https://www.nps.gov/tps/tax-incentives/reports.htm>

Annual Economic Impact of the State of Oklahoma Historic Preservation Tax Credit

						Estimated OK
Year		Output	Value Added	Labor Income	Employment	Tax Revenue
2011	Direct Effect	\$48,857,842	\$21,892,657	\$18,945,199	393	
	Indirect Effect	\$17,790,490	\$8,354,573	\$5,210,973	90	
	Induced Effect	\$18,060,769	\$9,859,854	\$5,581,557	137	
	Total Effect	\$84,709,102	\$40,107,084	\$29,737,729	620	\$2,060,753
2012	Direct Effect	\$17,905,351	\$8,023,189	\$6,943,009	144	
	Indirect Effect	\$6,519,833	\$3,061,772	\$1,909,710	33	
	Induced Effect	\$6,618,885	\$3,613,425	\$2,045,521	50	
	Total Effect	\$31,044,069	\$14,698,386	\$10,898,240	227	\$744,166
2013	Direct Effect	\$44,308,812	\$19,854,288	\$17,181,260	357	
	Indirect Effect	\$16,134,063	\$7,576,700	\$4,725,792	82	
	Induced Effect	\$16,379,177	\$8,941,828	\$5,061,873	124	
	Total Effect	\$76,822,052	\$36,372,815	\$26,968,925	563	\$1,881,973
2014	Direct Effect	\$45,094,393	\$20,206,298	\$17,485,878	363	
	Indirect Effect	\$16,420,115	\$7,711,033	\$4,809,579	83	
	Induced Effect	\$16,669,574	\$9,100,363	\$5,151,618	126	
	Total Effect	\$78,184,082	\$37,017,693	\$27,447,075	572	\$1,861,635
2015	Direct Effect	\$70,237,721	\$31,472,744	\$27,235,497	566	
	Indirect Effect	\$25,575,495	\$12,010,481	\$7,491,261	130	
	Induced Effect	\$25,964,046	\$14,174,462	\$8,024,011	196	
	Total Effect	\$121,777,262	\$57,657,688	\$42,750,770	892	\$2,895,507

Source: TXP, Inc

Technical and Administrative Issues

Overview

To qualify for the Oklahoma State tax incentive, projects must qualify for the federal tax credit, meeting the requirements established by both the Internal Revenue Service and the U.S. Department of the Interior. The State Historic Preservation Office (SHPO) serves as the initial point of contact for applicants, and it participates in the determination that a building is a "certified historic structure" and the review of rehabilitation work. The U.S. Department of the Interior, National Park Service (NPS), is the agency responsible for certifying historic structures and rehabilitation work. The Oklahoma Tax Commission (OTC) addresses taxpayer questions regarding the State tax return, State statutes, and OTC rules for using the State tax credits.

The administrative process has three parts:

1. **Building Eligibility.** In order to be eligible for historic preservation tax credits, all projects must be certified as historic structures. A *certified historic structure* is a building that is listed individually in the National Register of Historic Places —OR— a building that is located in a *registered historic district* and certified by the National Park Service as contributing to the historic significance of that district. The "structure" must be a building—not a bridge, ship, railroad car, or dam (A registered historic district is any district listed in the National Register of Historic Places. Buildings individually listed in the National Register of Historic Places are already certified historic structures).

Owners of buildings within historic districts must complete Part 1 of the Historic Preservation Certification Application—Evaluation of Significance. The owner submits this application to SHPO. The SHPO reviews the application within 30 days of receipt and forwards it to the NPS with a recommendation for approving or denying the request. The NPS then has 30 days to determine whether the building contributes to the historic district. If so, the building becomes a certified historic structure. The NPS bases its decision on the U.S. Secretary of the Interior's Standards for Evaluating Significance within Registered Historic Districts.

If the building is not within a historic district but otherwise qualifies for the National Register, NPS will issue a *preliminary determination of significance*. Under such circumstances, formal listing of the building in the National Register must occur within 30 months of the date the tax credits are claimed. The formal National Register listing process is separate from the Historic Preservation Certification Application process, though SHPO serves as the applicant's primary point of contact for both processes.

2. **Preliminary Certification of Qualified Expenses.** The NPS must approve, or "certify," all rehabilitation projects, ensuring that the proposed project will not damage, destroy, or cover materials or features, whether interior or exterior, that help define the building's historic character. Before rehabilitation work begins, the property owner completes a Part II application to receive preliminary certification of the proposed work. SHPO reviews the application within 30

days of receipt, requests additional information if needed, and transmits the application to NPS along with its assessment of eligibility. NPS then has 30 days to review and make a determination of eligibility.

In order to qualify for the federal credit, the following conditions must be met:

- The building must be depreciable. That is, it must be used in a trade or business or held for the production of income. It may be used for offices, for commercial, industrial or agricultural enterprises, or for rental housing. It may not serve exclusively as the owner's private residence.
 - Qualified rehabilitation expenditures (QRE) include costs of the work on the historic building, as well as architectural and engineering fees, site survey fees, legal expenses, development fees, and other construction-related costs, if such costs are added to the property basis and are reasonable and related to the services performed. They do not include acquisition or furnishing costs, new additions that expand the building, new building construction, or parking lots, sidewalks, landscaping, or other related facilities. On average, approximately 20 percent of the funds invested in a historic rehabilitation project are not eligible for the tax credit.
 - Upon receiving preliminary certification, the owner must complete the rehabilitation project within 24 months or in phases with all work completed within 60 months of the approved Part 2. Should changes in the proposed work be deemed necessary, the owner must submit an amendment sheet in the same manner as the original Part II.
 - The property must be placed in service (that is, returned to use). The rehabilitation tax credit is generally allowed in the taxable year the rehabilitated property is placed in service.
3. **Certification of Complete Work.** Upon completion of the rehabilitation project, the property owner completes the Part III application to obtain final project approval. Within 30 days of submission, SHPO conducts an on-site inspection of the completed project, and transmits the application to NPS along with its assessment of eligibility. NPS then has 30 days to review and issue the final certification.
4. **Tax Credit Receipt.** The federal tax credit is equal to 20 percent of QRE. This means that, when coupled with the State credit, 40 percent of eligible expenses may be reimbursed for qualified historic rehabilitation projects in Oklahoma. Owners may begin claiming the tax credits on the basis of their approved Part II application. However, failure to obtain an approved Part 3 application will result in recapture of any credits claimed.

Due to the transferability of the tax credit during the five years following the year of rehabilitation, developers are able to transfer the amount of the tax credit to an entity or person to offset tax liability. Applicants generally sell the credit to third parties and use the proceeds to reduce construction-related debt, but the sale of a HPTC certificate creates taxable income,

resulting in additional income tax due by the seller. As a result, only \$0.80 to \$0.90 of every Oklahoma tax credit dollar issued actually goes towards rehabilitation costs; the remainder goes to investors, tax credit brokers or syndicators, and the federal and state government (in the form of income taxes). This is higher than the nationwide average of \$0.65 to \$0.75 per dollar. Though the length of the transferability period allows the Oklahoma tax credit to convey more “bang for the buck” than those offered by other states, this also introduces a measure of unpredictability into the state budget.

The owner must hold the building for five full years after completing the rehabilitation or pay back the credit. If the owner disposes of the building within a year after it is placed in service, 100 percent of the credit is recaptured. For properties held between one and five years, the tax credit recapture amount is reduced by 20 percent per year. The NPS or the SHPO may inspect a rehabilitated property at any time during the five-year period. The NPS may revoke certification if work was not done as described in the Historic Preservation Certification Application, or if unapproved alterations were made for up to five years after certification of the rehabilitation. Work done after the initial five year period is not subject to review.

5. **Reporting.** Both SHPO and NPS maintain databases with information on tax credit projects, and NPS issues annual reports for each fiscal year. The Federal data on the completed projects is also available through the free data interface PolicyMap, with the name and address of the property, the final estimated qualified cost, and the use available.

Summary

Overall, the decision by legislators to tie the State tax credit to the federal process results in more efficient, streamlined, and accountable program administration. Each project is vetted and screened by SHPO and the NPS, and the credit is granted only after completion and certification of compliance with the U.S. Secretary of Interior Standards. The incremental burdens to the State above and beyond those involved in the administration of the federal tax credit program are minimal.

Outcomes

Outcomes

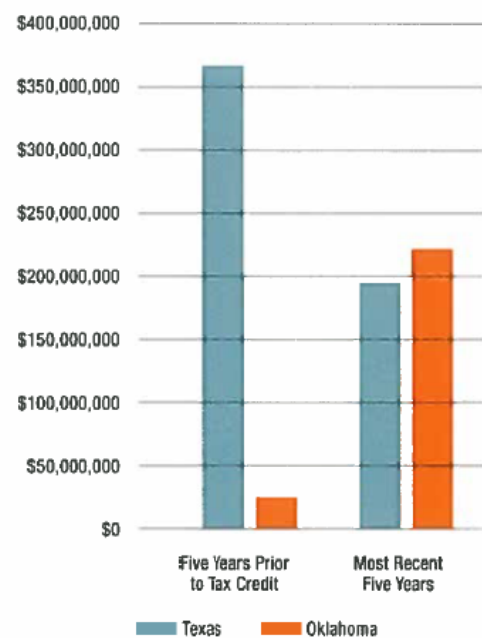
From the prior discussion, the following have been identified as key issues for evaluation:

1. What has been the impact of the credit on identified goals?
2. How does Oklahoma's experience compare to the nation as a whole and other states?
3. How should the identified costs be weighed against the benefits (both quantitative and qualitative)?

Impact: Increase Investment in Historic Rehabilitation

Whether the underlying goal is to increase property investment or support the construction industry or revitalize aging neighborhoods, the stated objective of the historic tax credit program is to increase the number of historic rehabilitation projects in the state of Oklahoma. The State tax credit program has been highly successful in this regard, both compared to the period prior to the tax credit as well as compared to nationwide trends. Since 2005, the year of that the program was tied to the federal process, the average number of annual historic rehabilitation projects has quadrupled, and the total development investment has increased by 82 times the prior investment, from just over \$1.0 million in 2005 to \$85.9 million in 2015. According to National Park Services Data, in FY2009, Oklahoma ranked 41st out of 47 states in the number of certified expenses; in FY2015, the state came in at 16th.¹⁶ Of the six states that border Oklahoma, only Missouri saw more historic property tax investment.

*Historic Preservation Investment
Oklahoma vs. Texas*



Source: Place Economics 2016

According to data compiled from the NPS by Place Economics, between FY2000-FY2005, developers in Texas invested almost 17 times more in historic preservation developments as developers in Oklahoma. These trends have changed demonstratively under Oklahoma's current regulations. In the last five years for which data was available, Oklahoma's historic preservation development was 14 percent higher than that of Texas. The recently-enacted Texas historic tax credit program was modeled after the Oklahoma Credit.¹⁷

¹⁶ U.S. Department of the Interior, National Park Service, Technical Preservation Services. March 2016. "Statistical Report and Analysis for Fiscal Year 2015." *Federal Tax Incentives for Rehabilitating Historic Buildings*. Available at: <http://www.nps.gov/tps/tax-incentives/taxdocs/tax-incentives-2015statistical.pdf>

¹⁷ Place Economics. 2016. *Oklahoma Historic Tax Credit: Impact on the Oklahoma Economy*. Prepared for the Tulsa Foundation for Architecture.

Impact on Identified Goals: the “But For” Analysis.

An important factor in considering the efficacy of incentives is the consideration of whether the incentive is necessary to spur the investment. In the theory of incentives, the ‘but for’ test refers to the argument that a project or a capital investment would not be made without the incentive (‘but for the incentive’ the rehabilitation project would not occur in Oklahoma). In the case of many projects, the existence of incentives in other states can be cited as a need for the Oklahoma incentive – ‘but for’ the Oklahoma incentive, the project will occur in other states. Tax incentives provide benefits to states to the extent they change behavior (as opposed to rewarding what a business or individual would have done anyway). In the case of historic preservation credits, the key question is to what extent the incentive caused rehabilitation to occur within the state that wouldn’t have occurred otherwise.

With historic preservation, this question is complicated by the presence of federal tax incentives for rehabilitating historic buildings, the largest of which provides a 20% credit that often stacks with state-provided credits. Evaluations not taking federal credits into account likely overstate the economic impacts of state incentives. However, it is extremely difficult and labor intensive to obtain the data necessary to disaggregate the impacts of these two tax incentives.

Several studies have developed methods to estimate the added value of the state tax credits. One approach is to present the results based on different scenarios, then analyze which scenario is most plausible. An assessment by the State of Connecticut presents four attribution scenarios: the incentive is responsible for 0%, 20%, 50%, and 100% of the measured economic activity.¹⁸ Another approach is to study projects that applied for state incentives but did not receive them. If projects that were rejected for incentives ended up going forward anyway, that could be a sign that the incentives often are not necessary.¹⁹ The State of Oklahoma does not retain this type of data, because it is not required under the federal process.

A third study used survey instruments and focus groups with tax credit users, who reported that very few, if any, of the projects on which they have worked or with which they are familiar would have been completed without tax credits. A few might have been done, but at such a low level of quality that they might not have been able to attract users. Both tax credit users and local-government officials stated that there is ample demand for rehabilitated historic properties in their cities, but the costs of rehabilitation are so great that tax credits are still needed to close the gap between market value after rehabilitation and the costs of rehabilitation.²⁰

¹⁸ Department of Economic and Community Development. September 2014. An Assessment of Connecticut’s Tax Credit and Abatement Programs. Available At:

http://www.ct.gov/ecd/lib/ecd/decd_sb_501_sec_27_report_revised_2013_final.pdf

¹⁹ Ohio Development Services Agency. 2015. Ohio Historic Preservation Tax Credit: 2015 Comprehensive Report. Available at: <https://development.ohio.gov/files/redev/2015OHPTCComprehensiveReport.pdf>

²⁰ Virginia Commonwealth University, Center for Urban and Regional Development. January 2014. Economic Impact of Historic Rehabilitation Tax Credit Programs in Virginia. Available at:

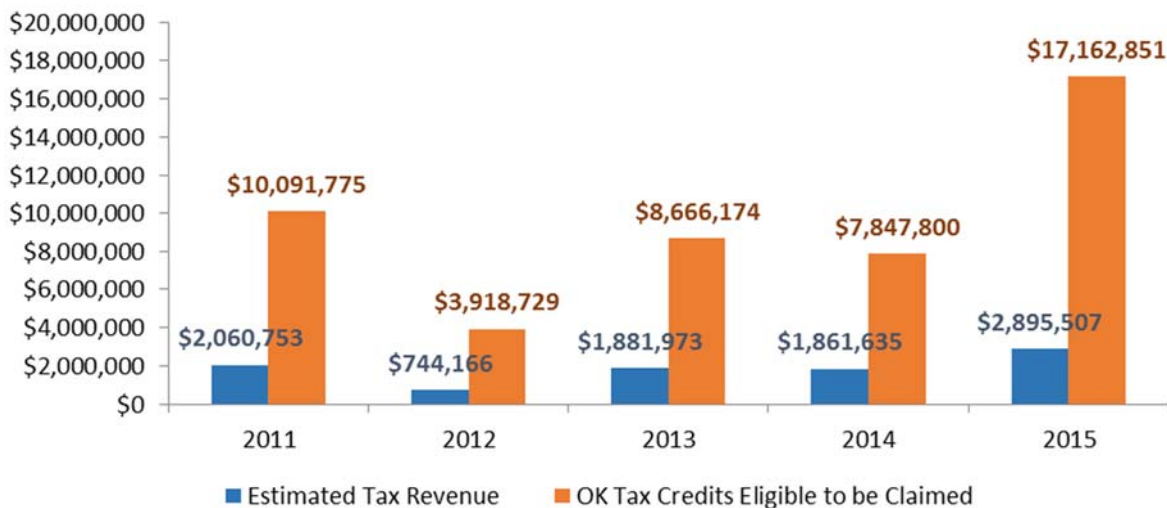
https://preservationvirginia.org/docs/VCU_Historic_Tax_Credit_Report_FINAL_21-1-2014smallpdf.com.pdf

In other words, it is not possible to conclusively demonstrate that the state tax credit changes behavior independently from the developer tax credit. However, self-reported data and findings from academic research indicate that this may be the case.

Cost Benefit Analysis

The financial analysis suggests that the costs of providing the historic tax credit are likely to continue to grow in the near future. The economic impact analysis suggests that the estimated tax revenue to the State of Oklahoma does not approach the level of the tax incentive.

Credits Eligible to be Claimed and Estimated Tax Revenue, 2011 to 2015



These are aggregate impacts, and do not take into account spillover effects on adjacent property values, the tipping point effect of a significant development in an otherwise underutilized retail corridor, or cost savings in local service provision due to infill development. In smaller towns, one building can have a big impact and start a wave of interest for new businesses and privately funded building rehabilitation projects. Local communities benefit from reuse of existing buildings because infrastructure is already in place. Constructing a new building on undeveloped land requires new roads and/ or utility lines. Historic buildings can often take advantage of existing roads and utilities, saving infrastructure costs to local governments. These local effects, which can be vitally important on the neighborhood and city level, are not reflected in the aggregate statewide perspective.

Recommendations

Recommendation: Reconfigure with a Program Cap

The historic rehabilitation tax credit is widely used around the country, and has been generally recognized for its significant and wide ranging impacts on the local level. State program evaluations and academic research have demonstrated a significant and positive effect on property tax values, business attraction, population regrowth, and higher employment. Though not readily quantifiable, the impact on place-making, heritage, and local identity is generally recognized to be significant and of intangible value. As such, historic rehabilitation tax credits are proven tools that help to drive local revitalization and promote more cost effective infill development patterns.

On a statewide level, however, the aggregate benefits of the program are less readily quantifiable. The total effect on job growth is limited to fewer than 900 jobs per year, and the estimated impact on State revenues is less than \$3.0 million per year, only 17 percent of the cost incurred by the State. This finding is consistent with those reported by other program analyses, largely because new jobs created by the program are limited to temporary construction work. The long-term fiscal impacts are experienced at the local level, through growth in assessed value.

The Oklahoma program is among the most efficient nationwide, because it is directly tied to the federal program with no additional administrative burdens or costs. The policies and procedures in place are timely, transparent, and accountable.

The 2005 legislation changes – including both the expansion of eligibility and the alignment of administrative procedures with federal requirements – have led to a substantial increase in tax credit utilization. Since 2005, the year of that the program was tied to the federal process, the average annual historic rehabilitation projects has quadrupled and the total development investment has increased 82 times, from just over \$1.0 million in 2005 to \$85.9 million in 2015. In FY2009, Oklahoma ranked 41st out of 47 states in the number of certified expenses; in FY2015, the state came in at 16th. The program has been exceptionally successful at increasing investment in historic rehabilitation in Oklahoma.

However, without a cap in place, the cost burden on the State could continue to grow beyond the point of desirability. Other states, such as neighboring Missouri, have experienced growth in this program far beyond the initial predicted utilization levels. At present, more than half of all states have an annual cap in place.

The project team recommends that Oklahoma adopt an annual cap to ensure some measure of future budget predictability. Further, in order to keep administration burdens to a minimum, once a program cap is in place, the team recommends that projects be accepted on a first-come-first-serve basis in lieu of a supplementary assessment procedure.