Department of Commerce

Responses to the DLS Analysis

of the Commerce FY 2021 Operating Budget Allowance

Prepared for the Hearings before the House Appropriations Subcommittee on Education & Economic Development on February 20, 2020 and the Senate Budget & Taxation Subcommittee on Education, Business and Administration on February 28, 2020.

DLS Operating Budget Recommended Actions:

1. **Add the following language:**

<u>Provided that $315,436 in general funds, $106,935 in special funds, and $15,202 in federal funds for turnover in subobject 0189 is reduced.</u>

Commerce response:

Commerce respectfully disagrees with this recommendation.

Although it is true that Commence has experienced a high vacancy rate recently, this is an anomaly and should not be expected to carry forward and impact the budget in FY 2021. The recent high vacancy rate resulted mostly from the agency restructure (during the restructure planning and development there was reduced recruiting functions) as well as staff retirements at end of CY 2019, as well as typical increased amounts of turnover at the end of a four year term. It is important to note as recently as October 2017 the percentage of vacancies at Commerce was only 2.2%.

The intent of Commerce is to have under 10 vacancies by the close of FY 2020 which is about a 5% vacancy rate. However, Commerce recognizes there will be fluctuations in actual turnover during the year resulting in a slightly higher rate of around 6% rate per the budget allowance.

The proposed change to turnover is not a cost saving, rather it would limit Commerce's ability to carry out the mission of attracting, creating, and retaining jobs and business for the State. If the turnover is kept at 8.5%, Commerce would be forced to make decisions to meet the budget restrictions. We either would have to maintain an artificially high amount of vacancies, which may decrease our customer service and put undue strain on our current staff, or the Department would have to find savings elsewhere to offset the budget reduction. Those reductions could include decreasing the amount of grants and contracts that are awarded directly to business in State. Either option is not in the best interest for Commerce or the State.

2. **Delete funding for the Howard Street tunnel project and instead provide that funding through the Transportation Trust Fund due to the transportation nature of the project.**

Reduction amount: $10,000,000 GF

Commerce Response:

Commerce respectfully disagrees with this recommendation.

According to projections from the Port of Baltimore the economic impact generated by the Howard Street tunnel project includes approximately 7,290 jobs. Of those, 2,950 are direct jobs, 3,400 are induced jobs, and 940 are indirect jobs. Additionally, new container activity at the marine terminal would be a major source of personal and business revenues annually, including $613M in personal income, $443M in business revenues, and $65M in state and local tax revenues. Due to the fact that the project is both a Transportation project and an Economic Development project it was determined it would be best to use both General Funds and General Obligation bonds to support the project. As such, General Funds were put into the Commerce budget as we are the State's economic development agency.

The Howard Street Tunnel project has been a State of Maryland priority for years. The State's investment in expanding capacity on the CSX-owned tunnel and associated Baltimore City bridges will unlock the Port of Baltimore's ability to reach Chicago and the heartland via double-stacked container service. This expanded capacity will provide immeasurable economic benefits for the State, with thousands of direct, indirect, and induced jobs, along with thousands more construction jobs during the project. The tunnel improvements will also allow the State to fully realize the significant investments the State has already made in Seagirt Marine Terminal.

The Port of Baltimore is one of the State's most prized economic engines, supporting 139,180 jobs. The Port is strategically positioned to capitalize in the coming years on its prime geographic location as the East Coast's most inland port, Baltimore's strong consumer base, and, perhaps most importantly, the strong Port workforce in Baltimore. The Port's workforce is consistently recognized as America's most efficient in the port industry.

When the opportunity for federal funding for the Howard Street Tunnel project came available, the State worked collaboratively with CSX across agencies to ensure the project would be fully funded and ready to begin construction next year. MEDAAF is meant for exactly these types of projects – job-creating, economic development projects –

and will provide the State and the City of Baltimore a quick and high rate of return on this investment.

3. **Reduce allowance for the More Jobs for Marylanders Income Tax Credit Reserve Fund to $2 million**

Reduction Amount: $7,063,374 GF

Commerce response:

Commerce respectfully disagrees with this recommendation.

The More Jobs for Marylanders tax credit program was adopted in 2017 to attract new manufacturers and it was expanded in 2019 to include non-manufacturers in Opportunity Zones. By operation of statute, programmatic funds are appropriated and reserved based on a first-come, first serve basis when Commerce approves the initial income tax credit application. Commerce awards the final tax credit when the business retains the newly created qualified positions for at least 12 months.

Businesses are eligible to receive the tax credit, which is equal to the highest withholding rate paid to those qualified positions, each year for ten years that those positions are maintained. Businesses are also eligible for additional tax credits based on new positions created and retained within that period.

Overall, this program remains in its early stages. Commerce has received to date 227 notices of intent and 92 enrollment applications.

To forecast future demand, Commerce relies on the information provided in the enrollment and initial applications. Commerce conservatively forecasts demand for the next two fiscal years using that information, with the reasonable assumption that those jobs will be created and would qualify at the expiration of the 12-month retention period.

However, the forecast does not account for businesses that have submitted their notices of intent but have not submitted any other applications mandated by statute as the same statute does not mandate any timeline for their submission of any one of the three applications required to be submitted to Commerce. Therefore, it is possible that a business simultaneously applies for an initial and final certification in the same fiscal year. Similarly, the forecast does not include unenrolled businesses that have received funding proposals by Commerce.

Conclusively, current utilization will not be predictive of future activity, and unused funds should continue to be applied to the program's reserve fund in anticipation of a rise in business demand.

4. **Adopt the following narrative:**

More Jobs for Marylanders Income Tax Credit Reserve Fund Annual Report: The committees request that the Department of Commerce (Commerce) Include in the annual report on the More Jobs for Marylanders Income Tax Credit Reserve Fund a cost estimate that accounts for projected participation in the program by new companies and includes projected expenses for five years. Commerce should also include this same information for the Sales and Use Tax Refund Reserve Fund

Commerce response:

Commerce respectfully disagrees with this recommendation.

As stated above, Commerce utilizes a conservative measure to forecast demand based on a reasonable assumption that a business must retain a position for at least 12 months before applying for final certification. Similarly, by operation of statute, a business certified in its first benefit year must reapply every year within its ten-year benefit period in order to receive the credit, and there is no mandatory timeline for submission. With the program at its infancy and demand growing, it would be infeasible to estimate project participation and expenses for the next five years.

The Department could report on the amount of future year benefits that companies currently enrolled in the program will potentially qualify for in the next five years, but we are unable to project that far out what new projects may enroll in the program in the meantime. Additionally, there may be projects which fall out or do not come to fruition which makes projecting that far out more difficult. The best we can do is assume that the current utilization will continue for the 10-year benefit period and that the utilization we projected for the upcoming fiscal year will carry forward as well.

5. **Delete funding for the More Jobs for Marylanders Sales and Use Tax Refund Reserve Fund due to lower than anticipated usage**

Reduction Amount: $1,000,000 GF

Commerce response:

Commerce respectfully disagrees with this recommendation.

Currently, Commerce has no projections on the anticipated use of the sales and use tax refund benefit, or the amount of refund that may be claimed in future years. There are four approved enrollment applications from new manufacturers that may qualify for the benefit, and there are currently no applications from new non-manufacturers in Opportunity Zones as that expansion of the program has been effective for less than a year. Those eligible businesses, however, would qualify for the benefit once they received their final certification for the income tax credit, which is anticipated in the current and future fiscal years.

The sales and use tax refund benefit serves to attract purchases from Maryland retailers and taxable service providers. The reserve fund, as statutorily created, assures those eligible businesses a partial return on their Maryland purchases.

6. **Reduce funding for tourism marketing in the Maryland Tourism Development Board.**

Reduction Amount: $250,000 GF

Commerce response:

Commerce respectfully disagrees with this recommendation.

The reduction of funds for the Maryland Tourism Development Board will stop the forward progress that has been made in growing revenue through visitor spending. The Tourism Promotion Act of 2008 identified eight sales tax codes that are tracked and multiplied by a tourism factor – the amount deemed attributable to visitor spending – by the Maryland Comptroller. This tax revenue has risen on average 4.4 percent since Fiscal Year 2015. Tax collections rose 4 percent to $1.3 billion in Fiscal Year 19, which is the same year that there was an increase of $1 million to Maryland Tourism Development Board appropriation. Fiscal Year 19 was also a time of relatively low inflation.

As the state's investment in tourism advertising and marketing dollars grows so has the sales tax revenue. Any reduction in advertising and marketing funding will lessen the amount of revenue and the benefits that the state derives from visitor spending.

The Destination Analysts' Advertising Effectiveness Study conducted in Fall 2019 shows that for every dollar spent in advertising and marketing Maryland as a travel destination, $31 is returned to the state's economy; thereby, a $250,000 decrease in general funds for the advertising and marketing conducted by the Maryland Tourism Development Board has the potential of eliminating $7.8 million in economic activity to the state.

7. Delete funding for a new contract to promote Maryland's business advantages. Reduction Amount: $1,000,000 GF

Commerce response:

Commerce respectfully disagrees with this recommendation.

Deleting this funding request reduces Maryland's ability to market the state as a premiere place to move and/or grow businesses. It is imperative to get Maryland's business strengths in front of executive level leaders in businesses in our key industry sectors like cybersecurity, life sciences, advanced manufacturing and financial services. Currently, our digital marketing budget allows Commerce to reach about 10 geographic locations a year. Additional funds would allow the expansion of that number and reach twice as many each year. Maryland is marketed in large mass audience publications each year but the number of times these advertising placements can be made is limited due to lack of funds. Frequency and consistency is the key to economic development marketing. Since 2015, along with the Maryland Marketing Partnership, Commerce has doubled its web and social media audience, improved the state's business-friendly image, and reached over 283 million business people. Two key projects were identified as part of this request as well.

1. Producing and distributing a Maryland publication that highlights the advantages of doing business and working in Maryland. This publication would be distributed to site location consultants, businesses and potential workers nationwide in a direct marketing campaign. This effort would complement current marketing efforts.

2. Sponsoring the Site Selectors Guild event being hosted in Maryland. This event brings site consultants from all over the country to Maryland next year for their annual conference. Funds would be used to sponsor this unique opportunity to showcase Maryland in front of a key national audience.

8. **Delete special funds for the Preservation of Cultural Arts (POCA) and adopt a BRFA provision transferring these funds to the General Fund.**

Reduction Amount: $1,000,000 SF

Commerce response:

Commerce respectfully disagrees with this recommendation.

The retention of the $1,000,000 from the POCA fund in the Maryland State Arts Council budget will allow the continuation and expansion of the Arts in Education programs for aging, incarcerated and veteran populations, County Arts Development programs, Grants for Organizations, the Creativity Grant program and the Professional Development Grant program.

DLS Budget Reconciliation and Financing Act Recommended Actions:

1. **Add a provision that transfers $1 million in special funds from the Special Fund for the Preservation of the Cultural Arts (POCA) in fiscal 2021 to the General Fund, and alters the distribution of admissions and amusement tax revenues such that funds that would otherwise go to POCA are instead distributed to the General Fund in fiscal 2022 and all future years**

Commerce response:

Commerce respectfully disagrees with this recommendation.

The retention of the $1,000,000 from the POCA fund in the Maryland State Arts Council budget will allow the continuation and expansion of the Arts in Education programs for aging, incarcerated and veteran populations, County Arts Development programs, Grants for Organizations, the Creativity Grant program and the Professional Development Grant program.

2. **Amend the provision that decreases the maximum amount of film production tax credits to $10 million in fiscal 2021 and apply to all future years**

Commerce Response:

Commerce respectfully disagrees with this recommendation.

On May 17, 2019, the Department of Commerce (DOC) sent Showtime a Letter of Qualification reserving $10,000,000 in tax credits from FY 2020 funds for the first season of the series The President is Missing (TPIM).

With the enactment of Chapter 595, Acts of 2018, the maximum amount of credits available to a production or a single season of an on-going series is $10 million. Based on the estimated amount of qualifying Maryland costs put forth in their application and using the 27% credit for a television series, TPIM would qualify for millions more in tax credits than they will receive with the $10 million cap.

Chapter 595 also created a tax credit program specifically for Maryland small and independent productions (Maryland Small Films). Ten percent of the annual tax credit appropriation is set aside for productions that meet the criteria in the statute to be classified as a Maryland Small Film.

Commerce supports the reduction in FY 2021 funding proposed in SB 192/HB 152 - Budget Reconciliation and Financing Act of 2020 because this reduction will still leave the Department with enough funding to cover the State's commitment to TPIM, but extending this reduction for future fiscal years will restrict Maryland's ability to attract future projects to the State. Additionally this reduction will leave less funding available for Maryland Small Films in future years.

Since the inception of the Film Production Activity Tax Credit in 2011, thirteen productions have utilized the tax credit program resulting in a combined economic impact of $890 million in Maryland.

A 2014 study by the Regional Economic Studies Institute titled "Economic and Fiscal Impacts of the Film Production Activity Tax Credit in Maryland" concluded that for every dollar claimed in film tax credits, $1.03 is returned to the State in total additional taxes, and every dollar claimed in tax credits generates an additional $3.69 in economic output.

These impact numbers do not take into account the fact that if you have a vibrant film industry, an experienced film crew, and infrastructure base, other non-incentivized productions (commercials, television segments, indie films, music videos, etc.) will come to film in Maryland, hire local crew and cast, and utilize local businesses. Over 20 Maryland colleges and universities are graduating students with majors or minors in film, communications, electronic media, and drama. Increased production means career opportunities, and will stem the tide of the creative brain drain to states with significant incentive programs and job opportunities.

In addition to these impacts, there are also the ancillary benefits of filming that have a positive effect on Maryland, including film induced tourism and a positive spotlight on Maryland.

Other Responses:

Commerce should comment on the reasons for the low activity level in MEDAAF

Projects in discussion or in the proposal letter stage being slower to move forward reflects more deliberative decisioning among companies prior to making a commitment to a major project, which began to emerge in mid to late summer. Underlying causes are rooted largely in macro factors (tariff and emerging economic uncertainty). Since that time, activity has resurged although business due diligence continues to be lengthy in both information sought and analyzed plus time.

To date FY 2021 proposals includes $28 million in total funds. The current pipeline includes 36 transactions: $27.1 million in state funds expected to spur $865 million in private investment.

Commerce should comment on the use of the additional tourism marketing funds

The additional marketing funds will allow the Maryland Tourism Development Board to purchase advertising in markets that have shown the highest return on investment.

Build upon success: An Advertising Effectiveness Research Study, conducted by Destination Analysts, on Maryland's advertising in Fall 2019 took place to ascertain those cities where consumers were influenced to visit Maryland after seeing its advertising campaign, Open for IT! That research showed that visitors from New York, Philadelphia and Washington, D.C., and Cleveland were influenced to come to Maryland and spent on average $750 per trip compared to the average visitor spending of $249[1].

Increase marketing in the "off-season": Most of the investment in advertising occurs to drive spring – summer travel. These additional dollars will allow the investment in "off-season" travel such as the fall, which will increase Maryland's viability as a multi-season destination.

Increase international presence: Additionally, these dollars will allow Maryland to build upon the marketing platform that has begun in Toronto, Canada to support this important international market where customers can drive and fly to Maryland.

The Advertising Effectiveness Study shows that for every dollar spent in advertising and marketing Maryland as a travel destination, $31 is returned to the state's economy; thereby, a $250,000 decrease in general funds for the advertising and marketing conducted by Maryland Tourism Development Board has the potential of eliminating $7.8 million in economic activity to the state.

[1] DK Shifflet