REPORT OF THE JOINT SUBCOMMITTEE
STUDYING ON

INCENTIVES TO PROMOTE ECONOMIC DEVELOPMENT IN THE COMMONWEALTH

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

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Introduction

The use of incentives has become an essential tool available to states and localities to promote their economic development goals. As competition among jurisdictions for new jobs and investments has escalated, particularly over the last decade, the role of incentives in encouraging a prospect to chose one jurisdiction over another has become more important. Since states throughout the South began to offer incentives as early as the 1950s by providing industrial development bond financing, their use has grown to where now every state has some form of incentives at its disposal.

As the use of incentives has become more frequent, the types of incentives has also evolved. Today, incentive programs range from workforce development programs to tax credits for job creation and investment to infrastructure development grants to elaborate tax rebate schemes. At the same time, the cost of incentives has increased dramatically. Not only are states forgoing revenue as a result of tax credits, but they are appropriating millions of dollars to support their ever more complex programs. Incentives, however, cannot and should not be thought of as solely tax credits and grant-type programs. A low tax rate, well-developed infrastructure, and location are also forms of "incentives" that are considered by businesses as they make location decisions.

In 1994, Governor Allen launched the *Opportunity Virginia* strategic planning process to create a comprehensive strategic economic plan for the Commonwealth. As part of that effort, over 800 business and community leaders participated in forums and regional planning sessions to examine those issues which most directly impact the state's ability to promote economic prosperity. Each of the state's eighteen Regional Economic Development Advisory Councils also took a critical look at its region's strengths and weaknesses in supporting business development.

One of the issues that was identified as critical to the state's ability to compete effectively in a global marketplace was its use of incentives. In the *Opportunity Virginia* report, an entire section was devoted to the development of a proposed incentives policy and concepts for changes to existing incentives or ideas for new incentives.

In that section, seven guiding principles for the use of incentives by the state to promote job creation and investment were outlined. These principles are:

1. Incentives should be used cautiously and only as a competitive necessity to attract or retain desirable jobs and investment.

2. Incentives must make good business sense.

3. Incentives must promote partnerships between the public and private sector.

4. Incentives must support the opportunities and priorities identified by the state's long-range planning for economic development.

5. Incentives must be available to both existing state businesses and recruited businesses in core sectors, as well as businesses that expand or add to Virginia's economic vitality.

6. Local and regional cooperation and participation are essential.

7. Incentives must be subject to ongoing evaluation and measurement to assess effectiveness and relevance.

In order for any incentives policy to be effective, the *Opportunity Virginia* strategic plan noted that Virginia must have an arsenal of incentives to effectively compete with other states in economic development, conform to the guiding principles (as outlined above), and provide professional economic developers, local governments, and the private sector with a set of guidelines on what Virginia is willing to do and not willing to do to attract and retain businesses.

For the most part, Virginia's existing economic development incentives meet the guidelines outlined in *Opportunity Virginia*. The state offers several specialized tax credit programs; including the Major Business Facility Job Tax Credit, the Recycling Tax Credit, and the income tax and real property investment tax credits under the state's Enterprise Zone program; a customized industrial training program; grants from the Governor's Economic Opportunity Fund; and industry specific performance grants such as the Solar Photovoltaic Manufacturing Incentive Grant.

While Virginia's incentives have generally been very effective in achieving the state's economic development goals in a cost effective manner, there are gaps that exist in meeting the needs of the marketplace that must be addressed as the state enters the 21st century. Moreover, as competition among jurisdictions continues to increase, the cost of incentives has escalated. In a time of tight state budgets, the cost of incentives has also increasingly become an issue.

As a result of the findings in *Opportunity Virginia*, the General Assembly passed Senate Joint Resolution 369 and House Joint Resolution 616 to create the Joint Subcommittee to Study Incentives to Promote Economic Development in the Commonwealth. In these resolutions, the General Assembly requested the Subcommittee to examine "various initiatives offered by the state to attract and retain businesses in the Commonwealth in order to promote job creation and investment in Virginia's communities and alternative incentive strategies to better utilize existing resources and new incentives."

This report reviews the materials that have been presented to the Subcommittee regarding the use of incentives in Virginia and neighboring states, materials on the national debate about the use of incentives, and the structure of Virginia's existing incentives. The report also makes recommendations for the General Assembly to consider to strengthen the state's existing incentives and create new opportunities for cooperation to promote economic development across the Commonwealth.

In addition to reviewing materials relevant to incentives, the Subcommittee also discussed issues relating to the formation of regional industrial parks. Senator Hawkins introduced Senate Joint Resolution 386 in 1995 to study this issue. He proposed a constitutional amendment to allow localities to form a separate government entity to form and govern industrial parks that would benefit a particular region. Each industrial park would set its own tax rate, and the proceeds from development of the park would be returned to the participating localities on a pro rata basis depending upon their contributions towards the initial construction of the park.

For the purposes of this study, incentives have been differentiated from small business financing and capital access issues. While incentives can promote capital access and business financing is an incentive, the Subcommittee focused on those ways in which the state provides some form of inducement to encourage a business to either relocate to or expand in the Commonwealth.

Existing Work on Incentives

Opportunity Virginia's examination of the incentives issue is part of an analysis that has been ongoing since the use of incentives dramatically increased in the Commonwealth during the 1980s. Prior to the completion of the *Opportunity Virginia* plan, several organizations, including the Virginia Chamber of Commerce and the Virginia Economic Developers Association, also examined the use of incentives in Virginia and made recommendations regarding policies that the state should adopt regarding how they are used to encourage business relocations or expansions. The following is a summary of their findings.

Virginia Chamber of Commerce

In order to provide a framework for the development of a statewide strategic plan, the Virginia Chamber of Commerce initiated the preparation of a vision statement in 1992 based upon the observations of business leaders from across the state about the direction Virginia should take as it approached the 21st century.

The Chamber noted that Virginia is fortunate to have many advantages over other states which has allowed it to have a relatively stable and diverse economy. A strong system of higher education, an excellent location, a high quality of life, and a "world-class" high technology industry have all helped to keep Virginia prosperous and offer many opportunities for growth in the future. Despite these advantages, the Chamber noted that Virginia was not aggressively pursuing some other industries which offer significant opportunities for job creation. Among these industries are aerospace, biotechnology, maritime, manufacturing technology, system integration, tourism, and international trade.

In order to further bolster Virginia's economic development effort, the Chamber made a number of recommendations for government and business leaders to pursue. The Chamber noted that Virginia must "acknowledge the widespread use and essential nature of business development incentives, fiscal and otherwise, and tailor a package in keeping with Virginia's needs and industrial opportunities." The Chamber also supported worker training initiatives and obtaining working capital for Virginia businesses in order to bolster the state's attractiveness.

Virginia Economic Developers Association

In 1993, the Chairman of the Virginia Economic Developers Association (VEDA) appointed a task force to develop an incentives policy for the state. All VEDA members were surveyed as part of the task force's activities to gauge their views on the role of incentives in promoting economic development. The responses formed the basis for the report of the task force which VEDA has termed a "work in progress" to guide the administration and the General Assembly.

Basically, there were five recommendations of the VEDA Incentives Task Force to state policy makers: develop and adopt a strategic plan that identifies targets of opportunity by business type or industry sector; adopt an incentives policy structure that takes into account benefits from the private sector, cost to government, rate of return, and performance standards; fully fund existing incentives such as state training efforts, road and rail access programs, and the Governor's Economic Opportunity Fund; consider appointing an incentives administrator to coordinate requests for incentives from local governments; and discuss ways local governments can be more creative and flexible when working with new or expanding businesses.

The Task Force made it clear that any reasonable incentives policy must be based on substantive policy guidelines and rigorous cost-benefit analysis, standards to ensure that companies meet specified performance guidelines in exchange for incentives, and that incentives should be focused on worker training and road access which will keep investments in Virginia. Questions such as how many jobs will be created, where they will be created, how much tax revenue will be generated, what are the company's future plans, what will a company contribute to strengthening existing industries, and how will a business support Virginia's high quality of life are all important in determining what is the right mix of incentives that the state should offer. Additional concerns about how to structure an incentive program to make sure the state does not lose money when granting incentives, business modernization issues, and ensuring that incentives benefit an entire industry cluster as opposed to one specific business must be considered. In order to keep interest in the state high, the Task Force also recommended that the Department of Economic Development must have the funding it needs to effectively market the state through industrial development advertising.

The National Debate about Incentives Use

Virginia is not alone in examining its use of incentives and how they fit into a strategic economic development plan. As the popularity of incentives has increased, serious questions have been raised about their effectiveness. Some people contend that they make no difference in a company's location decisions which are driven more by location, access to markets, and the skills of the workforce than state and local incentive offers. They contend that all incentives do is make a "good deal better." At the same time, many of these experts admit that incentives are here to stay, and that if they are to be used in a rational manner, that states and localities should adopt certain standards to ensure that taxpayers are protected.

The following is a summary of the reviews of incentives by the Corporation for Enterprise Development and the Council of State Governments where they examine how states use incentives and made recommendations to promote their effectiveness.

Corporation for Enterprise Development

Calling competition among states for economic development projects the "new Civil War," the Corporation for Enterprise Development (CED) explored the costs and benefits of the incentives offered by state and local governments. The CED's study noted that the cost for large economic development projects has risen dramatically during the past 15 years, from what was in 1980 considered a record of $11,000 per job to attract the Nissan project to Tennessee, to $200,000 a job to attract the Mercedes-Benz plant to Alabama. Of particular concern are claims by other states which have raised these battles to new levels. For example, Governor Jones of Kentucky appeared in a commercial on CNN telling business owners to "locate your manufacturing plan in Kentucky, and the state could reimburse your entire investment." Much of this growth in the incentive packages offered by states can be traced to reductions in federal assistance to promote business growth, stagnant employment growth, and increasing international trade competition.

Unfortunately, despite these large incentive packages, they do not always result in long term investments or the creation of permanent jobs. In 1978, Pennsylvania granted over $70 million to Volkswagen to build a plant in New Scranton which was expected to create 5,000 new jobs. There is some speculation that while Volkswagen had already chosen Pennsylvania before announcing that it was building a plant, the company kept the location decision secret while it sought offers from Pennsylvania and Ohio. After operating for less than ten years, the plant was closed. At no time had employment exceeded 2,500 jobs at the plant, and fewer than 10 percent of the anticipated spinoff jobs were ever created. The state lost its entire investment, however, negotiations between the state and Volkswagen may facilitate for arrangements to be made so that some of the loans from the state to Volkswagen can be repaid.

Many incentives offered by states are designed to attract manufacturing plants across state boundaries, however, the CED contends that its data showed that only four percent of employment growth among the top manufacturing firms resulted from relocating plants. Instead, over 60 percent was the result of expansions at existing sites while the remainder is attributed to new plant openings. Moreover, most employment growth in a state is the result of small business start-ups, not the growth of large, manufacturing plants.

The study concludes that incentives should only be a supplemental tool to promote economic development goals. Incentives do have a role to play, but they should follow five principles to ensure that they are reasonable and benefit the taxpayers. These principles are to develop policies that only use incentives when necessary and if sufficient safeguards such as sunset provisions are in place; that incentives should only have a limited and supportive role as part of an overall economic development strategy; incentives should be targeted towards creating new jobs or fostering or retaining jobs in economically distressed areas; tax competitiveness considerations should not be the sole or overriding standard in evaluating an area's tax or fiscal structure; and states or substate regions should cooperate on projects of mutual benefit instead of competing against each other for the same projects. Some specific recommendations to curb this intense competition is to further restrict the use of federal funds for plant relocations, establish a target rate of return for development incentives, requiring sunset provisions on all incentives to allow for legislative and executive branch review, and disclosure of the results of all development agreements with companies.

Council of State Governments

In October, 1993, the Council of State Governments convened a meeting of state economic development officials, corporate leaders, and university representatives to discuss the use of incentives by states to promote economic development goals. The report issued as a result of these discussions noted that the use of incentives is very widespread, and incentives such as inventory tax exemptions, job creation tax credits, tax exemptions on new equipment, and tax exemptions on raw materials exist in virtually every state. Mechanisms for delivering these incentives and assisting with business expansion and attraction such as state sponsored industrial development authorities, state bond financing, local revenue bond financing, local building loans, and state aid for plant expansions are also common. Southern states in particular have led in creating new economic development incentives.

This discussion group elaborated five policy options which should be considered by state government leaders when developing an incentives policy. These options are to have states periodically evaluate their business incentives; refrain from offering large, customized incentive packages that are firm-specific; implement policies that promote mutual cooperation between states to promote industrial development; initiate strategic planning efforts to improve the overall business climate and reduce regulatory barriers; and adopt sustainable development strategies.

The group was especially concerned about the escalating cost of incentives where the benefits may not equal the costs. Again in this report, the Mercedes-Benz project in Alabama which cost the state an estimated $300 million in incentives for a facility which is expected to create 1,500 jobs, was singled out as an abuse of the use of incentives. Further, many state incentives are designed to help only one particular company and lack any guarantees should the company move after using up its credits or fail to meet its employment expectations. Recognizing that states are increasingly relying on economic development incentives, some companies have resorted to "corporate blackmail" by threatening to move out of a state unless it is granted major tax exemptions and direct state grants.

Because competition for businesses will continue, the group has called for states to adopt a set of principles on interstate cooperation for industrial development. The fear is that much of this competition, especially when trying to lure a business from one state to another, is a zero-sum game that benefits one community at the cost of someone else. The National Governor's Association drafted a set of eight criteria on economic development subsidies which states should follow to avoid the pitfalls some states have encountered with incentives. These criteria include sharing economic development incentive information between competing states and lobbying the federal government to remove regulatory barriers which stifle business growth in all communities. Instead of engaging in competition, states should launch initiatives which improve the business climate to help all firms.

Review of Virginia's Incentives

During the past twenty years, and particularly during the past five years, Virginia has developed a variety of incentives to promote its economic development goals. Basically, the state's incentives fall into four categories; tax credits and exemptions, grants to localities and targeted industries, workforce training programs, and other financing packages such as industrial development bond financing. The following is a summary of each of these incentives.

Tax Credits and Exemptions

Tax credits and exemptions have been at the core of Virginia's economic development incentive arsenal for a number of years. Virtually all states offer some level of tax relief to encourage corporate expansions or relocations. Among these incentives are exemptions for inventory and intangible property and sales and use tax exemptions on production machinery, spare parts, industrial fuels, and raw materials used in the manufacturing process. Localities also have the flexibility to waive the local option sales tax and personal property taxes on pollution control facilities, energy conversion facilities, and solar energy collection and use properties.

Tax credits and exemptions are an excellent form of incentives for several reasons. Perhaps the best reason is that in actuality, a locality or state is not giving anything up. If the firm had never located or expanded within a jurisdiction, it would not have ever realized any increase in its revenues. Offering a partial exemption from taxation allows the locality to cover the costs of meeting the needs of the new business while spurring additional job creation and investment and increasing tax collections overall.

There are, however, several tax credits which are unique to the Commonwealth which target particular industries or activities. Both the Major Business Facility Job Tax Credit and the Clean Fuel Vehicle Job Tax Credit promote job creation through income tax credits. As part of the enterprise zone program, corporate income tax credits are offered in return for investments and job creation in distressed communities. Because of the importance of many of these incentives to Virginia's economic development goals, they have been summarized below.

Major Business Facilities Job Tax Credit - Enacted at Governor Allen's request in 1994, the Major Business Facility Job Tax Credit offers qualified companies a $1,000 credit against their income taxes for each permanent full-time job over 100 that they create. Companies located in an enterprise zone or in a distressed community (one that has an average annual unemployment rate 0.5% higher than the state average) need only create 50 jobs to qualify for credits. The credit must be taken in equal segments during a three year period. As passed by the General Assembly, the credit had a $1 million per company cap and the credits could be carried forward for no more than five years.

In order to be deemed a qualified company and thus be eligible for the credit, a business must create at least 100 jobs in one of the following industries: manufacturing and mining, agriculture, fishing, and forestry, transportation and communications, and public utilities. The jobs created by the business must also be ones that are traditionally associated with manufacturing or headquarters-type activities such as general management, accounting, legal services, and customer service operations.

In 1995, the law was amended to remove the $1 million per business cap and extend the carry forward provisions from five to ten years. These changes will provide the state with more flexibility in managing larger projects which require higher levels of incentives. The state's economic development team is still held back, however, by the tight definitions of what are qualified businesses and activities.

Enterprise Zone Program - Created in 1984 to promote community redevelopment and revitalization in the state's most distressed urban communities, the enterprise program has been greatly expanded during the past eleven years to become of Virginia's most important incentives for both urban and rural areas.

In order to be designated as an enterprise zone, a community must meet at least one of three criteria; it must have an unemployment rate 1.5 times the state average, it must have 25% or more of the population of the designated area with incomes below 80% of the area median average income, or it must have a floor area vacancy rate of industrial and/or commercial properties of twenty percent or more. Zone designations are for twenty years.

Once an area is designated an enterprise zone by the Governor, businesses within the zone have to meet certain criteria in order to qualify for tax credits. If the company is already located in the zone, then it must expand employment by at least 10%, and of the amount of increase in the number of jobs, at least 40% of the employees must come from families which have incomes of less than 80% of the area median income. If the business relocates to the enterprise zone, than it must only meet the 40% rule. Finally, the company had to earn at least 50% of its gross receipts from its activity taking place within the zone.

From 1984 until 1995, the number of enterprise zones steadily increased from six to twenty-five. The primary tax credits available to qualified businesses were a sales tax credit on materials purchased by companies located in a zone, an income tax credit, and an unemployment insurance tax credit. From 1984 until 1992, businesses could earn credits for up to five years. In 1992, the eligibility period was increased to ten years.

In 1995, the General Assembly passed a comprehensive package of changes to the state's enterprise zone program, including increasing the number of zones to fifty. The 50% gross receipts test was lifted to allow larger corporations and chain stores to qualify for tax credits. The sales and unemployment tax credits were eliminated in favor of the income tax credit. This credit provides a company with an 80% income tax credit in the first year after it becomes qualified and a 60% credit in years two through ten. A new tax credit to reward real property investment was added. This credit is a 30% refundable tax credit up to $125,000 for any five year period based on the value of property improvements or new construction. There was also developed a grant program which gives a qualified business $1000 for each job it creates in a zone if the employee lives in the zone or $500 for each employee does not live in the zone. Anti-pirating provisions were added to forbid a locality with an enterprise zone from "stealing" businesses from other jurisdictions. Finally, the amount of credits and grants available under the enterprise zone program was capped at $9 million a year.

The enterprise zone program has been among the most effective economic development tools used by the state, particularly in addressing job creation and investment in its most economically distressed areas. Through 1994, the program has played a role in the creation of 9,063 jobs. It is estimated that the state has foregone $8,998,840 in revenue, which averages $993 per job. Over 300 businesses have participated in the program since it was created.

Grants to Localities and Targeted Industries

The grants offered by the state take three forms; the Governor's Opportunity Fund, Community Development Block Grants (CDBG), and the Solar Photovoltaic Manufacturing Incentive Grant. The Opportunity Fund and CDBGs exist to provide money for infrastructure development in a locality to foster economic development. The Solar Photovoltaic Manufacturing Grant program is targeted specifically at the production of solar panels in the Commonwealth.

Governor's Opportunity Fund - Created in 1992, the Opportunity Fund provides grants to individual localities to facilitate the development of infrastructure such as paving, gas lines, and other services that will help the locality attract a new business or encourage the expansion of an existing company. Such improvements are meant to benefit not only the prospect, but also the entire community should the business leave the locality or go out of business.

Initially funded in fiscal year 1993 at $4.5 million a year, the Opportunity Fund was steadily increased to $10 million in fiscal year 1996. In order to receive a grant, a locality must submit an application to the Department of Economic Development requesting funding for a specific project, and it must have a letter from a prospect stating that the locality is actively being considered. The locality is required to match its request with local tax abatements and/or other incentives. Each locality is only allowed one grant per year.

The Appropriations Act contains eligibility criteria which set the minimum thresholds for a locality if it wants to receive an Opportunity Fund grant. Any locality with more than 100,000 residents must have a prospect that will create at least 100 jobs and invest $10 million. Localities with between 50,000 and 100,000 must have a project that will create 50 jobs and invest $5 million. Localities with fewer than 50,000 residents must have a prospect that intends to create at least 25 jobs and invest $2.5 million.

As of December, 1995, 82 Opportunity Fund grants had been awarded with a cumulative total cost of $22,462,950. Thirty-nine of these grants were for new companies relocating to the Commonwealth, and the remaining 43 grants were to existing companies. It is estimated that 18,865 jobs have been created as a result of the Opportunity Fund which equates to $1,498 per job created. It has also resulted in investment of $2,074,899,195.

As the popularity of the Opportunity Fund has increased, the Governor and the Department of Economic Development have begun to face a number of issues relating to offering grants from this fund. For example, the Opportunity Fund was not created to handle large projects that require multi-million dollar commitments from the fund to close a deal. The state has on three occasions awarded multi-year grants in excess of $1 million because no other incentive was available to ensure that the project came to the state. Additional issues, such as changes to the eligibility criteria and capping the amount of the grant also need to be addressed.

Community Development Block Grants - These grants, referred to as CDBGs, are funded by the U.S. Department of Housing and Urban Development, and are provided to localities to meet critical infrastructure needs (including sewer and water upgrades), fund affordable housing, and to promote economic development. Cities with a population of over 50,000 receive funds directly from the federal government. Funds for all other localities are administered by the Department of Housing and Community Development.

In order to receive funding for economic development projects, a locality must complete a lengthy application and ensure that it can meet strict government requirements. Funds can only be used to provide off-site infrastructure by a locality for a specific business. Any business that benefits from such improvements must certify that at least 51% of the employees that it hires are from low-to-moderate income families. Grants are limited to $700,000 per project. CDBGs are often used to complement other incentives, such as tax credits and grants from the Governor's Opportunity Fund, to help the Commonwealth's most economically distressed areas.

Because of the relatively low limit on grants from the CDBG program, the federal government allows states to pledge a portion of their allocations through the Section 108 Loan Guarantee program to support major economic development projects. Such projects would, however, have to meet federal guidelines, including the hiring of at least 51% of new employees from low-to-moderate income families. This program allows states to use CDBG funds as guarantees for federal government securities that are issued to finance economic development projects. The CDBG leverage allows states to borrow up to five times their annual allocation against future CDBG allocations. In most cases, the funds are loaned to a locality or its industrial development authority to construct a business facility. The business which occupies the facility repays the locality which then pays off the CDBG loan.

While the authority to use CDBG Section 108 Loan Guarantees has existed for a number of years, Virginia has never taken advantage of this opportunity. Guidelines do exist for the use of this program, including a limit of $15 million on the amount of the state's allocation that can be pledged for this program.

Solar Photovoltaic Manufacturing Incentive Grant Fund - The Solar Fund program was created in 1993 by the General Assembly to attract manufacturers of solar panels to the Commonwealth since this industry had been identified as a high-growth industry. The program offers solar panel manufacturers $.75 for each kilowatt hour of rated capacity for the solar panels they produce in the Commonwealth and the sale of them. The maximum amount of kilowatt hours permitted by statute is six million, thus limiting the size of the fund to $4.5 million.

This type of incentive has been widely hailed as being on the cutting edge because of its features that protect the taxpayers from poor company performance. Because it is a performance based incentive, the eligible company receives no grant until it can certify that it has produced and sold solar panels. Therefore, if the company does not meet its job creation and investment totals, it does not receive the full amount of the grant that it had been offered as part of its incentive package.

While the solar fund program remained unused until the first solar panel manufacturer located in Virginia in August, 1995, it has now become an important economic development tool. This performance-based concept also served as the model for the incentive packages offered to both Motorola and IBM/Toshiba.

Workforce Training Programs

Virtually every state offers as part of its economic development incentive package some form of training assistance for companies relocating to or expanding in their state. Virginia has established the Workforce Services Program which reimburses companies for the training of their employees as long as certain criteria are met. The actual training is provided in cooperation with the Virginia Community College System. Currently, a company must invest at least $500,000 and create 15 new jobs in order to receive Workforce Services funds. In addition to the training cost reimbursement, the Workforce Services Program offers train-the-trainer programs, jobs skills video production services, and productivity consultative services. In fiscal year 1996, $7.5 million was appropriated for the program.

Because of the popularity of this program, it is almost always oversubscribed, thus requiring current commitments to be pushed into future years where additional funding may be available. While such a strategy can work in the short term, it cannot be allowed to persist as Virginia's economic development efforts continue to increase.

The state also has access to a variety of federal funds through the Job Training Partnership Act, however, these funds cannot be used for economic development purposes.

Industrial Bond Financing and other programs

The Virginia Small Business Financing Authority is a statewide issuer of tax-exempt and taxable industrial development bonds. Tax-exempt bonds for land, buildings and equipment provide long-term financing at below-prime interest rates. The technical expertise and knowledge of the Authority's staff is available to assist smaller projects through what can be a somewhat overwhelming process. Such assistance in determining eligibility criteria and working directly with the business's financial institution is generally not available through a local industrial development authority (the alternative issuer). The goal is to assure that as many smaller companies as possible take advantage of this lower cost method of financing. Taxable bonds issued by the Authority provide investors with only an exemption from state personal income tax, but such an exemption does help to lower the borrowing rate to the business.

Current federal legislation restricts the use of tax-exempt bonds in many ways, including limiting issues to $10 million and allowing only a small portion of the bond proceeds to finance associated office and warehouse space.

The ability of state and local governments to make project financing available in Virginia as an economic development incentive to attract new industry as a business-retention tool is limited, however. The state has allowed local governments to form Industrial Development Authorities to provide a mechanism for that locality to be proactive in areas such as acquiring and developing industrial park sites, completing infrastructure projects to support industrial development, and other related activities. The state has also maintained the Shell Building Program whereby local IDA's could develop "shell" industrial buildings as a lure for new industry, affording the opportunity to occupy a new structure and begin production sooner than would otherwise be the case. This program has had mixed success in predominantly rural areas in stimulating economic development.

One of the greatest barriers to additional incentives from a locality is that local governments are restricted, however, from sharing revenues as a result of economic growth except in order to settle issues relating to annexation. For example, in the case of a project like Motorola, utility services will be provided through regional agreements. Yet, while Goochland County will end up paying for the bulk of the cost to supply utility services, it will also derive exclusive benefit from the property taxes paid by the company. The "costs" associated with new in-migrants who will work at Motorola, however, will be borne by all neighboring localities without sufficient offsetting revenues. It is clear that localities need to be given additional flexibility to execute binding agreements to share revenues resulting from projects such as these.

Another alternative for localities to use is Tax Increment Financing. The Code of Virginia already permits localities to designate certain areas to for Tax Increment Financing and utilize the increased tax revenues that result from an area's redevelopment to be used to pay off revenue bonds that were issued to support that redevelopment. It has not been used in Virginia, however, in spite of the fact that it is a popular tool in other states. One reason could be that the process is very cumbersome, requiring a referendum to designate an area eligible for Tax Increment Financing. The process could be simplified, particularly the referendum requirement, to make this a more effective economic development tool. Because these revenue bonds are public debt, a constitutional amendment would be necessary to remove the referendum requirement.

A final alternative, and one that is gaining popularity across the South, is to allow localities to levy fees on a business instead of taxes. These fees would then support revenue bonds which provide funds for infrastructure or other services for the new company. Virginia's constitution, however, requires that all property be taxed. In order to pursue this proposal, a constitutional amendment would be necessary.

Proposed Concepts for Incentives

Opportunity Virginia set forth five organizing components for a comprehensive set of economic development incentives to allow Virginia to remain competitive. As part of the deliberations of the Subcommittee, each of these organizing components and questions relating to the state's incentives policy were discussed in order to provide direction for the Subcommittees recommendations. These components and the fundamental questions are as follows.

Worker training strategy - While Virginia's well-respected Workforce Services Program, which assists with training employees for specific job opportunities at new or expanding companies, is an effective economic development tool, overall, the state's worker training system is disparate and unable to meet the needs of business. Many of the problems exist because of the variety of federal mandates which detail how funds can be spent. Often, these funds are targeted at providing training for specific segments of the workforce instead of promoting general workforce preparedness and skills development. Therefore, the state must address those items that it can control relating to the Workforce Services Program and its effectiveness as an economic development tool such as:

* What is the proper role for the state in providing worker training services as an economic development incentive?

* What is an adequate funding level for the Workforce Services Program?

* Should the state offer tax credits to companies which invest in retraining their employees?

* Should the minimum thresholds for participation in the Workforce Services Program be changed?

* How should workforce services training programs be delivered to companies?

* What are some other innovative approaches in partnership with industry to address broader workforce training issues?

Governor's Opportunity Fund strategy - As the state's experience with this program has developed, several issues such as multi-year grants have come under scrutiny which must be addressed. These issue are:

* Should there be a cap on the amount of grant a locality can receive?

* What is the appropriate funding level for the Opportunity Fund?

* Should the local match requirements be changed?

* Should multi-year grant commitments be made?

* Should the job and investment thresholds be changed?

Tax credits and exemptions strategy - Granting tax credits has been a successful economic development incentive for the state because it ties the granting of public funds to actual performance by a company. These credits and exemptions also send a clear signal to eligible companies that the state wants to be a partner in their success. Tax credits and exemptions are particularly popular among economic development professionals because they can be offered to both new and expanding companies as long as the minimum eligibility criteria are met. Among the issues for discussion are:

* Should the Major Business Facility Tax Credit program be amended?

* Should the eligibility criteria for state tax credits be changed?

* Should specific industries be targeted using tax credits? (e.g. Clean fuel vehicle industry)

* What other opportunities should local governments have to offer tax credits?

* Should the Recycling Equipment Investment Tax Credit be extended?

* What method of cost/benefit analysis should be used to measure the effectiveness of the state's existing tax credits?

* Are there tax credits which should be phased out?

* Does the state need additional tax credits to promote economic development in distressed areas?

Financing strategy - The issues of financing and capital availability are two of the most frequently cited limitations on Virginia's ability to attain its overall economic development goals. With regards to the issue of the availability of capital for business startup, expansions, and working capital, the General Assembly created the Joint Subcommittee to Study Capital Access and Business Financing to discuss many of these issues. This group is currently in the process of developing its final recommendations for the General Assembly and the Governor to consider for the 1996 Session. The financing issues relating to incentive use are:

* Are changes to Virginia's current program permitting the formation of local and regional IDA's necessary?

* Is the shell building program still a valuable economic development tool for rural economic development attraction?

* Does Virginia need a "Kentucky-model" business and industrial bond financing program at the state level to meet its economic development goals and the competitive market forces?

* Does the state need to adopt legislation which will allow local governments to work together on a cooperative basis to fund larger industrial development projects?

* Should Virginia examine the possibility of using Community Development Block Grant programs Section 108 loan guarantees to finance economic development projects?

* Are there other programs which would encourage greater private sector financing of high priority economic development projects consistent with the state's economic development strategies?

Performance grants strategy - There are certain industries which have been identified in Opportunity Virginia as key sectors for the growth of Virginia's economy in the future. In order to attract and retain these businesses, new economic development incentives may need to be used. Many of these projects are of such a magnitude that a single project could exhaust the funds available through programs such as the Governor's Opportunity Fund. The Subcommittee discussed the following points:

* Are performance grants for targeted industries preferable to general tax credits?

* What should be the state's policy in offering these grants?

* What types of analysis should the state perform to support these grants?

* Do performance grants provide the necessary level of accountability for the use of public funds?

* What information does the General Assembly need to support the performance grants concept?

* Should performance grants be offered only to create new jobs or also to retain jobs?

Recommendations

In response to the questions raised above and the other issues examined by the Subcommittee, the following recommendations are offered to help Virginia move towards enhancing its competitive position and ensuring its future economic prosperity.

Funding for Incentives

a. **The Subcommittee supports funding the Governor's Opportunity Fund in the $20 million range per year.**

b. **The Subcommittee endorses of funding in the $10 million range per year for the Workforce Services Program.**

Changes to Existing Incentive Programs

a. **The Subcommittee believes that there should be no multi-year commitments from the Governor's Opportunity Fund. Secondly, it has become obvious that there should be a contract signed among the State, the locality, and the company in order to protect the state and decrease the amount of the incentives should the company not meet its employment projections or announce layoffs. Such a contract would be in addition to the existing verification performed by the Department of Economic Development. Finally, the maximum sized grant from the Governor's Opportunity Fund should be limited to no more than $1 million.**

b. **The Subcommittee endorses the idea, advanced by the Virginia Economic Developers Association, that incentives should generally focus on investments in infrastructure and people (through training and skills enhancement).**

c. **The Subcommittee endorses changing the threshold requirement for the Workforce Services Program to require the creation of at least 25 new jobs or investment of at least $1 million.**

d. **The Recycling Equipment Tax Credit program, which is set to expire in 1996, should be extended until 2001.**

New Incentives

Opportunity Virginia addressed five primary categories of incentives which Virginia should utilize for its economic development activities. Most of them are in place, and with the exception of the changes noted above, the programs have proven effective and are working well. The state's current arsenal of incentives, however, has a major void when it comes to dealing with projects that are too large for the Opportunity Fund but smaller than the "mega projects" that warrant use of the performance-based grant approach. The state should create a program(s) which would encourage more participation by the locality (or group of localities within a region) to share in the incentives either out of current or future revenues because they will, in most cases, derive a greater benefit from the investment and jobs created by a project than will the State.

These situations must be alleviated if the state is to remain competitive and to keep the State from bearing the burden of incentives. The following are concepts would help address the issue of regional economic development cost and benefit sharing.

a. **The Subcommittee endorses the formation of regional Industrial Development Authorities in order to permit localities to cooperate on the construction of industrial parks and sites and share the benefits that result from the development of these areas. The Subcommittee also supports allowing localities to share the benefits of economic development even when annexation is not an issue.**

b. **The Subcommittee endorses the use of performance-based incentives such as the Solar Photovoltaic Manufacturing Incentive Grant Fund and those offered to both Motorola and IBM/Toshiba in situations appropriate to these types of incentives. This type of incentive is useful in achieving strategic economic development objectives and is particularly attractive because it only rewards companies when they actually meet their employment and investment targets.**

c. **The Subcommittee supports the creation of a tax credit to companies which provide training for their employees. The credit should be limited to only that training which is for specific skills enhancement and not sending employees to seminars, for example. A 25% credit with strict eligibility criteria should be considered. Such a credit not only provides an incentive that companies will find attractive, but it helps to promote investment in Virginia's workforce. Enactment of such a credit should, however, be delayed until at least 1997.**

d. **The Subcommittee recommends that the Commonwealth aggressively pursue the use of Section 108 Community Development Block Grant Loan Guarantees in situations where prospects will need a large amount of unskilled labor. Special caution should be exercised, however, to ensure that the state's CDBG allocation is not jeopardized by these loans.**

e. **The Subcommittee supports the state's facilitation of the establishment of a AAA Bond Financing Pool, funded through a consortium of insurance companies. New companies wishing to build plants or pre-existing companies in Virginia engaging in capital expansions could have their credits enhanced through a AAA Enhancement Pool. The enhancement from their present rating to a AAA rating would allow them to save money in the capital markets when the bonds are sold, thus reducing the cost of new facilities. For example, a company with a BBB minus rating would have their credit upgraded to a AAA for a fee, and the savings would be the cost of their**

present financing, plus the cost of the insurance, less the savings from the enhancement. Such a program does <u>not</u> involve either the debt capacity or obligations of the Commonwealth, but simply puts the Department of Economic Development and local economic developers in the position of "bringing deals to the pool," assuming the consortium of insurance companies agrees to set it up.

f. **The Subcommittee supports the introduction of a constitutional amendment to permit localities to use Tax Increment Financing by a supermajority vote of the local elected governing body instead of through referendum.**

g. **The Subcommittee supports the introduction of a constitutional amendment to permit localities to adopt fee-in-lieu tax collection policies which allow localities to issue revenue bonds to support economic development projects.**

1995 SESSION

LD7755812

SENATE JOINT RESOLUTION NO. 369

Offered January 23, 1995

Establishing a joint subcommittee to study incentives to promote economic development in the Commonwealth.

Patrons—Hawkins, Bell, Calhoun, Colgan, Holland, C.A., Holland, E.M., Holland, R.J., Nolen and Robb; Delegates: Albo, Callahan, Cantor, Crouch, Dudley, Fisher, Harris, Ingram, Kilgore, McClure, Morgan, Nixon, Parrish, Purkey, Ruff and Wilkins

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Referred to the Committee on Rules

WHEREAS, competition among states and localities for business expansion and relocation projects has become increasingly intense during the past decade; and

WHEREAS, in order to successfully attract and retain these projects, state and local governments have created a variety of incentives to encourage companies to locate or remain in a particular area; and

WHEREAS, the federal government has also created several tax relief and grant policies to foster growth in economically disadvantaged localities; and

WHEREAS, incentive packages offered to business have become an important factor to many companies concerning where a relocation or expansion will occur; and

WHEREAS, as a result of the perceived importance of incentives, the number of incentives offered and the cost of these incentives to state and local governments continues to increase; and

WHEREAS, the Commonwealth has undertaken several studies to examine the costs and benefits of particular incentives; and

WHEREAS, none of these studies have effectively examined the incentives currently offered by the state to determine their effectiveness and to ensure that they are being targeted most efficiently; and

WHEREAS, "Opportunity Virginia: A Strategic Plan for Jobs and Prosperity" identified the need for a comprehensive study of incentives to promote economic development; and

WHEREAS, there are additional economic development incentives which require further study before being implemented; now, therefore, be it

RESOLVED, by the Senate, the House of Delegates concurring, That a joint subcommittee be established to study incentives to promote economic development. The joint subcommitte shall conduct a comprehensive study examining the following: (i) various initiatives offered by the state to attract and retain businesses in the Commonwealth in order to promote job creation and investment in our communities; (ii) the powers of the proposed Virginia Economic Development Partnership and (a) whether it should be directly involved in assisting with site and project development and (b) what its role should be with managing state incentives; and (iii) alternative incentive strategies to better utilize existing resources and new incentives.

The joint subcommittee shall be composed of 13 members as follows: three members of the Senate to be appointed by the Senate Committee on Privileges and Elections; two members of the House of Delegates to be appointed by the Speaker of the House; the Secretary of Commerce and Trade; the Secretary of Finance; and six members appointed by the Governor.

The Department of Economic Development will provide staff support to the subcommittee. All agencies of the Commonwealth shall, upon request, assist the subcommittee in conducting this study.

The direct cost of this study shall not exceed $7,500.

The subcommittee shall complete its work in time to submit a report of its findings and recommendations to the Governor and the 1996 General Assembly as provided in the procedures of the Division of Legislative Automated Services for the processing of legislative documents.

Implementation of this resolution is subject to subsequent approval and certification by the Joint Rules Committee. The Committee may withhold expenditures or delay the period for the conduct of the study.

LD7755812

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SENATE JOINT RESOLUTION NO. 386

Offered February 3, 1995

Establishing a joint subcommittee to study the need for an amendment to the Constitution of Virginia requiring the General Assembly to authorize certain agreements between cities and counties that will provide for a special governing body for industrial parks.

Patrons—Hawkins and Schewel

Consent to introduce

Referred to the Committee on Rules

WHEREAS, intergovernmental cooperation rather than competition between cities and counties for industrial development is essential; and

WHEREAS, Virginia's unique system of independent cities and city-county separation often renders it difficult for these separate governments jointly to develop and administer projects such as industrial parks, where costs must be shared, resources pooled, and revenues allocated between jurisdictions; and

WHEREAS, a desirable alternative may be to allow the local governments involved to establish a separate, narrowly focused governing body to develop the park, exercise governmental powers, and carry out the necessary governmental functions in the land area of the park; and

WHEREAS, an amendment to the Constitution of Virginia may well be necessary in order to permit the General Assembly to authorize and provide by law for such a special governing body; and

WHEREAS, it is desirable to assess the impact upon the county and city governing bodies of authorizing special governing bodies for industrial parks before an amendment is proposed; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That a joint subcommittee be established to study the necessity and desirability of amending the Constitution of Virginia to require that the General Assembly provide by general law for special governing bodies for industrial parks and other ventures if two or more counties and cities by agreement so desire. The joint subcommittee shall include in its examination procedures for adopting an agreement to establish such a special governing body, membership selection, powers and functions which the governing body would be authorized to exercise, and such other related issues as the joint subcommittee deems appropriate. The joint subcommittee shall also assess the impact upon the cities and counties involved of establishing a special governing body.

The joint subcommittee shall be composed of nine members as follows: three members of the House of Delegates to be appointed by the Speaker of the House; two members of the Senate to be appointed by the Senate Committee on Privileges and Elections; one elected or appointed county official and one elected or appointed city official to be appointed by the Speaker of the House of Delegates; and one elected or appointed county official and one elected or appointed city official to be appointed by the Senate Committee on Privileges and Elections.

The direct costs of this study shall not exceed $4,600.

The Division of Legislative Services shall provide staff support for the study. All agencies of the Commonwealth shall provide assistance to the Division, upon request.

The joint subcommittee shall complete its work in time to submit its findings and recommendations to the Governor and the 1996 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for processing legislative documents.

Implementation of this resolution is subject to subsequent approval and certification by the Joint Rules Committee. The Committee may withhold expenditures or delay the period for the conduct of the study.

GENERAL ASSEMBLY OF VIRGINIA -- 1995 SESSION

HOUSE JOINT RESOLUTION NO. 616

Establishing a joint subcommittee to study incentives to promote economic development in the Commonwealth.

Agreed to by the House of Delegates, February 23, 1995
Agreed to by the Senate, February 22, 1995

WHEREAS, competition among states and localities for business expansion and relocation projects has become increasingly intense during the past decade; and

WHEREAS, in order to successfully attract and retain these projects, state and local governments have created a variety of incentives to encourage companies to locate or remain in a particular area; and

WHEREAS, the federal government has also created several tax relief and grant policies to foster growth in economically disadvantaged localities; and

WHEREAS, incentive packages offered to business have become an important factor to many companies concerning where a relocation or expansion will occur; and

WHEREAS, as a result of the perceived importance of incentives, the number of incentives offered and the cost of these incentives to state and local governments continues to increase; and

WHEREAS, the Commonwealth has undertaken several studies to examine the costs and benefits of particular incentives; and

WHEREAS, none of these studies have effectively examined the incentives currently offered by the state to determine their effectiveness and to ensure that they are being targeted most efficiently; and

WHEREAS, "Opportunity Virginia: A Strategic Plan for Jobs and Prosperity" identified the need for a comprehensive study of incentives to promote economic development; and

WHEREAS, there are additional economic development incentives which require further study before being implemented; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That a joint subcommittee be established to study incentives to promote economic development. The joint subcommittee shall conduct a comprehensive study examining the following: (i) various initiatives offered by the state to attract and retain businesses in the Commonwealth in order to promote job creation and investment in our communities; (ii) the powers of the proposed Virginia Economic Development Partnership and (a) whether it should be directly involved in assisting with site and project development and (b) what its role should be with managing state incentives; and (iii) alternative incentive strategies to better utilize existing resources and new incentives.

The joint subcommittee shall be composed of nine members as follows: three members of the House of Delegates to be appointed by the Speaker of the House; two members of the Senate to be appointed by the Senate Committee on Privileges and Elections; two citizens to be appointed by the Governor; and the Secretary of Commerce and Trade and the Secretary of Finance.

The Department of Economic Development will provide staff support to the subcommittee. All agencies of the Commonwealth shall assist the subcommittee in conducting this study, upon request.

The direct cost of this study shall not exceed $7,500.

The subcommittee shall complete its work in time to submit a report of its findings and recommendations to the Governor and the 1996 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Services for the processing of legislative documents.

Implementation of this resolution is subject to subsequent approval and certification by the Joint Rules Committee. The Committee may withhold expenditures or delay the period for the conduct of the study.