How to create a

Community Economic Development Incentives Program

Transparency
Consistency
Simplicity
Beneficial to All Parties

Prepared by

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Economic Analysis Everyone Understands

Dear Community Leader,

In 1981 when I was Mayor of Tiffin, Ohio, our county had more than 10% unemployment, factories and retail stores were closing, revenue to the city was declining, and the community dwelled in an emotional morass.

One day the local plant manager of a small manufacturer of material handling equipment (forklifts) came into my office. The company employed fifty well paid workers in my city.

He explained the company had three small manufacturing plants (Tiffin, Minnesota, and Pennsylvania) and because of the recession was going to close two of them, consolidating in one location. He asked, “Is there anything the city can do to get the company to move everything to Tiffin? We would hire twenty-five more workers.”

I asked, “What do you mean by ‘move’?” He said, “Transporting the machinery from the other two plants to the new location.” I responded, “What if the city paid for the trucking of the machinery, would that help?” He said, “The company would go along with that.”

The city council agreed with the idea. We scrounged $40,000 out of our city budget, paid the trucking company directly, and the company moved in. The city recaptured the $40,000 from the city income tax paid by the workers in just 3 years. In 1983 the company expanded into an empty factory and added more jobs.

It was my first experience with incentives.

Over the years the use of incentives by communities has proliferated and is commonplace throughout the United States. I have seen communities use incentives wisely to improve their local economies. I have also seen some really, really stupid mistakes made by communities.

As an educational tool for local government officials and community leaders, I wrote the following … *How to Create a Community Economic Development Incentives Program*.

From my years of experience in economic development, I found it necessary to explain the nature of incentives, why there are objections to them, and, in my opinion, the best structure for a local program so community leaders can effectively and safely use this tool to help build their local economies.

Sincerely,

William H. Fruth
President

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How to Create a Community Economic Development Incentive Program.

Introduction

Throughout the United States communities have been aggressively implementing economic development programs to improve the economic quality of life for the people living and working in the area.

The principle means to improve a local economy is to increase the number of wealth importing "primary" enterprises in a community. A primary enterprise is one which sells its goods or services outside the area, thus importing wealth to the community.

Since there is a limited number of wealth creating companies looking to expand or locate in any given year, there simply are not enough of them to go around.

Competition among states and communities for these wealth generating companies is extremely keen.

As a result, virtually every state and county has an economic development incentive program to help attract new companies to its area or assist in the expansion of existing companies.

The purpose of this study is to describe the nature of economic development incentives, why they are offered, why there are objections to them, and the best structure for a local incentive program.

The financial inducements or benefits discussed in this paper are limited to those offered to private sector enterprises which are considered primary in nature. Incentives offered by local governments to assist in or to cure socio-economic problems (urban blight) are not considered. Basically, the incentive program discussed is directly related to the economic development program and not community development programs.

The following issues are reviewed:

- Why offer incentives?
- Economic Impact.
- Types of incentives.
- Objections to incentives.
- Issues which influence the economic impact of a Project on a Community.
- Structure of a local economic development incentives program.

Why offer incentives

To better comprehend the reasons communities offer incentives to private sector companies, we need to understand the difference between a "primary" employer and a "consumptive" employer.

Within a local economy, money flows into the area, within the area, and out of an area. Money is imported to the community typically through the business activity of the primary enterprises. These companies sell their goods or services outside of the community thus importing wealth to the area.

After the money is brought into the area it circulates, going from person to person - business to business, until it is consumed and leaves the community. The circulation and consumption of the wealth is facilitated by the consumptive enterprises.

Only about 5% of the businesses in a community are primary in nature with about 95% being consumptive in nature.

Local economic activity and the consumptive businesses, including local government, depend upon the wealth being imported to the area. A local economy will grow or decline in direct proportion to the volume of money being imported to the community.

The dependence of an area on the primary enterprises is similar to how a common backyard lawnmower functions. When all of the various parts of the lawnmower (spark plugs, carburetor, belts, piston, and blade) are working properly, the machine creates a nice, beautiful, crisp lawn.

However, nothing can happen unless the lawnmower has gasoline (sometimes electricity). Without the fuel to create the energy to move all the parts of the machine, nothing happens. The lawnmower will do its job until it runs out of gasoline, which then has to be replenished.

The mechanical parts which make up the lawnmower are similar to the consumptive businesses in the community. Each has a part to play in the economy for it to function properly. The fuel to create the energy for the consumptive business is provided by the primary enterprises. The wealth or money imported by the primary enterprises is the fuel (gasoline) for the economy.

Should the amount of money imported by the primary businesses be significantly reduced the overall economy of the area will decline rapidly as there is less fuel.

The most obvious example is the ghost towns which were created in the old west after gold and silver mines played out. When wealth abruptly stopped entering the area (gold and silver no longer was exported), the entire economy collapsed as there was no fuel.

A more recent example is the overall decline of the industrial Midwest in the 1970's and 1980's after manufacturing fled to other areas. Hundreds of billions of dollars no longer entered the economies of Ohio, Michigan, Pennsylvania, New York, and others causing significant job losses and a decline in population.

Many of the economically depressed areas in the United States are in that condition as a result of the closure of a major primary employer with no other industry replacing it.

Over time community leaders in the United States have learned how important the wealth generating, primary businesses are to their economy and community. As a result, thousands of economic development organizations have been created to retain and recruit primary employers to the area. While the general theme for the creation of economic development organization is to create jobs, its real purpose is to import wealth to the community.

The most sophisticated and informed community leaders understand that a primary employer is a wealth generator for the area. They also understand the significant difference between the business-market structure of a primary employer and a consumptive employer.

A consumptive business, such as a retailer, most service companies, healthcare facility, and local government, depend upon and participate in the local marketplace. The greater the disposable income and wealth available within the geographic area, the greater is the opportunity for success.

Most important, the consumptive businesses also function on the same "playing field" regarding locally created costs of operation. Taxes, regulations, labor, transportation systems, utilities, and a host of others issues are essentially the same for all enterprises.

Should local costs increase, the costs are typically passed along to the local consumer.

As a result, the success of a consumptive business locally depends upon its ability to provide a quality product or service for a competitive price, competing with like-type businesses within the geography of the economy.

For a primary employer, its goods or services created are exported to other communities, many times internationally. It is not dependent upon the success of the local economy for its revenue as are the consumptive businesses. Consequently, it does not have to be located in the community for that purpose.

However, many of its costs of operation are influenced locally.

Here lies the significant difference between a primary business and a consumptive business.

Typically a primary business is not competing locally with other like-type companies. The primary employer's competition could be located in another county, another state, or another country.

Each location has different locally created costs. In other words, there is not a level playing field for a primary employer regarding costs of operation as there is for a local consumptive employer.

When locally generated costs reach a level which prevents the primary company from being profitable, it cannot increase the cost of its product or service to compensate as would be the case for the local consumptive businesses.

After attempting to create as much efficiency as possible which still does not reduce costs sufficiently, the company must do one of two things: 1) move to another location or 2) go out of business. Under either scenario, the wealth generated by this company will no longer enter the local economy.

Successful economic development organizations consistently attempt to reduce locally levied costs for primary employers to enable them to be as profitable as possible, encouraging them to grow and expand and remain in the community, to keep adding fuel to the economy.

A strong argument could be made that the primary businesses should not be taxed locally, but that discussion is left for another day.

This brings us to why communities offer financial incentives to primary employers.

The reason is very simple.

Primary employers are generators of wealth. They create the marketplace for the consumptive businesses, are responsible for a vast majority of all the jobs in the area, and are the root source for most of the taxes collected by local government.

Once again, while publicly many times the stated purpose of giving an incentive to an existing company or to lure a new company to the area is to "create jobs," the actual purpose is to reduce the overall costs to a primary employer which enables it to be more competitive in the national marketplace causing more wealth to be imported and distributed in the local area.

The following are several specific reasons why incentives are provided by communities to primary employers:

- Reduce initial set-up costs.
- Reduce long-term operating costs.
- Project business friendly image.
- Increase revenue to local government.
- Overcome geographic disadvantages of the area (remote location).
- Overcome self-inflicted disadvantages (high taxes, punitive regulations).
- Encourage development in blighted areas.

Typically, the cost of the financial incentives presented to a primary employer, whether existing or new to the community, is typically a small percentage of the overall fiscal, social, and economic benefit the company has upon the community.

Economic Impact

An economic development incentive program should reflect the economic impact of the Project. [1]

When a primary employer locates to an area and sells its products, it has a positive (additive) economic impact upon the area.

The overall impact upon a local economy is determined by the wages paid, the amount of local support needed by the company (local purchases of products or services), capital investment (taxes paid), and the potential for ancillary companies to be formed because of the presence of the business in the community. The economic impact a primary enterprise has upon a community varies among industrial sectors.

For example, an automobile assembly plant will likely employ about 1,000 workers, piecing together parts to make the car. The cost of constructing the factory including equipment could very well be $2-3 billion and wages are very high. For this sector, this is just the beginning.

It is quite likely more than 50 other companies in close proximity will employ another 8,000 people. These companies are manufacturing the parts for assemblage or providing technical support. As a result, the assembly plant has a significant overall economic impact upon the local economy.

Suppose there is a headquarters for a major insurance company that employs 1,000 workers. The wages are very high for this company as insurance actuaries and corporate executive are compensated very well.

However, this type of enterprise does not need very many support companies, like the automobile manufacturer. Typically, it will occupy a general office building which costs much less than an auto factory.

While is it a very desirable business to have in a community, the overall economic impact is much, much less than the automobile assembly plant.

Continuing, a manufacturer of simple plastic products such as milk jugs or tubing requires few if any support companies and a relatively low-skilled, low-wage workforce. While it contributes to the economy, the “ripple effect” or impact is much less than the first two examples.

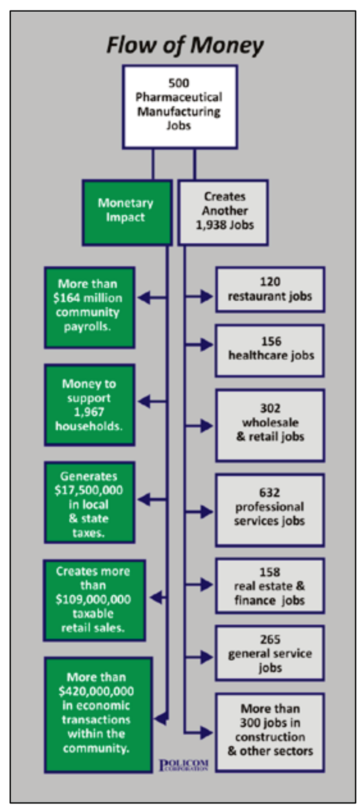
[1] The word “Project” is used for a company which is conducting a search for a community to establish a facility or an existing company looking to expand. It is a term used by the economic development community.

The following is a general list of industrial sectors ranked from the greatest economic impact to the least. The ranking is based upon the wages paid, the value of the product or service, capital Investment, and the amount of local support companies needed (suppliers).

1. Manufacturing of high-value – high-bulk products.
2. Manufacturing of high-value – low-bulk products.
3. Manufacture of energy.
4. Sophisticated information and technology services.
5. Transportation of products.
6. Research and development.
7. Federal and state government.
8. Corporate headquarters.
9. Manufacturing of mid-value products.
10. Information, telecommunication centers.
11. Manufacturing of low-value products.
12. Retirement industry.
13. Tourism.

“Retirement” is primary in nature when the flow of money into an area for retirement benefits is greater than what is extracted by way of the payroll tax for Social Security and Medicare. Retirement typically causes the formation of low-wage service and retail jobs.

Economists have developed formulas which estimate the economic impact a specific event or company has upon a local economy. One of the most popular used by economic development organizations is IMPLAN.



The impact study is the mathematical calculation of the economic activity occurring during the mixing and churning of wealth within the local area as a result of the Project.

Several years ago POLICOM created a comprehensive economic impact study for a proposed 500 job pharmaceutical manufacturing company to be located in a Florida county using IMPLAN.

Pharmaceutical manufacturing has one of the greatest economic impact multipliers of any industrial sector.

As a result of the wealth flowing into the economy, an additional 1,900 jobs will be created in the consumptive sectors likely within fifteen months after the company reaches full production.

Additionally, as the wealth and money is distributed within the economy the Project generates more than $100,000,000 of taxable retail sales, $17,000,000 of state and local taxes, and $164,000,000 of community payrolls on an annual basis.

If the county gave this company $2,000,000 in "cash," the county would likely recapture its investment in just two years from retail sales tax collections alone. It would enjoy the economic and social benefit created by the company for many years.

Types of incentives

When a primary business is looking to expand in or local to an area, three issues are considered: 1) costs, 2) time, and 3) community attitude.

Costs are examined two ways.

The first of the "costs" are the initial set-up expenses in the community. These include but are not limited to the cost of land and infrastructure, permitting, construction, and the relocation of key employees, machines, and equipment.

The second and most important are the long-term operating costs. These are influenced by the workforce, utilities, insurance, local and state taxes, transportation, proximity to its supply-chain, and a host of other issues. Many of the costs are influenced locally.

"Time" is how long it will take for the company to become operational in a community.

The time necessary for land use and zoning approvals, permitting, infrastructure development, facility construction, workforce training and acquisition, and public comment all influence the community selection process.

This issue is one of the reasons most Projects will only consider communities which have improved, approved industrial property available for construction of a facility.

For undeveloped greenfield land, it could take years for acquisition, land use designation, zoning, infrastructure development, and site plan approval. Even more time would be needed if there is community resistance or lawsuits filed by environmental or "no-growth" groups.

"Community attitude" is a reflection of how business friendly or welcoming the local government and community at large is toward industry in the area. This issue is very important to Projects.

Aside from a geographic move by a company's vendees which causes a company to chase its market, the most frequent reason a company leaves a community is "local community attitude," how it has been treated over the years in the area.

Escalating taxes, onerous regulations and fees, abusive local government officials, vocal and influential community groups which oppose the activity of the company or free enterprise in general, all contribute to an environment which adds costs and time for the company.

As a result, a Project will target communities which want to assist the company in its efforts and appreciate its monetary and social contribution to the area.

To determine if an area is business friendly, the Project will meet with existing companies, study past issues of the local newspaper, and examine the frequency of tax increases and regulatory changes by local government.

Typically, incentives offered by communities address these three issues. The following are the most frequent types of incentives at the local level.

- Abatement of property taxes.

  The abatement of real and personal property taxes is one of the most frequent incentives offered by a community and requested by a company. Whether in whole or in part, abatement of taxes provides the company a long-term reduction in operating costs. For the community, there is no “cash outlay” as the issuing government simply returns to or credits the company what the company would have paid and what the community would not have collected had the company not expanded or located to the area.

  Typically only the taxes levied by the granting authority can be abated, usually the county or city portion of the property taxes. Property taxes levied by other taxing authorities are not abated, including the public schools.

- Grants or cash gifts.

  Many areas have “job creation funds” which are direct payments to companies for expanding in or locating to the area and are an expense to the local government.

  Typically drawn from the general fund of the county or city, money is given to the company based on the number of jobs created and the wages paid. Grants can range from $500 to $20,000 per new job created and typically do not have any restrictions on how the company uses the money.

  Usually the grant is awarded after the company has become established in the community and its employment level determined. Also, instead of a lump sum payment, some communities are making “installment” payments to the company, which are spread out over a series of years. Sometimes in the past grants were paid in advance of the company becoming fully operational, but this practice is becoming infrequent.

- Discounts on land and buildings.

  Throughout the United States, a large number of communities have created community owned industrial parks and have constructed speculative buildings to attract companies to their area. Most are small Metropolitan or Micropolitan areas.

  Depending on the quality of the company (economic impact), a community will discount the price of the land or the rent or sale price of a building. In some distressed areas, it is not unusual for a community to provide the land at no cost to the company and/or the building for a $1 a year lease.

- Low Interest Loans.

  During the recession years in the 1980's and 1990's, many communities created low interest loan funds to help recruit or create small companies in their areas.

  Beginning in the 2000's, a large number of federal and state government loan programs were created to assist small companies in starting or expanding.

  Since there are so many programs available, few counties or cities are using general fund money for loans to companies. However, cities and counties can apply for and administer federal and state programs, but this should not be considered a "local incentive."

  An exception to this is a community loan fund created to help finance start-up companies at an economic development incubator. Most of these funds include private sector investors and possible local government revenue.

- Regulatory Relief – Expedited Permitting.

  The 21st century economy is technology driven. Technology is changing everything almost on a daily basis.

  Businesses must be able to rapidly change their process and methods quickly as a result. If the physical plant needs to be changed, altered, expanded, the company needs to be able to do such expeditiously.

  Every city and county has regulations and rules regarding land development, zoning, construction, business operations, and other issues which influence the time and cost of establishing a company in the area.

  In some areas, the process is simple, expedient, and inexpensive. In others, it is laborious, complicated, costly, and time consuming.

  Understanding that the initial set-up costs and the time necessary to become operational in a community are major concerns for a company, many communities have created special exceptions for primary enterprises in order to reduce initial costs and time.

  "Expedited permitting" is being offered by a large number of areas. While not typically waiving requirements, the community accelerates the approval process for site planning and construction.

  Additionally, many times the fees associated with the process such as the cost of the building permit or impact fees are reduced or mitigated completely.

This incentive has become very important to companies as they need assurances they can begin construction as soon as possible in an area and not wait months and months for the approval process to be completed.

- Training Grants.

  When selecting a community, the most important short and long-term issue for the company is the availability of trained or trainable workers.

  Technology is rapidly changing how things are done. Workers need to have the skills necessary to perform the tasks of the company reflecting these changes. As a result, continuous specialized training programs need to be established in the community for it primary employers.

  Typically, training programs are provided or funded by the state or federal government, many times administered through the local community college or technical school.

  Since a company typically will not locate to an area in which it cannot get a trained workforce, as an incentive, communities will arrange for customized worker training for the company which is usually funded by the state.

  If outside funding cannot be secured through the normal efforts and under the time frame of the company, the community should consider paying the costs of worker training for the company.

  This is an "up front" out of pocket expense for the local government. But the money (value) does not go to the company, but the residents of the community in the form of "skills education."

Objections to Incentives

Providing an incentive to a private sector company by a community or the state has not been without controversy. While incentives have been offered for more than 100 years, there have always been individuals or community groups which have questioned the practice.

On several occasions objections have been legitimate. Offering incentives over the years has been a learning process for states, cities, and counties. However, in today's sophisticated economic development marketplace most of the controversial issues are addressed.

The following is a list of the most frequent objections to offering business incentives on a local basis.

- "The community paid too much to the company."

  When the value of an incentive exceeds the economic and social benefit of the Project, one could say the community "paid" too much to the company.

  While occurring less frequently today than in the past, communities around the country likely have granted incentives much greater than they should have.

  Excessive incentives can be offered for generally two reasons: 1) political pressure and 2) blind negotiations.

  If the governor or local officials campaigned on the issue of creating jobs and there has not been much success in doing so, when a new employer shows interest in locating to an area sometimes the reaction is "give them anything they want" or "don't lose this deal."

  Consequently more incentives than are necessary are offered to a company as a result of the state or local government's pressure to "get the deal done."

  However, this does not occur very often.

  The most frequent reason an excessive amount of incentives are offered to a company is the community has "negotiated against itself."

  Interfacing with Projects is usually a confidential process. The local economic development organization (EDO) typically does not know the name of the company nor the other communities in which it is considering.

  The EDO does have quality information regarding the needs of the Project and reasonable assurances it is a legitimate organization.

  During discussions with the Project representative, both parties collect information on the other. There comes a time when "incentives" are discussed.

  Suppose the EDO is communicating with a Project which will employ 300 people and pay 150% of the area average wage, one which the community would love to secure.

  The EDO has been informed the Project is considering two other communities. At some point the Project representative states, "Please provide the value and type of incentives your community will offer the Project."

  Being a quality Project, the EDO provides a proposal for incentives.

  A couple days later the Project representative states, "Other communities are offering more incentives, you will have to increase your package or you will be dropped from the list."

In order to keep from being deleted from the list of communities being considered, the EDO increases the value of the first proposal.

A couple days later the Project representative states, “Other communities are offering more incentives, you will have to increase your package or you will be dropped from the list.”

In order to keep from being deleted from the list of communities being considered, the EDO increases the value of the second proposal.

You see what is happening.

The EDO does not know 1) the names of the other communities (competition), 2) whether or not there actually are any other communities being considered by the Project, 3) if there are other incentive proposals made by other communities, 4) and if the company might very well have accepted the first proposal, but the Project representative is simply trying to get more.

The EDO is involved in a blind auction, raising its bid without any other bidder present. It is a trap in which a community can be easily snared, especially if there is pressure to “get a company to move to the area.”

The best course of action is to not become involved in the process in the first place.

Excessive incentive awards can be easily avoided by creating a pre-approved incentive formula which, for the most part, is fixed. The incentive package is provided to the Project and aside from minor “tweaking,” that is it.

There comes a point when the community simply has to “walk away” from the process, or call the bluff of the Project representative.

- Incentives for new companies hurt existing companies.

An argument is sometimes made that recruiting a new company to the community which pays a high wage will hurt existing companies which pay less, as they will lose their workers to the new company. Sometimes a low-wage employer will actively try to keep other companies from moving to the community for that reason. Providing an incentive to a company puts “salt on the wound” so to speak.

Let us return to the purposes of an economic development program, which are to increase the size and quality of a local economy.

A new high-wage primary employer will increase the wealth flowing into the area and create a higher step on the wage-skill ladder (discussed later), providing upward mobility and improving the standard of living for many.

So, the community needs the high-wage employers. But what about the low-wage employers?

With the community's help (training) , they will draw from a pool of workers who are a step below the employer in skills and wages and will be trained to perform the tasks required. This will improve the standard of living for those individuals.

Long term, all employers in the community benefit as the pool of trained workers increases.

- "Money should be directed to education."

  The objection assumes that incentive money which goes to the company could have gone to the public school system if no abatement had been awarded.

  In reality, property taxes levied by the school system are rarely abated and county and city governments rarely share their tax revenue with the public school system anyway.

  Public schools have their own dedicated property taxes in a county. There are few if any communities which are able to abate school property taxes, as abatements are typically limited by statute to the county or city portion of property taxes.

  In fact, the public schools typically are one of the biggest financial beneficiaries of a new company locating to an area as property tax revenue to the schools is substantial.

- "The Company would have come here anyway."

  One of the common misunderstandings regarding awarding incentives to a company is that the incentive is the "reason" the company came to the community. In a vast majority of cases, it is not.

  When searching for a community, a company will have a long list of geographic-economic needs or issues which influence the profitability of the business.

  Some of these are absolute, meaning if a community does not meet the requirement, it is dropped from consideration. A company needing a deepwater port will only locate in a community with a deepwater port, no matter how large the incentive package is in an area without one.

  During the community search, next comes a list of "important" issues. Communities which do not meet the criteria for most of the important issues will be dropped from consideration. Thresholds are set for many issues such as the cost of electricity, proximately to a commercial airport, or internet speed.

  This leaves a short list of communities which meet the absolute needs of the company and most of the important issues. This is the time incentives come into play.

Yes, companies will look at the dollar value of the incentive package. But what is equally important is that the community is “offering incentives,” as it demonstrates the community has a strong desire for the company to locate in the area and it broadcasts a “business friendly” attitude.

The company understands the incentives will reduce the short and long-term costs to the company and expedite the time necessary to become operational in an area.

They have value to the company and are taken into consideration. But it is not true that community which offers the most incentives will land the Project.

So, if a company locates to the community and accepts an incentive package, did the company locate to the area because of the incentive? Likely not. Many other geographic-economic issues were actually more important and considered before incentives are discussed.

However, it is very possible that if the community did not offer an incentive, the company would have gone to one which did, as that community demonstrated a greater desire for the location of the company.

Quite a paradox.

- “The Company did not live up to what it promised.”

  During negotiations a Project might “promise” it will create a certain number of new jobs and the incentive is based on this number.

  After establishing itself, the company winds up employing fewer workers than promised as a result of a downturn in its marketplace or production efficiencies resulting in a fewer employees needed than originally projected.

  In the past a community might have to honor the original incentive commitment even though the company did not reach promised job levels.

  To avoid having to honor an incentive for a Project which did not have the economic impact as originally anticipated, today “claw-back” provisions are incorporated into incentive agreements which basically cause the company to repay a portion of a previously awarded incentive and/or suffer a reduction in a future incentive if the agreed upon company performance thresholds are not achieved.

  A new trend is to award all incentives in arrears with as little up-front cash granted as possible. Annual performance assessments are conducted which determine the value of the incentives based on an agreed upon formula.

- “Everything is done in secret.”

  With open meeting and “sunshine” laws prevalent in most levels of government, the residents of a community are used to being informed regularly on the activities of the local county commission or city council. Few issues are discussed in secret. Economic development recruitment is typically one of them.

The names of companies and negotiations with them are usually confidential. There are a host of reasons why. Many times the EDC and local government leaders do not know the name of the company until all government and real estate issues have been settled.

So when the community learns that the county commission voted to give an unknown Project a large incentive package, this is the first time any information has been disclosed to the public and some in the community become suspicious of the action.

Many questions are asked of local officials such was "why so much money, what assurances do we have the company will earn the incentives, how was the incentive determined, why are we doing this all off a sudden?"

There is no escaping the secrecy surrounding the recruitment of a new company or a major expansion by an existing company, but the method of awarding an incentive should be discussed and approved in advance of any incentive offer.

Consequently, a community needs to establish an incentive policy in full view of the people in advance so it can be implemented during confidential negotiations.

When it comes time to announce a Project, when asked the question "Was the incentive package in accordance with the published policy of the county or city," the answer will be yes. This reduces much of the objection to secret negotiations with a company.

- "Awards are inconsistent, haphazard."

One of the most controversial issues regarding incentives is inconsistency by local government regarding what type of company will receive an incentive and the value of the incentive.

While many communities in the United States have established basic incentive policies, many have not.

Unfortunately, some local government leaders have decided to avoid a potential political controversy regarding offering incentives to companies by delaying a discussion on the issue until absolutely necessary. "We will cross that bridge when we come to it" policy not only places the EDO in a difficult position when negotiating with a Project, but it also results in awarding excessive incentives.

It also leads to awarding an incentive to one company but not another, without a rational reason.

Existing companies in the community are typically the most irritated by the absence of a stated policy as some expanding companies receive incentives while those which are "not politically active" do not.

Also, not having a published policy is one of the reasons communities "pay too much" for some projects as there are no restrictive guidelines to follow.

- "The government is picking winners over losers."

  The inference of this objection is that local government, by giving financial incentives to a company, is providing a "competitive advantage" to one enterprise over like-type businesses in the community. This certainly would be the case if a county government gave incentives to a building supply store while another building supply store did not receive the same benefit.

  Of course, as we discussed, incentives are not given to consumptive businesses unless it is to cure a socio-economic problem (distressed area) which is a community development issue, not economic development issue.

  But what if there are two or more manufacturers of automobile fenders in the community, like-type primary employers.

  If the community gave an incentive to one of these companies but denied them to another, then there is a problem. This circles us back to the last objection – "Awards are inconsistent, haphazard."

  This issue can be avoided by establishing criteria in advance of awarding an incentive and applying the criteria equally to all companies.

  Essentially, if any company meets the criteria for receiving an incentive, then all companies are "winners" and none are excluded from the process.

To avoid public objections to incentives and to have an effective program, the incentive program should be based on the following:

- Transparency – The reason incentives are offered and the process for awarding an incentive should be presented to the community before the program is initiated. Once the process is approved, negotiations with confidential Projects will be less objectionable.

- Consistency – The incentives program should be applied equally to all applicants and incentives awarded based upon the published criteria. It is important existing companies be given equal or even favorable treatment when awarding an incentive.

- Simplicity – Determining if a Project qualifies for any incentives should be a simple process of imputing a set of variables to preset formulas. Formulas for determining incentives might seem complicated to the inexperienced, but if they are thoroughly tested for numerous scenarios and the mathematics is understood by EDO and county, city staff, then the process of determining the incentive for a future Project becomes expeditious, understandable, and requiring minimal effort.

- Beneficial to all parties – As with all negotiations and business transactions, it is important both parties benefit. The value of the incentive package needs to be high enough for the company to believe it is receiving a true benefit, but it cannot be a financial burden to the community, otherwise there will be friction between both for many years.

Issues Which Influence the Amount or Value of Incentives for a Project

The value or amount of incentives offered by a community should be in proportion to the economic impact of the Project. The following are issues which measure the economic and social impact and benefit and are used to determine the incentive award for each Project.

Primary – Contributory Enterprises

As previously explained, the primary industries import wealth to the community and generate the fuel for the economy.

About 90% of the business enterprises in a community are "consumptive enterprises." They sell or provide services to the local marketplace, thus are dependent upon the amount of money in the economy and the disposable income of the resident population. Therefore, these companies need to have the primary businesses to grow if they are going to grow.

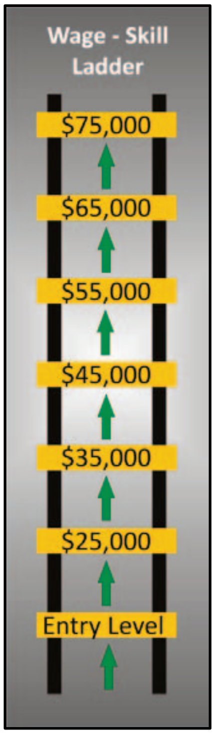
The Economic Development Incentive Program is expressly limited to primary, wealth importing companies as the consumptive, dependent enterprises will grow naturally in direct proportion to the marketplace.

Wage Level – Quality of the Economy

Improving the standard of living for the residents of an area is one of the principal reasons communities conduct an economic development program. For the most part, a person's standard of living or "economic quality of life" is determined by how much the individual earns each year.

The quality of an economy is therefore dependent on the wage level of the employers. Typically, the wage paid by the "primary employers" determines the overall quality of an economy.

If the primary employers are low-wage employers, it will be a low-wage economy. If the primary employers are high-wage employers, it will be a high-wage economy.



Therefore, a community economic development program should focus upon primary employers which pay a wage higher than the area average wage as this will improve the quality of the overall economy.

The Wage-Skill Ladder illustration provides insight on how the formation of high-wage jobs improves the standard of living for most residents.

Suppose a company is considering moving to the area and intends to employ 200 people. From a review of the local workforce, the company determines it will have to pay $65,000 to attract workers with the necessary skills to perform the tasks needed by the company.

The company will initially draw from existing workers who earn $55,000 per year, as they have demonstrated the aptitude to earn $65,000 after necessary training.

Once the 200 workers move up the step from $55,000 to $65,000, a void or vacuum occurs at the $55,000 level. At that moment, the $55,000 employers will draw from the $45,000 workforce step as these individuals have the aptitude, after training, to earn $55,000.

More “vacuums” occur as workers on each step of the ladder are pulled upward. Eventually, 200 individuals will be pulled into the workforce at the Entry Level.

Theoretically, under this scenario, as a result of a 200 job employer paying $65,000 entering the economy, as many as 1,000 people could climb the wage-skill ladder, each improving their standard of living.

Of course, this dynamic does not occur as smoothly as just recited, as the company might bring with it some of the workforce, others might come from adjoining counties, and others who are presently under-employed might jump from $35,000 to $65,000.

But the principle of how creating high-wage jobs improves the overall quality of a local economy is very reliable, as many more people than the initial 200 high-wage workers will climb the ladder.

The reverse is also true. Purposely forming low-wage primary industry jobs will actually create downward pressure, as the economy will seek the level of the wages paid by the primary employers.

Consequently, the Economic Development Incentive Program should reward high-wage employers. In a free economy, if a low-wage employer desires to enter the economy, it is free to do so, but such a company should not be induced to do so through incentives.

There are exceptions to the rule. The wage criteria for awarding incentives is many times determined by the condition of the local economy.

If the area is chronically distressed with high unemployment, poverty, and constant economic decline, then “any new job will help the area.” In such areas, incentives for low-wage employers are appropriate.

In addition to improving the standard of living for a large number of people, a high-wage worker has much more disposable income than a low-wage worker. Consequently, the high-wage job has a much greater economic impact upon the local economy.

Employment – Number of Jobs

Obviously, the number of jobs created by a Project has a direct social benefit for the individuals accepting the positions. Also, it is principally through the wages paid to the workers that wealth enters the economy. As a result, Projects which create the most jobs receive the most financial benefits though the incentive program.

Land Utilization

This issue is not considered in many local incentives programs, but it should be.

When a Project is constructing a new facility, a parcel of land is utilized. The land is improved (infrastructure) and approved (zoning).

Communities do not have an unlimited supply of improved, approved real estate for Projects. In fact, in most areas the supply is extremely limited.

Consequently, Projects which have the highest number of jobs, payroll, and capital investment per acre should be provided a greater incentive.

From public data sources, POLICOM evaluated two Projects which were announced and/or constructed in 2018 in Florida.[2]

Let us examine these Projects to better understand the issue of land utilization.

The *Chewy Warehouse* Project and the *UTC Center for Intelligent Buildings* Project both announced they would employ about 550 people, but Chewy consumed approximately 56 acres of land while UTC absorbed only 10 acres.

Additionally, the announced annual wage per worker was much higher for UCT than Chewy.

The following is a breakdown for these Projects.

[2] The data used for each example was “announced data” and the actual Project after construction might be more or less for each issue.

Chewy – Ocala, Florida – Warehouse – Year: 2018

New employment	550
Size of Parcel - Acres	56
Workers per acre	10
Payroll per acre	451,786

UTC Center for Intelligent Buildings – Palm Beach Gardens, Florida - Office-Research – Year: 2018

New employment	550
Size of Parcel - Acres	10
Workers per acre	55
Payroll per acre	4,565,000

As you can see, by this measure, the UTC Center had ten times the positive economic impact per acre than Chewy.

Capital Investment

One of the principal reasons to have an aggressive economic development program is the fiscal or financial benefit to local government. With additional financial resources, local government, especially the public school system, can afford to provide to the residents the highest level of service possible.

The most direct financial benefit to local government is the increase in property tax revenue created by the capital investment of the Project.

The fiscal impact of a Project is in direct proportion to the capital investment by the Project. It can be measured as the total amount of new taxes created and the impact on a per acre basis.

As an example, the following shows the contrast between the Chewy and UTC Center Projects. Based on the Project's announced capital investment, the amount of new annual property tax revenue was calculated.

Chewy – Ocala, Florida – Warehouse – Year: 2018

Capital Improvements	40,000,000
Estimated Property Tax	831,304
Property Tax per Acre	14,845

UTC Center for Intelligent Buildings – Palm Beach Gardens, Florida - Office-Research – Year: 2018

Capital Improvements	115,000,000
Estimated Property Tax	2,389,999
Property Tax per Acre	239,000

Both Projects had 550 new jobs and a large capital investment, but the UCT Center had a significantly greater tax per acre than Chewy, consequently the UCT Center should be granted a larger incentive award.

Creating a Community Incentives Program

While the economic principles regarding how local economies grow or decline are the same for every community, how each community behaves is different. As a result, no two incentive programs are likely to be the same.

Incentive thresholds for extremely weak areas will probably be much lower than strong, dynamic areas. Strong areas are likely to be able to afford to invest more money than the weak areas.

There are three steps to create a community economic development incentives program.

1) Create an inventory of incentives which are offered. These have been previously discussed. A community needs to determine what type of incentives it wants to offer.

2) Determine the Project's Incentive Impact Points. A mathematical "matrix" or scorecard needs to be created which measures the economic and social impact the project has on the community.

   In order to determine the scope of the incentive award given to a Project, the economic impact issues (primary in nature, wages, jobs, land utilization, and capital investment) are measured. These issues generally reflect the economic and social impact of the Project.

   From the Project data, the estimated economic benefit of the Project is converted to Impact Points based upon the issues discussed.

   The number of possible points for each issue is the measure of the importance of the issue.

   Maximum and minimums are used to determine how many points are given to the Project. If the Project is below the minimum, no points are awarded. If it is at or above the maximum, all points are awarded.

   In many areas, a Project needs to pay at least 115% of the area average wage to qualify for most incentives. This is the minimum. However, a company which pays 130% of the area average has a greater impact than one which pays 115%. Therefore this Project should get more "points."

   Let us assume this issue is assigned 20 points with a minimum of 115% and a maximum of 130%. With the range and points set, the following are the points awarded for this issue.

114% - Does not qualify for incentives as the wage is too low.
115% - No points awarded but qualifies for incentives.
120% - 7 points.
128% - 17 points.
130% - 20 points.
150% - 20 points.

Minimums and maximums and the number of points are assigned to each impact issue.

The following are a sample of some of the measurements which should be used for determining the impact Points.

- Annual wages as % of area average.
- Real property tax per acre.
- Personal property tax per 1,000 SF.
- Square feet of building per worker.
- Payroll per acre.
- Floor to area ratio (building % of land).
- Payroll per 1,000 square foot of building.

Bonus points can be given for the following issues:

- Existing Company.
- Occupy vacant existing building.
- Locate in distress area.

3) Establish formulas which use the impact points to determine the value or amount of the incentives. From these formulas, the incentive for a specific project can be quickly and consistently determined.

   Minimums and maximums of the impact points should be created for each incentive.

   As an example, suppose it is decided that if a Project does not achieve at least 50% of the impact points, it will not qualify for any property tax abatement.

   Simplistically, then the % of impact points can be used to determine the % of tax abatement. A Project with 75% of the impact points could receive 75% tax abatement, 100% of the impact points, 100% tax abatement.

It is stressed that the three issues discussed <u>must be customized</u> for the community. Not one system will fit all. The condition of the economy, the fiscal condition of local government, the willingness of the community to support incentives, along with other issues must be taken into consideration when creating a local program.

Conclusion

A local economy will grow or decline in direct proportion to the wealth imported to it by the "primary industries" which sell their goods or service outside the area.

Since there is a limited number of private sector wealth generating enterprises expanding or relocating each year, most communities and states have initiated economic development incentives programs to help attract them to their area.

To be successful for the long-term, it is very important a local economic development incentive program adhere to four basic principles:

- Transparency
- Consistency
- Simplicity
- Beneficial to all parties

By basing the economic development incentive program on the economic, fiscal, and social impact of the Project and by creating pre-approved formulas to determine incentives, these four issues can be achieved.

POLICOM is happy to evaluate a community's current economic development incentive program to identify its strengths and weaknesses and to make recommendations on how to "modernize" the program so it can be effective in the marketplace.

About POLICOM – William H. Fruth

This study has been prepared by William H. Fruth, President of POLICOM Corporation who has served as an economic development consultant to communities for the last twenty-five years.

POLICOM specializes in studying the dynamics of local economies. Through its research, it determines if an economy is growing or declining, what is causing this to happen, and offers ideas and solutions to improve the situation.

Fruth has personally evaluated the data for more than 800 local economies in the United States, created more than 200 economic and community studies, and has provided presentations and workshops for state-national associations and community forums in 40 states.

Fruth is the author of the booklet *The Flow of Money … How local economies grow and expand*. It is used nationwide by universities, economic development organizations, and local governments as a teaching tool to explain the nature of economic development.

Additionally, Fruth recently published the narrative *How to Create a Community Economic Development Incentive Program* which explains why communities offer incentives to companies, indentifies the negative issues regarding incentives, and provides a guide for communities to modernize their incentive programs.

Annually POLICOM ranks all of the Metropolitan and Micropolitan Areas in the United States for “economic strength” which is the long-term tendency for an area to consistently grow in both size and quality.

Posted on POLICOM’s website (www.policom.com) for downloading are the 2019 Economic Strength Rankings and maps which identify the Metropolitan and Micropolitan Areas.

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