The State of State Incentives

By Kathy Mussio, Managing Partner, Atlas Insight, LLC

With continuing economic woes and uncertainty, incentives are becoming increasingly more important in companies' decision-making processes. This trend can be seen in the results of several recent surveys in which "Incentives" have become one of the most important site location factors.

Budget shortfalls make some incentives funds more scarce; however, the need for job creation forces states to try harder than ever to attract jobs and investment. Even with most states facing severe to catastrophic budget shortfalls, states are still willing to offer incentives to strategic projects. These game-changers typically bring large number of jobs and capital investment and offer a piece of the incremental new state revenue back to the company over an agreed upon period of time.

Recent Trends

What is a surprising trend is that many states are actually becoming more aggressive with their incentive programs. States are being forced to come up with more creative, better targeted and more responsible incentive programs in order to continue attracting jobs. There has been an ongoing trend to incentivize targeted industries. These targeted industries vary from state to state, depending on what industry cluster the state is attempting to grow. While most states would happily welcome new high-wage technical jobs, some states are actually incenting average wage jobs that are connected to a high priority industry for the state.

During 2009 and 2010, we have seen several states work within their existing programs as opposed to creating a new incentive program. Like a manufacturer who retools, states lacking the political capital required to pass new legislative incentive programs have instead retooled existing incentive programs.

North Carolina, for example, has relaxed the wage threshold typically required for state incentives. This has resulted in a spike in the number of supported projects which will pay below average wages.

Finally, economic development organizations are increasingly recognizing the importance of finding ways to help retain existing businesses. It is much easier to retain an existing company than it is to attract a new one. While states are still eager to attract new jobs and investment, they cannot neglect companies located in their own backyards. There are states throughout the country that realize this (IL, IN, OH, KY and MI to name a few), with established retention programs in place.

Incentives are Win/Win

It is a misconception to think that incentives are state giveaways and do not require a positive Return On Investment (ROI). Incentives are typically awarded after a state determines that the project will have a positive ROI. Even the coveted "deal closing funds" go through a comprehensive cost/benefit analysis by the states before a dollar is awarded.

Most incentives are post-performance, as these programs offer incentives based on a portion of the net new revenue to the state. These types of incentives are fiscally neutral and net revenue generators for the state. A company only receives a piece of the new incremental revenue after it meets or exceeds its agreed upon performance thresholds (jobs and capital investment). If a company does receive an incentive but does not meet the obligations of the contract, there are often severe clawback penalties.

Clawbacks require a company to return some or all of the incentive if it fails to meet a pre-agreed upon job commitment.

States are looking to close budget gaps in any way they can. This includes a closer scrutiny of companies' annual compliance submissions, which are required to actually receive the promised incentives. Companies sometimes call us (consultants) in after the fact to help manage the compliance once they realize they are in over their heads with the compliance materials. We have noticed a trend that even for statutorily-defined incentives, states are increasing the number of "desk audits" in which lower credit thresholds are being examined, and they are being examined with more scrutiny.

A Successful State Incentive Toolbox

While there are a number of strategies which can make a state more competitive in its ability to both attract and retain companies, there are three important "tools" every state should have in its "incentives toolbox": deal closing funds, salable/refundable/transferrable credits and withholding tax rebates.

Deal closing funds are probably the #1 incentive tool a state can posses. Deal

Experience

Kathy has over 20 years of combined experience as a management, incentive and site selection consultant. She is widely considered an industry expert in the site selection and incentive negotiation business. Her consulting career has focused on securing statutory and discretionary incentives for various projects as well as helping site selection clients to select optimal locations for expansion projects. Kathy has conducted successful negotiations for some of the world's largest corporations. She also has assisted small to mid-sized companies. Some of her various sized and sector clients served include: AIG, Edwards Lifesciences, GlobalWatt, Pfizer, The Sun Products Corporation, UTi and Whole Foods Market. Before co-founding Atlas Insight, Kathy was a Regional Practice Leader in the Business Location Incentive and Site Selection group at BDO Seidman.

Kathy is a reliable opinion source for trade publications and AP stories. Kathy has been a frequent guest of state governments to assist with development of strategic plans to attract business investment.

Kathy has an expertise in working on highly complex real estate development projects, including working with New Markets Tax Credits, Brownfield Tax Credits and various other land use entitlements. Kathy also oversees the Renewable Energy Practice for Atlas Insight.

Kathy holds a Master of Science in Real Estate from New York University.

Education

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closing funds help to offset some of the initial capital outlay for a new project as a portion of the incentive is received within the first year. States which offer deal closing funds are highly coveted, maybe now more than ever.

Some states continue to have fund allocations equal to or greater than past allocations; however, other states have cut back on this year's allocation or did not re-fund. States which offer these funds are often put on a long list automatically if there is no geographical constraint to a projects location.

Anecdotally, we have heard that these states have seen an increase in the number of short lists that they make. States that want to increase their incentive competitiveness would do well to create a deal closing fund which could be used as another incentive tool to attract strategic projects.

Not all credits are created equal. Credits that are "use it or lose it" in the year in which they are earned often have no value to a company. States that hold these out as viable incentives are fooling themselves…and sometimes the companies. Instead, states should make every effort to allow credits to be sold, transferred or refunded. These types of flexible credits enable many companies, who do not have the tax liability in a particular state, to allow for the sale and/or transfer of the tax credits to qualified companies that can utilize them. These credits can be valuable to a company who is in a net operating loss position in a particular state as well as startup companies. Even better are the states which allow some or all of the unused credits to be refunded in cash. After monetizing the credits, companies can take the cash received and reinvest it the business, which hopefully will create new jobs and additional capital spends.

The third suggestion for improving a state's incentives toolbox would be the addition of withholding tax rebates for new job creation. This type of incentive can have value for companies without large tax liabilities and is directly tied to job growth. The amount of funding awarded to a company is 100% paid for by the new incremental withholding taxes generated by the project. If the jobs aren't created then there will not be an incentive awarded. Oklahoma's Quality Jobs Program is a good example of this type of self-funding incentive. Quality Jobs provides a withholding tax rebate to a company for new jobs created in the state based on payroll.

Incentives Remain Critical

The cost of doing business has always been a critical location factor in a company's decision-making process. In the past two years, particularly, companies have turned their attention to cost-reduction initiatives. As such, consolidation and right-sizing efforts have ruled the day. While we see no near-term end to this trend, there has also been an uptick lately in new expansion activity and we expect this slow and shallow upward slope to continue. One thing that is evident is that the ability for incentives to help reduce project costs continues to be a key factor to decision-makers. We do not see this desire for incentives waning; in fact, companies we work with tell us that the ability to access incentives to help offset project costs (especially those which help offset a portion of the initial cost outlays), will continue to be key.

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