

FALL 2007

SMITH ANDERSON

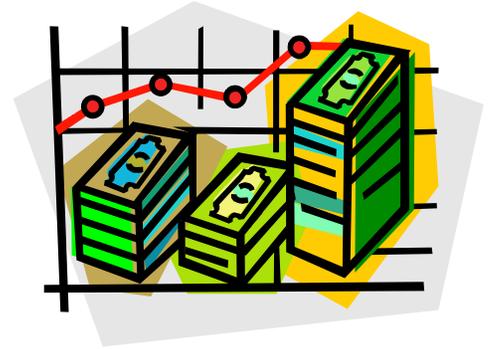


North Carolina's Economic Development Landscape

Stephen T. Parascandola

November 14, 2007

What is economic development?



Economic development is defined by the NC Economic Development Association as:

“activities and programs aimed at improving local, regional, State, and national economies by attracting or creating investment to expand the tax base; and by increasing jobs, wages, and personal incomes.”

Major Players

- NC Economic Development Board
- NC Department of Commerce
- Regional economic development partnerships
- County and municipal economic development
- Private companies



North Carolina Economic Development Board

- Appointed by the Governor and the General Assembly
- Responsible for recommending economic and community development policy for the State to the Commerce Dept. Secretary, the General Assembly, and the Governor
- Develops and updates annually a strategic economic development plan as required by N.C. Gen. Stat. 143B-434

North Carolina Economic Development Board

Strategic Plan

- Investing in education and training a globally competitive workforce
- Developing communities that are prepared for economic success
- Building and maintaining and integrated, modern infrastructure for business
- Nurturing innovation and the commercialization of ideas through investment in science, technology and university outreach



North Carolina Economic Development Board



Strategic Plan, cont.

- Maintaining an exceptional business climate with affordable costs and providing programs and services for businesses to attract new companies to NC, support the growth and success of existing businesses – large and small – and encouraging entrepreneurial startups
- Fostering a high quality of life and developing our cultural, natural and heritage assets

North Carolina Department of Commerce

- The mission of the Dept. of Commerce is “to improve the economic well being and quality of life for all North Carolinians.”
- Specific to economic development, the Department’s policy is “to assure throughout State government, the **coordination** of North Carolina’s economic development efforts.”

North Carolina Department of Commerce

- Regional Dept. of Commerce representatives provide guidance and incentive information to clients interested in locating within their designated regions.
- The Department is responsible for providing and monitoring pass-through funds budgeted for the regional economic development partnerships and other non-profit entities.

North Carolina Department of Commerce

- **Recurring State Funding to Non-profits:**
 - Rural Economic Development Center
 - Regional Economic Development Partnerships
 - Council of Governments (COG) Funds
 - Biotechnology Center
 - NC Institute of Minority Economic Development
- **Non-GF Funding to Non-profits:**
 - Golden LEAF



Regional Partnerships/Commissions

- Organized into seven regions
- Promote through marketing strategies economic development opportunities in NC's 100 counties
- Enable regions to compete for new investment and devise economic development strategies based on regional opportunities and advantages
- Receive State and private funding

Regional Partnerships/Commissions



Local Economic Development



- **Members of town, city, or county governments, public or private local organizations or commissions, or any other combination of public, quasi-public, private, or non-profit local economic development associations**
- **Focus on marketing their own ideas to increase economic development opportunities within their own boundaries**

Other Economic Development Participants

- **Community colleges & universities**
- **State Ports Authority**
- **Banks**
- **Electric utilities & natural gas companies**
- **Railroads**
- **And the list goes on...**

Economic Development Incentives

Types of Incentives:

- Tax
- Non-tax



Tax Incentives

- Overall tax rates and structure
- Tax credits
- Tax abatements (not in NC)
- Other tax relief
 - Rebates & refunds, exceptions & deferrals, accelerated depreciation
- Tax increment financing



Non-Tax Incentives

- Direct cash grants
- Free land or at below-market prices
- Infrastructure
- Low-interest loans
- Worker training
- Innovation and technology support
- Export assistance



How Incentives Work

- Stimulate private investment by reducing the costs of land, labor, capital, etc.
 - Lower the costs of doing business
- Stimulate private investment by helping firms compete through modernization, market development, upgrading worker skills, etc.
 - Increase efficiency

STATE INCENTIVES IN NORTH CAROLINA



State Incentives in North Carolina

- Article 3J tax credits (replaces Bill Lee Act [BLA])

- One North Carolina Fund



- One North Carolina Small Business Fund

State Incentives in North Carolina, cont.

- **Job Development Investment Grant (JDIG)**

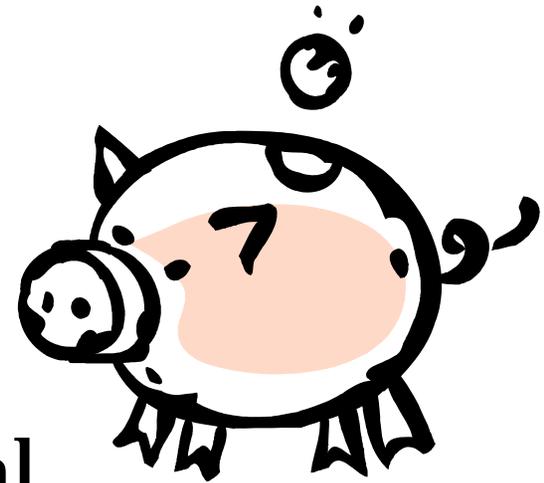
- **Infrastructure Fund**



- **Industrial Revenue Bonds (IRB)**

State Incentives in North Carolina, cont.

- **Industrial Development Fund (IDF)**
- **Green Business Fund**
- **Job Maintenance and Capital Development Fund**



Article 3J Tax Credits

- Article 3A of Chapter 105 of the General Statutes (commonly referred to as the Bill Lee Act) was enacted in 1996
- Significant changes made to the BLA each year between 1997 and 2006
- Article 3J was enacted in 2006 as a replacement of the BLA.
 - The BLA remains in effect for certain types of taxpayer through the 2009 taxable year.

Article 3J and Bill Lee Act Development Tiers

Bill Lee Act

- 5 enterprise tiers
 - 10 counties in tier 1
 - 15 counties in tier 2
 - 25 counties in each tiers 3, 4 and 5
- Exceptions may move some counties lower, but not higher
- As a result, the tier structure became bottom heavy

Article 3J

- 3 development tiers
 - 40 counties in tier 1
 - 40 counties in tier 2
 - 20 counties in tier 3
- Exceptions may move some counties lower and some counties higher

Article 3J and Bill Lee Act Development Tiers

Bill Lee Act

- 3 factors determine initial ranking – unemployment, per capita income, population growth
- Adjustments based on tier 1 or 2 status, population level, unemployment level, and multi-county parks

Article 3J

- 4 factors determine initial ranking – unemployment, median household income, population growth and assessed property value per capita.
- Same adjustments as under BLA, except for high employment

Article 3J and Bill Lee Act General Administration

Bill Lee Act

- Credit is taken against **one of** income, franchise, or gross premiums tax
- Credit may not exceed 50% of tax liability
- Carryforward period ranges from 5 years to 20 years

Article 3J

- Credit is taken against income, franchise, or gross premiums tax
- Credit may not exceed 50% of tax liability
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Article 3J and Bill Lee Act Specific Credits

Bill Lee Act

- Creating jobs
- Investing in M&E
- Technology commercialization
- R&D
- Worker training
- Central office or aircraft facility property
- Other real property
- Development zone projects

Article 3J

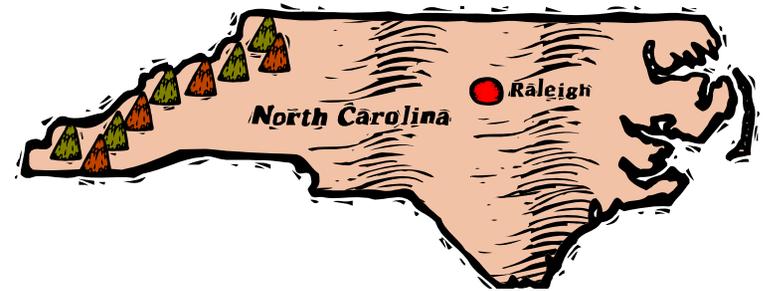
- Creating jobs
- Investing in business property
- Investing in real property



Article 3J Tax Credits

- For 2007, taxpayers can choose between the BLA and Article 3J
- Beginning in 2008, the BLA is repealed for all taxpayers except for the following:
 - Interstate air couriers (FedEx)
 - Eligible major industries (Dell, Merck)
 - Certain development zone taxpayers (Dole, Cheesecake Factory)

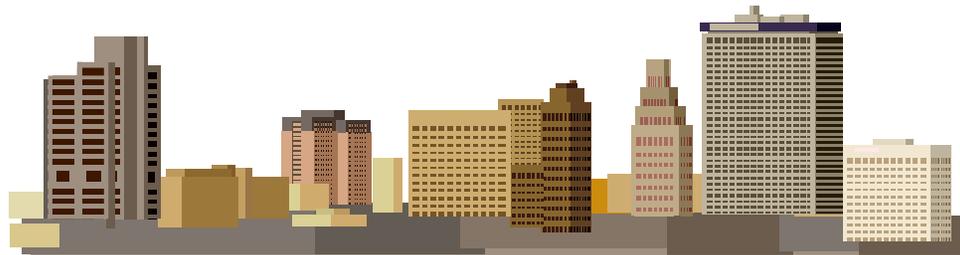
One North Carolina Fund



- Discretionary grant program
- Provides grants through local governments to attract business projects. Grants are contingent on local match.
- Subject to annual appropriation of funds.
- Created in 1993, but provisions were not codified until 2004
- Formerly known as the Industrial Recruitment Competitive Fund

One North Carolina Fund

- Awards: \$37.9 million to 181 companies since 2001
- Potential jobs: 24,462
- Potential investment from companies: \$3.7 billion



One North Carolina Small Business Fund

- **Created in 2005**
- **Grants that enable small businesses to conduct innovative research and development technology in an effort to bring new products to the marketplace.**
- **Awards: \$1.1 million to 24 companies since Jan. 2006**

Source: NC Department of Commerce

Job Development Investment Grant (JDIG)

- Discretionary grant program
- Grants to new and expanding businesses measured against a percentage of withholding taxes paid by new employees. First grant awarded in 2003.
- Set to expire January 1, 2010 (has been extended 3 previous times)
- Only available when the project would not locate in NC “but for” the program.

Source: NC Department of Commerce

Job Development Investment Grant (JDIG)

- Awards: \$188.5 million to 42 companies since '03
- Potential jobs: 15,940
- Potential investment from companies: \$2 billion



Infrastructure Fund

- Legislation appropriated \$24 million for site development
- Health insurance, safety and environmental impact standards must be met
- Company must spend at least \$100 million in private money and create at least 100 jobs.



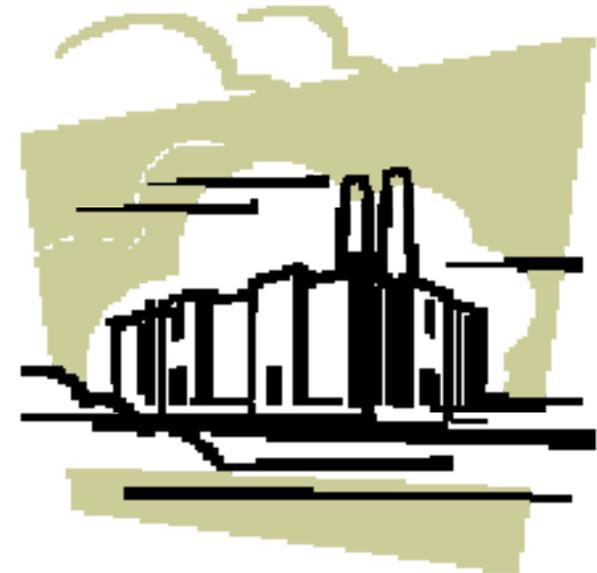
Industrial Revenue Bonds (IRB)

- Financing available for certain qualified facilities
- NC Capital Facilities Finance Agency pools groups of borrowers to reduce insurance costs for individual borrowers.



Industrial Development Fund (IDF)

- Provides grants to local governments for infrastructure improvements necessary to serve a project business that commits to creating jobs.
- Awards: \$6.7 million to 31 municipal governments since 2001
- Potential jobs: 2,443



Source: NC Department of Commerce

Green Business Fund

- Established in 2007
- Provides grants to private businesses with less than 100 employees, non-profit organizations, and State agencies to encourage the growth of the green economy in the State.



Green Business Fund



- Grants focused on 3 priority areas:
 - To encourage the development of the biofuels industry;
 - To foster the development of the green building industry; and,
 - To leverage investments in additional clean technology and renewable energy products and businesses.

Job Maintenance and Capital Development Fund

- Enacted in 2007 Extra Session after original legislation was vetoed
- Total commitment of State funds not to exceed \$60 million.
- Appropriated \$5 million for 2007-2008



Job Maintenance and Capital Development Fund

- **Requires:**
 - Maintenance of at least 2,000 jobs
 - Investment of \$200M over 6 years
 - Location in development tier 1 area
 - All newly-hired employees authorized to work in US
 - Enhanced wage standard
 - Health insurance, OSHA, and environmental standards

Job Maintenance and Capital Development Fund

- **Businesses selected by Economic Investment Committee**
- **Individual agreements required**
- **Agreements must include a provision that:**
 - **The grant is reduced for reductions in the workforce**
 - **The business is ineligible for a grant in any year in which employment is less than 80% of that required**
- **Requires recapture of all sums if business fails to meet investment requirement**

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LOCAL INCENTIVES IN NORTH CAROLINA



Local Incentives in North Carolina

- **Cash grants tied to performance**
 - Based on projected tax revenues
- **Land, infrastructure, site preparation**
- **Project Development Financing (TIF)**
- **Incentives for retail projects**

State Incentives for Dell

• Computer mfg. credit	\$200 million
• Lee Act tax credits	\$21.4
• JDIG	\$ 8.8
• Training	\$ 3.3
• Golden Leaf funds	\$ 3.3
• Infrastructure	\$ 3.0
• Triad workforce dev.	\$ 1.7
• Sales tax refund	\$ 1.0
TOTAL (over 15 years)	<u>\$242.5 million</u>

Local Incentives for Dell

Winston-Salem

- Upfront project costs \$ 7.0 million
- Cash incentives (15 years) \$ 8.4
- Land costs \$ 3.5
- Total \$ 18.9

Forsyth County

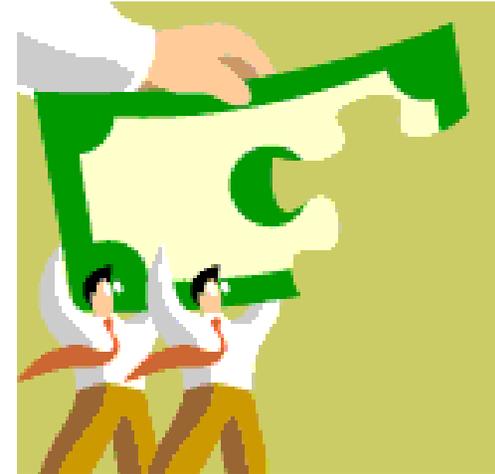
- Site preparation \$ 6.0 million
- Cash incentives (15 years) \$ 8.8
- Land costs \$ 3.5
- Total \$ 18.3

TOTAL (over 15 years)

\$37.2 million

The Incentives Debate

- Do they work?
- Arguments for and against
- Accountability
- Background, developments and court cases
- Questions to consider



Do incentives work?

- Not typically the most important factor in site decisions
- Can tip the scale in some cases
- Do not compensate for major shortcomings in location
- Tend to benefit prosperous communities

A look at the Arguments...

FOR

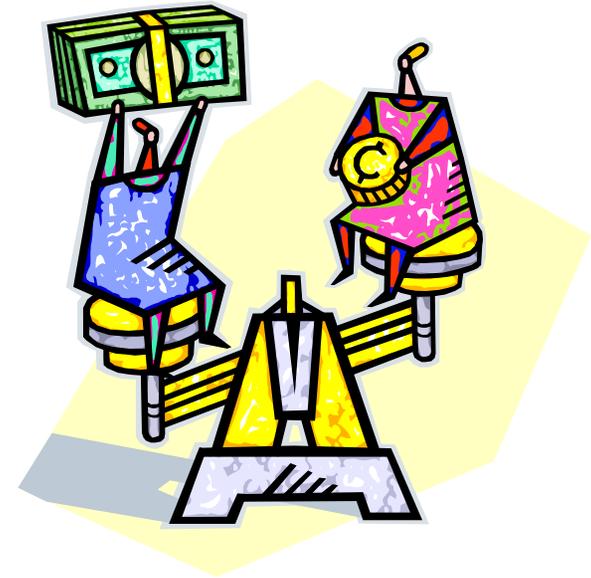
- Generate new tax revenues that otherwise would not be available
- Necessary evil to compete
- Companies say they matter
- Economic investment in the future

AGAINST

- Slippery slope of escalating demands
- Competition among jurisdictions is counterproductive
- Firms don't always deliver
- Divert public dollars away from other programs

Accountability

- Safeguards to protect the public's investment
- Measuring results and outcomes
 - Economic impact analysis
 - Fiscal impact analysis
 - Cost-benefit analysis
 - Return-on-investment
 - Program evaluation
- Clawback provisions



Incentives: Recent history

- Mid 90s: Economic development opportunities seemed to be going elsewhere
 - New businesses
 - Expanding businesses
- **Maready v. Winston-Salem (1995)**



Established that incentives are lawful

- Economic development is a public purpose
- Expenditure does not lose its public purpose merely because it is a private actor

Incentives: Recent history



- 1995 – NC Economic Development Board created the Incentives Task Force

Key findings:

- NC's trade tools of training and infrastructure are matched by other states
- Growing use of incentives lowered effective tax rates on investments and raised the after-tax rate of return
- NC did not need to match other states' incentive packages dollar for dollar
- NC needed to address the issue of how tax incentives affected the rate of return.

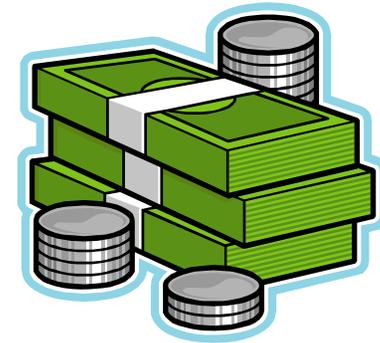
Incentives: Recent history

1995 –Task Force Recommendations

- Incentives should be tailored to meet specific economic policy goals
 - High quality jobs
 - Widely-shared prosperity
- Incentives should be fiscally responsible and accountable
 - Corporate tax incentives
 - Forfeiture provisions



Incentives: Recent history



Bill Lee Act, enacted in 1996

- Investment tax credit with an investment threshold. (Less developed counties would have a lower threshold.)
- Expansion of jobs tax credit to all counties. (Higher level credit per job for less developed counties.)
- R&D credit
- Job training tax credit

1998: Key Incentives

The FedEx logo, featuring the word "FedEx" in a bold, sans-serif font. The "Fed" is in blue and the "Ex" is in orange.

- Sales and property tax reductions

- Enhanced investment tax credits

- Applicable to franchise tax

- Credit may equal 100% of tax due.

The NUCOR logo, featuring the word "NUCOR" in a bold, black, sans-serif font with a horizontal line underneath.

1999: Key Incentives



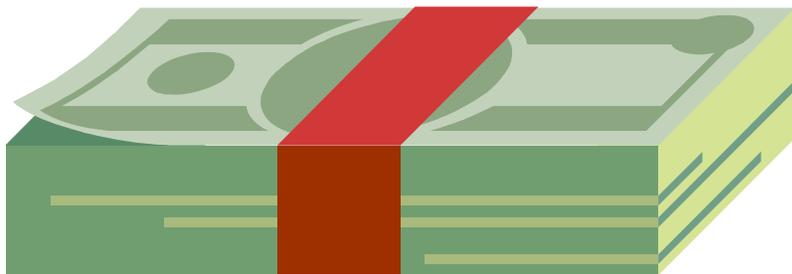
U.S AIRWAYS



- Target businesses in urban areas
- Sales tax exemptions and reductions
- New, more generous investment tax credits

And so on...

- 2000: Midway Airlines, Buckeye Project, Blue Ridge (Champion Buyout)
- 2001: Lowe's, Alcoa
- 2002: FedEx
- 2003: Merck, RJ Reynolds
- 2004: Lorillard, Phillip Morris
- 2005: Dole, Cheesecake Factory
- 2006: Efird and American, Novo Nordisk
- 2007: Lab Corp



And, most recently...

A shift from creating jobs to **retaining jobs!**



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Legal challenges



Dell Lawsuit

- Battle over the money
- \$300 million total incentive package



Constitutional Challenges

“Public purpose” Clause

- Individual incentives not a public purpose



Constitutional Challenges, cont.

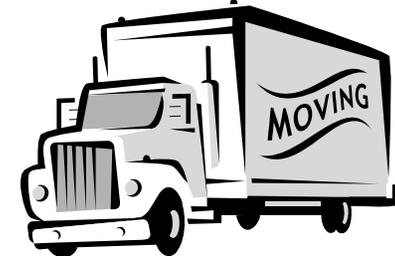
Equal Protection Clause

- Individual “giveaways” unfair to other businesses



Constitutional Challenges, cont.

“Common Clause”

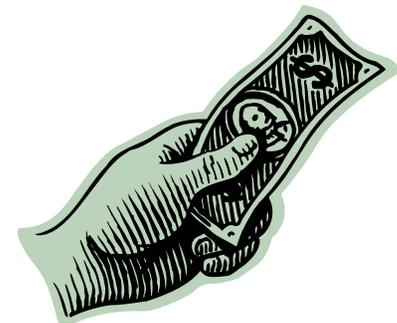


- “Dormant” (negative) commerce clause prohibits economic protectionism.
- Cannot benefit in-state businesses at expense of out-of-state competitors.

Constitutional Challenges, cont.

“Exclusive Emoluments” Clause

- No separate advantages may be granted by government except for public services.



U.S. Supreme Court



Cuno v. DaimlerChrysler

- Involved the standing of taxpayers to challenge state tax laws in federal court.
- Sixth Circuit found property tax exemption and investment tax credit violative of Commerce Clause.
- The Court unanimously ruled that state taxpayers did not have standing under Article III of the US Constitution to challenge state tax or spending decisions simply by virtue of their status as taxpayers.
 - Sixth Circuit Court of Appeals vacated in part and remanded.

Dell Incentives Case (*Blinson v. State*, 16 Oct. 2007)

Whether these incentives are lawful...was settled by *Maready*...To the extent plaintiffs question the wisdom of the incentives and whether they will in fact provide the public with the benefit promised, they have sought relief in the wrong forum.

Dell Incentives Case (*Blinson v. State*, 16 Oct. 2007)

Once the Supreme Court upheld in *Maready* that economic development incentives to recruit business to NC involve a proper public purpose, it became the role of the General Assembly and the Executive Branch...to determine whether such incentives are sound public policy.

Questions raised

- Are State incentives connected to long-term strategic economic development goals?
- Are incentives sufficiently targeted?
- Are we accurately estimating the costs and benefits of projects?
- Are there sufficient safeguards in place?

Joint Select Committee on Economic Development Incentives (2007)

- Created by the General Assembly in 2007
- Tasked with:
 - Evaluating what the State is doing and at what cost
 - Revisit and reassess the State's economic development goals
 - Identify the incentives that will give the State the best value for its investment
 - Determine sound public policy

Economic Development: *Lobbying, Ethics and the General Assembly*

- Economic development efforts often require conversations with public officials.
- New rules governing this process were adopted in 2006.



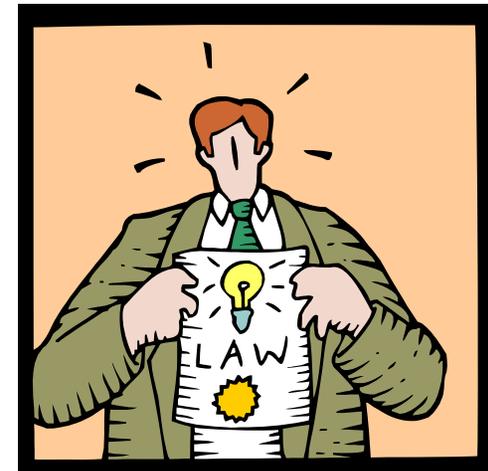
State Government Ethics Act



The most comprehensive regulation of the interaction between the public and State employees and elected officials since the passage of the law requiring the registration of lobbyists.

State Government Ethics Act

- Passed in August 2006 (S.L. 2006-201)
- Effective January 1, 2007 (some provisions have an even earlier effective date)
- Codifies a new Chapter 138A and creates a new State Ethics Commission with expanded responsibilities



Expanded definition of lobbyist

Definition is expanded to include anyone who is employed by a person and a “significant part” of the employee’s duties include lobbying.



Test included in new definition

- 5 percent threshold



- An employee not considered a lobbyist “if less than 5% of the employee’s actual duties in any 30-day period include engaging in lobbying.”

Expanded definition of lobbying



Definition expanded to include not only influencing or attempting to influence legislative or executive action through direct communication or activities, but it also includes developing goodwill, *including the building of relationships.*

Definition of lobbyist principal

Includes the association or organization that retains a “lobbyist,” but not the individual members of such association or organization.



Definition of Executive Action

- The preparation, research, drafting, development, consideration, modification, amendment, adoption, approval, defeat, or rejection of a policy, guideline, request for proposal, procedure, regulation, or rule by a public servant purporting to act in their official capacity.



Lobbying regulation in NC now applies to:

- **Advocacy contact with executive and legislative branch officials**
- **Goodwill development – simply building goodwill with State officials for the purpose of lobbying.**

Lobbyists and Principals must provide reports

- Quarterly reports of all “reportable expenditures”

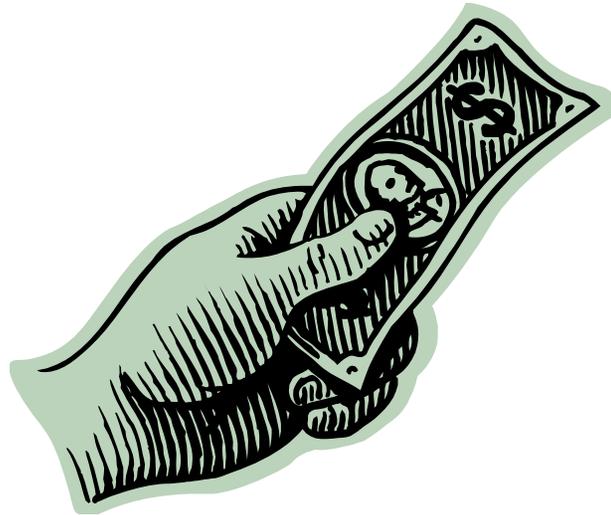
OR

- Monthly reports of all “reportable expenditures” if made during the time the General Assembly is in session.



What is a reportable expenditure?

Essentially any expenditure that benefits a legislator, legislative employee or public servant.



Question:



**So...do discussions with the Secretary of
Commerce on an economic development
matter constitute lobbying?**

Answer:

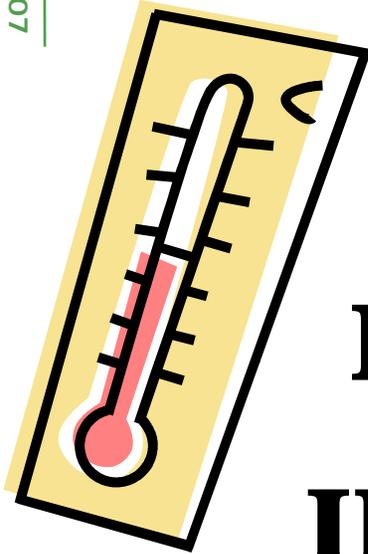


IT DEPENDS

To determine the answer:

- **Review definition of lobbyist**
 - 5% threshold
- **Review definition of executive action**

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BUSINESS CLIMATE IN NORTH CAROLINA



Awards

- **“2007 – Top Business Climate” *Site Selection* magazine**
 - This is the third consecutive year (and 6 of the last 7 years), NC has been named the “Top Business Climate”



Awards

- “Number 3 for Business” Forbes.com
 - NC ranks #3 for second consecutive year.
 - Trails only #2 Utah and #1 Virginia



Awards

Site Selection magazine ranks two NC projects among
North America's 2006 Top 20 Deals

Fidelity Investments a "Top 10 Deal"

- \$100M investment to expand in RTP
- 2,000 new jobs (on top of 1,000 existing jobs)

Vaccine-maker Novartis a "Top 20 Deal"

- \$267.5M investment in Holly Springs
- 350 new jobs



Economic Development Best Practices

- Strategic planning and targeting
- Increasing use for existing industry
- Tying incentives to company performance
 - Job creation
 - Capital investment
 - Production
- Performance-based contracts



Questions?



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