Date of Hearing: April 23, 2013

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE ECONOMY
Jose Medina, Chair
AB 28 (V. Manuel Pérez) – As Amended: March 4, 2013

SUBJECT: Economic Development: Enterprise Zones

SUMMARY: Makes six programmatic/fiscal improvements to the geographically-targeted economic development area programs, (G-TEDAs) relating to cost, transparency and accountability including, but not limited to:

1) De-designation of poor performing zones;
2) Better tracking of local financial and nonfinancial contributions to zone activities;
3) Restricting eligible areas for new zones to low-income census tracks;
4) Limiting size of new zones, in areas where previous zones had existed;
5) Better linkages between state funded job programs and G-TEDA businesses; and
6) Expansion of state-level reporting on job creation and business development.

Specifically, this bill:

1) Requires new enterprise zone designations to only include eligible areas comprised of low income census tracts. Existing law allows applicants to choose among several economic distress factors, including low income households. Communities can still use other criteria to determine eligibility, but one criterion must be low household income. The reforms also modify the application bonus point system to better target lowest income neighborhoods.

2) Limits the size of a new zone that includes an area from an existing or pervious zone to 115% of the size of the existing or previous zone. For rural areas, as defined, the size of the new zone is limited to 125%. In addition, for proposed new zones that includes area from two or more current or previous zones, the size of the zone is limited to 115% of the largest current or previous zones.

3) Authorizes the Department of Housing and Community Development (HCD) to increase the state fee that is assessed on each hire credit voucher submitted for certification from $15 to as high as $20, based on the actual increase in program costs. HCD currently has sufficient moneys to oversee these program changes, in the future; however, costs may increase and should be covered. HCD receives no General Fund moneys to administer the G-TEDA program.

4) Links each zone's required biennial progress report to the HCD audit and zone de-designation process. Currently, there are no specified penalties for a zone that fails to submit its biennial progress report or that fails to meet goals and objectives, as outlined in its memorandum of understanding with the state. By linking poor performance with the existing HCD audit procedures, a process is established to identify and de-designate poor performing zones.

5) Requires local governments to identify in its application the types of local resources they are committing to use in implementing its economic development strategy and then have each zone document in its biennial progress report the actual amount of local resources (including incentives) that were dedicated to zone activities.

6) Requires state agencies and departments, when developing workforce programs and services to consider how the enterprise zone program could be better integrated into serving their target client including Career One-Stop Offices, CalWORKS and the Department of Education.

7) Requires a more comprehensive review of the program based on information from the zones and affiliated state agencies. New areas of information would include the type of businesses being served in zones, the amount of capital investments being made by zone businesses, and wage rates of employees on which hiring credits are claimed.

EXISTING LAW:

1) Provides for the establishment of G-TEDA programs to stimulate business and industrial growth, and create jobs in depressed areas of the state. Specifically, existing law:

   a) Establishes the Enterprise Zone (EZ) Program with a maximum of 42 EZs, each designated for an initial 15-year period by HCD;

   b) Establishes the Local Agency Military Base Realignment Area (LAMBRA) Program with a maximum of eight LAMBRAs, each designated for an eight-year period by HCD. Limits designation to one LAMBRA per geographical region of the state;

   c) Establishes the Manufacturing Enhancement Area (MEA) Program with a maximum of two MEAs, each designated for a 14-year period by HCD. Limits MEA designation to impoverished areas along the California-Mexico border; and

   d) Establishes the Targeted Tax Area (TTA) Program, administered by HCD, within the County of Tulare for a 15-year period.

2) Provides legislative intent that the "health, safety, and welfare of the people of California depend upon the development, stability, and expansion of private business, industry, and commerce, and there are certain areas within the state that are economically depressed due to a lack of investment in the private sector. Therefore, it is declared to be the purpose of this chapter to stimulate business and industrial growth in the depressed areas of the state by relaxing regulatory controls that impede private investment. Further, that is in the economic interest of the state to have one strong, combined, and business-friendly incentive program to help attract business and industry to the state, to help retain and expand existing state business and industry, and to create increased job opportunities for all Californians. "

FISCAL EFFECT: Unknown

COMMENTS:

1) Framing the Policy Issue: The measure seeks to increase the transparency and accountability of the G-TEDA programs. As currently drafted, the bill does not address proposed chances to the G-TEDA tax provisions, however staff understands those issues are under discussion.

   This analysis includes background on the G-TEDA programs including a discussion on the impact of the program on California communities and a history of the quest for a comprehensive reform package.

2) The California Enterprise Zone Program: The EZ and the other G-TEDA programs are among the largest state economic development programs in California. HCD administers four G-TEDA programs including programs for the EZs, MEAs, LAMBRAs, and one TTA.

HCD is authorized to designate up to 42 enterprise zones based on a statutory list of criteria related to poverty and economic dislocation. The G-TEDA programs are based on the economic principle that targeting significant incentives to lower income communities allows these communities to more effectively compete for new businesses and retain existing businesses, resulting in increased tax revenues, decreased reliance on social services, and lower public safety costs. Residents and businesses also directly benefit from these more sustainable economic conditions through improved neighborhoods, business expansion, and job creation.

Enterprise zones are located in portions of 54 Assembly Districts and 32 Senate Districts. Enterprise zones range in size from one square mile to 70 square miles and in geographic locations ranging from Eureka and Shasta Valley near the Oregon border to San Diego and Calexico along the Mexican border.

Under the program, businesses and other entities located within the area are eligible for a variety of local and state incentives. In its application, a prospective enterprise zone is required to identify specific local government incentives that will be made available to businesses located in the proposed zone. The local incentives can, among other things, include, writing down the costs of development, funding related infrastructure improvements, providing job training to prospective employees, and/or establishing streamlined processes for obtaining permits.

The state additionally offers a number of incentives, including tax credits, special tax provisions, priority notification in the sale of state surplus lands, access to certain Brownfield clean-up programs, and preferential treatment for state contracts. In addition to enterprise zones, the state is also authorized to administer several other G-TEDAs including a TTA, MEA and LAMBRA. Below is a chart comparing the state tax incentives offered to businesses located in a G-TEDA.

Comparison of State Tax Benefits by Targeted Area

	Hiring Credit	Longer NOL[1] Carry- Forward Period	Sales and Use Tax Credit	Accelerated Depreciation	Lender Interest Deduction
Enterprise Zone	X	X	X	X	X
Manufacturing Enhancement Zone	X				
Targeted Tax Area	X	X	X	X	
Local Agency Military Base Recovery Area	X	X	X	X	
Source: Legislative Analyst's Office					

The Franchise Tax Board (FTB) reported that in 2010 – the most current comprehensive data available – $721.5 million in enterprise zone business incentives were claimed through corporate and personal income tax (PIT) returns. Additionally, FTB reported hundreds of millions in carryover credits have been earned by businesses, but have not been claimed. Below is a chart that displays the dollar amount of enterprise zone incentives claimed through each of the tax incentives.

[1] NOL= Net Operating Loss

Enterprise Zone Tax Incentive Usage*								
Source: http://www.ftb.ca.gov/aboutFTB/Tax_Statistics/Reports/2011_Tables_Memo.pdf http://www.ftb.ca.gov/aboutFTB/Tax_Statistics/Reports/2011_Table_2_EZPA.pdf http://www.ftb.ca.gov/aboutFTB/Tax_Statistics/Rev_Est_Exhibits_1212.pdf								
	2004	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Hiring and Sales Tax Credit	$349,127	$362,620	$385,677	$430,934	$462,682	$458,912	$697,912	$476,205*
NOL Deductions	$72,326	$74,024	$126,106	$207,993	$50,418	$5,588	$6,521	--
Tax Impact	$5,171	$5,966	$11,351	$15,807	$3,433	$359	$523	--
Net Interest Deductions	$432,867	$490,129	$517,310	$520,372	$264,547	$265,683	$335,982	--
Tax Impact	$29,103	$32,395	$34,156	$34,438	$17,282	$12,268	$22,986	--
Business Expense Deductions	$4,387	$4,770	$4,463	$5,136	$5,637	$4,365	$4,481	--
Tax Impact	$222	$200	$188	$197	$199	$163	$159	--
Total Tax Impact	$383,624	$401,181	$431,371	$481,376	$483,596	$474,515	$721,580	--
***Data shown in Thousands**								
Data Provided by the Franchise Tax Board 4/2013 *Estimated based on preliminary data (returns processed through November 11, 2012)								

Across the U.S., 37 other states have G-TEDA type programs. Economic developers have testified that the G-TEDA programs are among the state's last remaining marketing tools for attracting new businesses and investment to California. Others, however, remain unconvinced and have suggested that this level of tax expenditure could be better spent elsewhere.

3) Assessments of the California Enterprise Zone Program: Measuring the success and failure of the enterprise zone and other G-TEDA programs has been central to the debate on whether to expand or limit, as in this case of this measure, the G-TEDA programs. Complicating the matter is that much of the discussion around the relative success or failure of the G-TEDA programs is anecdotal. The academic attempts to assess the state's G-TEDA programs have produced mixed results. Some of the variance among study findings can be attributed to the limited access to good data sets. Research generally requires development of a set of assumptions to undertake a study. The assumptions made in the case of the G-TEDAs have, however, left most, if not all, of the methodological approaches open to debate. Moreover, the problems in assessing the G-TEDA programs have been further complicated by a lack of consensus on why the programs were established and what objectives they were designed to achieve.

Responding to the differing reports, HCD commissioned its own study in 2006, which looked at the impact of the enterprise zone program on neighborhood poverty, income, rents, and vacancy rates. The report showed that, on average, within enterprise zones between 1990 and 2000:

- Poverty rates declined 7.35% more than the rest of the state;
- Unemployment rates declined 1.2% more than the rest of the state;
- Household incomes increased 7.1% more than the rest of the state; and

- Wage and salary income increased 3.5% more than the rest of the state.

Since HCD's 2006 report, two additional reports have been released. One report found favorable impacts of the enterprise zone program and another found the program lacking in its ability to stimulate jobs. In November 2008 and later revised and re-released in March 2009, economists from the University of Southern California (USC) found that federal empowerment zones, federal enterprise communities, and state enterprise zones have "positive, statistically significant impacts on local labor markets in terms of the unemployment rate, the poverty rate, the fraction with wage and salary income, and employment."

The Public Policy Institute of California (PPIC) released its study of the enterprise zone program in June 2009, examining whether the program had been successful in creating more jobs than would have otherwise been established without the enterprise zone. The main finding of this report was that, "enterprise zones have no statistically significant effect on either business creation or employment growth rates."

The PPIC report also noted that the effects of the program differed among enterprise zones, appearing to have a greater effect on job creation in zones with lesser amounts of manufacturing and those where the administrators spent a greater amount of time on marketing and outreach activities. The report further stated that the PPIC encouraged a more critical evaluation of the program overall and on individual zones using both employment and other metrics such as poverty, unemployment, and property values.

It is important to note, however, that while the USC and PPIC reports discussed above were released in 2008 and 2009, the business development data used to form the statistical analyses were from <u>2004</u> and earlier. This date is significant, as both HCD and the Legislature approved significant reforms to the program in 2006 (discussed below), and only two of the 42 current zones were subject to the study, raising the question as to whether either two of the studies accurately reflect the impact of the enterprise zone program today.

4) <u>The Pursuit of Comprehensive Reforms (list of bills is under comment 7)</u>: While the G-TEDA programs have been around for decades, it was not until the winter of 2005 that the first comprehensive legislative oversight hearings were held. The impetus for these hearings, jointly held by the Assembly Committee on Jobs, Economic Development and the Economy (JEDE) and the Assembly Committee on Revenue and Taxation (R&T), was the introduction of several comprehensive and controversial reform efforts in 2004. During the course of these first oversight hearings, the committees struggled to develop a framework for evaluating the state's return on investment.

   Due to the lack of clear data and the state's poor administration of the program when it was overseen by the now defunct Technology, Trade and Commerce Agency, JEDE's focus shifted to improving the transparency and accountability of the G-TEDA programs as a first step toward broader reform efforts. Following the three hearings, publication of a final report, and extended work group meetings led by JEDE, legislation was negotiated and approved by the Senate and Assembly Floors on 40-0 and 77-0 votes [AB 1550 (Arambula and Karnette), Chapter 718, Statutes of 2006].

The requirements of the 2006 reforms were just coming into effect when there were new calls for further G-TEDA reforms in 2009. In preparing to vote on another set of comprehensive reforms, JEDE initiated a second round of hearings, which included an examination of how the prior reforms were progressing and what additional areas were in need of improvement. During the course of its 2009 review, JEDE held three public hearings, met with a variety of stakeholder groups, and produced an updated report that detailed the structure and activities of the G-TEDA program. In addition to the authors of the USC and

PPIC reports, speakers included economic development practioners, researchers, nonprofit organizations, local governments, labor, and business leaders.

A final summary report of the proceedings was released by JEDE in January 2010; it included a comparative review of how California's program stacked up against other state's enterprise zone programs, summaries of each hearing and a list of 100 reform recommendations. The JEDE report made five key findings, including the need for more structure and accountability mechanisms within the tax incentives and the need to better link workforce development into the overall G-TEDA framework.

In March 2010, at the request of the Speaker, JEDE convened a working group to review the final report recommendations and develop a comprehensive set of reforms to the G-TEDA programs. The work group, comprised of representatives from local governments, labor and the business community, met extensively through the spring and summer of 2010 on the premise that they would put forward a consensus-based set of reforms. Key program revisions under discussion included:

a) Increasing accountability of the program;
b) Tighter targeting of tax incentives to low income households;
c) Reforms to structure the hiring credit including targeted higher wage and manufacturing-related jobs; and
d) Increased integration of the enterprise zone program with other state and local community development programs, including public programs that support workforce development and job placement.

Ultimately, one of the primary stakeholder groups withdrew from the negotiations based on their position that the overall reform package must result in a substantially smaller program and perhaps be only limited to the state's rural areas.

5) 2011-12 Enterprise Zone Actions: In January 2011, Governor Brown released, as part of his 2011-12 proposed budget, a proposal to eliminate the G-TEDA programs, including any previously earned credits that had not yet been applied toward tax liability. His proposal was met with both support from the critics of the program, including labor, and opposition from supporters of the program, including local government and business representatives.

Responding to the Governor's proposal, an comprehensive reform measure was introduced, AB 231 (V. Manuel Pérez and Alejo), which included many of the reform recommendations from the 2009 hearings and working group meetings, including proposals for reducing the overall cost of the program and increasing transparency and accountability. In the Governor's May 2011 budget report, his G-TEDA proposal was modified from eliminating all the G-TEDA programs to eliminating the requirement that the hire credit be targeted toward underserved populations, limited the hire credit to only net new hires (similar to the provisions in SB 412), and reducing the value of the individual hiring credit from $37, 400 over five years to a one-time credit of $5,000. The Legislature did not take action on the Governor's May revision proposal.

In addition to the Governor's proposal and AB 231, three other measures tried to advance reform efforts. First, a narrowly focused reform measure was advanced through the Senate, SB 301 (DeSaulnier), which limited the size of new enterprise zones in instances where the new zone would include areas that were previously included within a zone. In July 2011, the provisions of SB 301 were amended into AB 1411 (V. Manuel Pérez and Alejo) which was a second, although less comprehensive, reform measure. Responding to a local plant closure, a third measure, AB 1278 (Hill), was amended to prohibit hire credits for employees that replace workers who lost their job as a result of a plant relocation. The AB 1278 provisions were similar, but more restrictive than the AB 231 relocation provisions, and AB 1278 failed move to out of JEDE in 2011.

In the fall of 2011, HCD announced that no new zones would be designated until major reforms were implemented and scheduled listening sessions around the state to help in the development of a comprehensive set of regulations that would "increase transparency, accountability, cost effectiveness, and to more effectively stimulate job growth in California." In deference to the Governor's renewed interest in developing a reform compromise, the author did not set AB 231 in JEDE for the January 2012 two-year bill hearing. AB 484 (Alejo) was later amended to allow for the extension of two enterprise zones (Watsonville and Antelope Valley) that were expiring and would not have an opportunity to re-apply due to the designation black-out. Later in the year, the author tried to move AB 1411 through the Senate, but it was ultimately held in Senate Rules Committee. By the end of the 2011-2012 Session, all the enterprise measures had been held or died.

The regulation package, expected in February 2012, was not published until January 2013. Key elements in the regulations include:

a) Require voucher applications to be made within one year from the date of hire. A one-year catch-up period was proposed for existing hires;
b) Modify supporting documentation to the voucher application, most significantly, prohibit the use of a W-4 form for documenting residence of an employee;
c) Require, for the first time, HCD to collect data from zone administrator on vouchering statistics;
d) Create audit procedure including a process to allow audit failures result in zone decertification; and
e) Update the voucher application fee from $10 to the $15, maximum allowed by statute.

Upon publication, the local government and business community stakeholders expressed significant concerns that the regulations went beyond existing statutory authority and represented programmatic policy changes that were more appropriately within the purview of the Legislature. No response has been made from HCD since the public comment period ended on February 28, 2013.

6) Why Continue Seeking Reforms? In California, poverty is primarily concentrated among communities of color which have a statistical correlation with lower levels of educational attainment and access to basic health care. This creates a significant socioeconomic disparity within our society, which has led to two separate and unequal societies. Research by the California Endowment shows that more than half of the Latinos in this country and nearly 65% of African Americans live in neighborhoods of color, generally low-income communities.

Economically distressed communities typically lack jobs, good schools, and safe and well-maintained housing. Conversely, these areas often have high crime rates, gang violence, and unemployment. Moreover, they do not have the sufficient social support to eliminate or overcome these obstacles on their own. Narrow focused programs are generally ineffective because there is an array of complex issues that drive poverty. Comprehensive programs, however, are expensive an can be difficult to measure impacts. Yet, leaving poverty unaddressed results in its expansion, creating higher unemployment levels and increasing disparity within the broader community.

Research shows that effective solutions to poverty must be deep, long-term and center on policies which provide economic opportunities and individual and neighborhood empowerment. As a framework, the enterprise zone program could provide such a community development program.

7) Related Legislation: Below is a list of current and prior legislation.

a) *AB 9 (Holden) Wage Base Reforms*: This bill modifies the enterprise zone hire credit conditions by requiring employees receive a qualified wage that exceeds an average monthly wage $2,000 and expands the definition of a qualified employee by expanding the dislocated worker requirements to reflect recent economic considerations. Status: Two-year bill in JEDE.

b) *SB 113 (DeSaulnier) Size Limitations on New Zones*: This bill prohibits a jurisdiction which applies for an enterprise zone designation, on or after January 1, 2012, that includes area that was once within a previously designated zone from receiving a new zone designation that has a geographic area of more than 115% of the size of the previous zone. The bill also limits new zone designations in cases where the proposed zone area had been within one or more previously designated zones to 115% of the largest of those zones. Status: Pending in Senate Committee on Transportation and Housing.

c) *SB 434 (Hill) Capped and Allocated Hire Credit*: This bill converts the hire credit to a capped and allocated credit; revises the percentage of qualified wages allowed per year of employment; limits the hire credit available to relocated businesses; and prohibits a person from charging a contingent fee for services rendered in connection with a G-TEDA tax credit. Status: Pending in the Senate Committee on Governance and Finance.

Legislation from prior Sessions

d) *AB 231 (V. Manuel Pérez and Alejo) Enterprise Zone Reforms*: This bill would have made a number of changes to the California Enterprise Zone Program including the following:

i) Reforms to reduce the cost and size of the program including, but not limited to: limiting the use of the tax credits and deductions to 50% of tax liability for the 2011 and 2012 tax years, requiring vouchering of qualified employees within 36 months of employment, reducing the five-year credit to three years, limiting the hiring credit for relocating businesses, scaling back the size of the targeted tax area, limiting the carry forward of credits to 15 years, requiring new zones to exclusively designated based on lower income households, and limiting the merging of zones.

ii) Reforms to increase program accountability including, but not limited to, de-designation of poor performing zones, prohibiting "bad actor" businesses from accessing tax incentives, tracking local resources dedicated to zone activities, and expanding state-level reporting.

Status: Held by JEDE in 2012.

e) *AB 1139 (John A. Pérez) Enterprise Zone Hiring Credit*: This bill would have made four changes to the G-TEDA programs:

i) Establishing a two-tier hiring credit – one funding level for jobs with health care and another for those without;
ii) Requiring applications for hiring credit certification to be submitted to the certifying agency within 21 days of the commencement of employment;
iii) Removing from the hiring credit qualified employee list, employees who reside within a targeted employment area; and

iv) Requiring annual reporting from tax payers who have certified an employee under the hiring credit.
Status: Held in JEDE in 2010.

f) *AB 1159 (V. Manuel Pérez) Enhancement of Sales and Use Credit for Cleantech Projects:* This bill would have established the California Cleantech Advantage Act of 2008 providing a targeted incentive to strengthen California's competitive edge in the leading emerging clean technologies. Status: Held in Assembly Committee on Appropriations in 2010.

g) *AB 1278 (Hill) G-TEDA Hiring Credits*: This bill, as it was heard in JEDE, would have limited the application of the new hire credit in instances where the tax payer has relocated from one area of California to a G-TEDA on or after January 1, 2011. Under this circumstance, a G-TEDA hire credit would only be allowed for qualified employees who represent a net increase to the total number of California workers employed by the tax payer over the previous tax year. Further, the tax payer would be is required to have also made a bona fide offer of employment at the new work location to each employee at the old location that was displaced by the move. The bill did not pass JEDE in this form. The G-TEDA language was stripped from the bill and different language was included which changed its jurisdiction. Status: Vetoed by the Governor, 2012.

h) *AB 1411 (V. Manuel Pérez and Alejo) Accountability Reforms*: This bill would have made a number of changes to the enterprise zone program related to accountability and transparency including, but not limited to, limiting new zone designations to lower income census tracts, increasing reporting of the programs impact, and de-designating poor performing zones. Status: Held in Senate Rules Committee in 2012.

i) *AB 1550 (Arambula) Final Enterprise Zone Reform Act from 2005-06 Session*: This bill made a number of significant changes to the management and oversight of the G-TEDA programs. The bill was the result of extensive oversight hearings held by JEDE and R&T, as well as extended discussions with stakeholder groups. Status: Signed by the Governor, Chapter 718, Statutes of 2006.

j) *AB 2589 (Runner) Aggregate Credits to Offset Tax Liability within Zones*: This bill would have authorized a business to use credits generated in an enterprise zone to offset taxes attributable to the business from any enterprise zone. Status: Held in the Revenue and Tax in 2006.

k) *AB 2476 (V. Manuel Pérez) Reform of TEA*: This bill would have tightened the criteria for designating a TEA for the purposes of establishing one of the thirteen worker eligibility criteria under the enterprise zone hiring tax credit requirements. Status: Held in the Assembly Committee on Appropriations in 2010.

l) *AB 301 (DeSaulnier) Size of Zones*: This bill would have prohibited a jurisdiction which applies for an enterprise zone designation, on or after January 1, 2012, that includes area that was once within a previously designated zone from receiving a new zone designation that has a geographic area of more than 115% of the size of the previous zone. The bill also limits new zone designations in cases where the proposed zone area had been within one or more previously designated zones to 115% of the largest of those zones. Status: Amended into another subject matter.

m) *SB 974 (Steinberg) Career Pathways Credit and Hiring Credit Swap*: This bill would have established a new Career Pathways Investment Credit for qualifying business entities that partner with local education agency programs to develop and support career pathway programs, as specified.

Funding for the credit would be provided by limiting the eligibility criteria on the existing enterprise zone hiring credit. Status: Held in JEDE in 2010.

n) *SB 1008 (Ducheny) Initial Enterprise Reform Act from 2005-06 Session*: This bill would have made a number of significant changes to the G-TEDA programs including streamlining the selection criteria, authorizing noncontiguous zones, extending certain zone designations, and tightening up of the TEA. Status: Held in JEDE in 2006.

8) Double Referral: This measure was referred by the Assembly Rules Committee to policy committees. Should this measure pass JEDE, AB 28 will be referred to the Assembly Committee on Revenue and Taxation for further consideration.

REGISTERED SUPPORT / OPPOSITION:

Support

CalChamber
California Asian Pacific Chamber of Commerce
California Association of Local Economic Development
California Business Properties Association
California Manufacturers & Technology Association
California Retailers Association
El Centro and Brawley Chambers of Commerce
League of California Cities
Pacific Merchant and Shipping Association
SSA Marine

Opposition

None received

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