13 VAC 5-112 – Virginia Enterprise Zone Grant Program
Department of Housing and Community Development
April 7, 2006

Summary of the Proposed Regulation

The Board of Housing and Community Development (board) proposes to promulgate a permanent Enterprise Zone Grant Regulation that will establish the criteria and procedures for the designation, amendment, and administration of enterprise zones along with incentive qualification criteria. The proposed regulation will make amendments to the provision of the three incentives under the previous Enterprise Zone Regulations[1] (General Income Tax Credits, Investment Tax Credits, and Job Grants) and will establish rules for the provision of two new grant-based incentives (the Real Property Investment Grants and the Job Creation Grants).

Results of Analysis

There is insufficient data to accurately compare the magnitude of the benefits versus the costs. Detailed analysis of the benefits and costs can be found in the next section.

Estimated Economic Impact

The Enterprise Zone Act (Chapter 22, 59.1-270 through 50.1-281.01) became effective since 1982 and expired on July 1, 2005. Under this statute, the governing body of any county, city or town might make written application to the Department of Housing and Community Development (DHCD) to have an area or areas declared to be an enterprise zone. Upon recommendation of DHCD, the governor might approve the designation of up to 60 enterprise zone areas. In making an application for designation as an enterprise zone, the applying

[1] The previous Enterprise Zone Regulations (13 VAC 5-111) expired on July 1, 2005 and an emergency regulation based on the Enterprise Zone Grant Program was effective on September 30, 2005.

localities might propose local tax incentives[2] and regulatory flexibility[3]. The major incentives in the Enterprise Zone Act included (i) General Income Tax Credits, (ii) Investment Tax Credits, (iii) Real Property Improvement Tax Credits, and (iv) Job Grants.

As promulgated pursuant to the Enterprise Zone Act, the Enterprise Zone Program Regulation (13 VAC 5-111) has achieved great success in stimulating business and industrial growth which result in neighborhood, commercial and economic revitalization by means of tax incentives and regulatory flexibility. According to the *2004 Tax Year Annual Report of the Virginia Enterprise Zone Program*,[4] the 199 businesses that qualified for the 2004 general income tax credits created a total of 4,903 net new jobs during tax year 2004, among which 1,111 were filled by low-to-moderate income persons. For tax year 2004, 158 businesses that qualified for the real property improvement tax credits made a total of $82,095,081 of qualified improvements[5] to non-residential properties within 32 enterprise zones, which indicated a 30% increase from the 2003 tax year. And 3,548 net new full-time jobs were created in the tax year 2004 by the 148 businesses that received $1,960,000 job grants.

Since the Enterprise Zone Act expired on July 1, 2005, the 2005 General Assembly passed legislation creating the Enterprise Zone Grant Act (Chapter 47, 59.1-538 through 59.1-549) and made amendments to section 59.1-279, 59.1-280, 59.1-280.1, 59.1-282.1 and 59.1-282.2 of the Code of Virginia in order to continue certain aspects of the previous Enterprise Zone Program. Accordingly, the board promulgated an emergency regulation which was effective on September 30, 2005. Now the board proposes to promulgate a permanent Enterprise Zone Grant Program Regulation.

[2] According to 59.1-283 (Expired July1, 2005), local tax incentives includes, but not limited to: (i) reduction of permit fees, (ii) reduction of user fees, (iii) reduction of the business, professional, and occupational license tax, (iv) partial exemption from taxation of substantially rehabilitated real estate pursuant to 58.1-322.1, and (v) adoption of a local enterprise zone development taxation program pursuant to Article 4.2 (58.1-3245.6 et seq.) of Chapter 32 of Title 58.1.

[3] According to 59.1-283 (Expires July 1, 2005), regulatory flexibility includes, but not limited to: (i) special zoning districts, (ii) permit process reform, (iii) exemptions from local ordinances, and (iv) other public incentives proposed in the locality's application, which shall be binding upon the locality upon designation of the enterprise zone.

[4] By Virginia Department of Housing and Community Development

[5] According to 59.1-280.1, qualified improvement means the amount properly chargeable to a capital account for improvements to rehabilitate or expand depreciable real property placed in service during the taxable year within an enterprise zone, provided that the total amount of such improvements equals or exceeds (i) $50,000 and (ii) the assessed value of the original facility immediately prior to the rehabilitation or expansion.

As authorized by the new statute, the proposed regulations will revise the rules for providing the General Income Tax Credit, Investment Tax Credit, and the Job Grants to allow businesses meeting certain conditions to continue to receive the incentives available under the previous program. Businesses that have already started their qualification periods for the three incentives under the previous program can finish out their incentive periods provided they continue to meet the qualification requirements for those incentives.[6] In addition, small qualified business firms, large qualified business firms and large qualified zone residents that have a signed agreement with the Commonwealth regarding the use of the tax credits on or before July 1, 2005 may initiate use of the tax credits according to their agreement. The proposed provisions for the three incentives are similar to those under the previous regulations.

The proposed regulations will establish the processes and procedures for the provision of two new grant-based incentives: the new Job Creation Grants and the new Real Property Investment Grants. There are two major differences between the old Job Grants and the new Job Creation Grants. While qualification for both incentives is based on the creation of net new permanent full-time positions, under the new Job Creation Grants, those new positions must pay wage rates of at least 175% of the Federal minimum wage and offer health benefits (so-called "wage-based") in order to qualify for grants as required by statute. The old Job Grant had no such qualification requirements.[7] This requirement will increase the effectiveness of the grants by focusing on the quality of job creation as well as the quantity. Another difference is that positions in local services,[8] retail, food and beverage businesses are not eligible for the new Job Creation Grants as required by statute (59.1-547), while they were for the old Job Grants. Since location and expansion decisions of these businesses are more driven by demographic and market factors than the availability of financial incentives, this change will raise the efficiency of the incentives by targeting on businesses that are more likely to be influenced by financial

[6] According to DHCD, Real Property Improvement Tax Credits had to have been taken for the tax year in which the real property was placed in service. Real property placed in service on or after January 1, 2005 would need to qualify under the new statute.

[7] According to 59.1-282.1, the amount of the job grants for which a business firm is eligible in any grant year shall be equal to (i) $1,000 multiplied by the number of eligible positions filled by employees whose permanent place of residence is within the enterprise zone, and (ii) $500 multiplied by the number of eligible positions filled by employees whose permanent place of residence is outside of the enterprise zone.

[8] According the proposed regulations, "local service" means a business which provides services primarily within the city or county in which the business is located.

incentives. On the other hand, it may have a small adverse affect on businesses in local services, retail, food and beverage that would otherwise apply for job grants after July 1,2005.

The proposed regulations will also establish rules for providing the new Real Property Investment Grants, which will replace the Real Property Improvement Tax Credits under the previous regulations. Replacing the tax credits with grants will increase fiscal accountability for and hone in economic situations that can best benefit from financial incentives.[9] It also provides more flexibility to the qualified businesses.

Under the previous program, the total amount of tax credits (including the General Income Tax Credits, Investment Tax Credit, and Real Property Improvement Tax Credits) was capped at $19 million annually; and Job Grants was capped at $1.96 million in fiscal year 2005.[10] The caps under the new program are revised to accommodate the elimination of Real Property Improvement Tax Credits and the creation of two new incentives, with the total ($21 million) almost the same as that under the previous program ($20.96 million). As shown in the last column of Table 1, the total tax credit allocation (including General Income Tax Credits and Investment Tax Credits) will be $7.5 million annually. The total grant allocation (including Job Grants under the previous program, Job Creation Grants and Real Property Investment Grants) will be $13.5 million for fiscal year 2006. According to DHCD, the new caps were decided based on the projected amount of total tax credits and grants that will be received under the new program. Comparing column 4 with column 6 of Table 1 indicates that the cap for the total tax credits (including General Income Tax Credits and Investment Tax Credits) is close to the actual amount of tax credits received in tax year 2004 for these two tax credits; the total grant allocation (including Job Grants under the previous program, Job Creation Grants and Real Property Investment Grants) is close to the actual combined amount of Real Property Improvement Tax Credits and Job Grants received in tax year 2004, with the Real Property Improvement Tax Credits being replaced by the Real Property Investment Grants. Therefore, the revision of caps will likely not have any significant impact on the qualified businesses.

The proposed regulations will also revise language pertaining to designation, amendment, and administration of enterprise zones in order to be consistent with the statute. For example, any

[9] The grants are dealt with through budget language for DHCD and the amount is authorized for each fiscal year.
[10] Ibid.

enterprise zone may consist of three non-contiguous areas instead of two under the previous regulation; zone specific census-based and floor area vacancy rates are removed as eligibility requirements; new maximum and minimum acreage requirements are established to offer more flexibility to participants; and a section is added to describe the distress factors[11] of the entire locality that will be considered for zone designations. The impact of these regulatory changes will be that zone designations will be more targeted where there is the greatest need and the most potential for effective use of an enterprise zone designation. Since zone designation is based on locality-wide need instead of the need of the zone area, and since there is no requirement that an enterprise zone be a distressed area but rather just be located somewhere in a distressed locality, localities have more flexibility in where to locate their enterprise zone and will more likely maximize the zone effectiveness. However, the maximum number of zone designations will be 30 instead of 60 under the previous program; initial designation period will be 10 years with the possibility of two five-year extensions as specified in the statute (used to be a 20-year period). Therefore, localities will compete for fewer slots and less distressed localities[12] will have fewer chances to have their application approved.

In sum, the proposed regulatory changes, as required by statute, will improve zone effectiveness and efficiency by making the zone designations more targeted where there is the greatest need and the most potential for effective use of an enterprise zone designation, and zone incentives more targeted on businesses that are more likely to be influenced by financial incentives. Although businesses in local service, retail, food and beverage will not be able to apply for Job Creation Grants, businesses from other industries as well as residents in localities where the enterprise zone is located will benefit from the proposed regulatory changes. Since the benefit and the cost can not be measured in monetary term, it is not known whether the total benefit exceeds the total cost.

[11] According to the proposed regulations, the distress factors will account for at least 50% of the evaluation consideration for zone designation. These factors include: (i) the average unemployment rate, (ii) the average median adjusted gross income, (iii) the average percentage of public schools students within the locality receiving free or reduced price lunches over the most recent three-year periods.
[12] See note 11.

Table 1. Number of Qualified Businesses, Amount of Incentives and Caps for Incentives

<table>
<tr><th></th><th>Number of Qualified Businesses in Tax Year 2004</th><th>Credits/Grants Received in Tax Year 2004</th><th>Credits/Grants Received in Tax Year 2004</th><th>Cap Under Previous Program</th><th>Cap Under Current Program</th></tr>
<tr><td>General Income Tax Credits</td><td>199</td><td>$6,818,310</td><td rowspan="2">$7,151,041</td><td rowspan="3">$19,000,000</td><td rowspan="2">$7,500,000</td></tr>
<tr><td>Investment Tax Credits</td><td>1</td><td>$332,731</td></tr>
<tr><td>Real Property Improvement Tax Credits</td><td>158</td><td>$11,848,959</td><td rowspan="2">$13,808,959</td><td>N/A</td></tr>
<tr><td>Job Grants</td><td>148</td><td>$1,960,000</td><td>$1,960,000</td><td rowspan="3">$13,500,000</td></tr>
<tr><td>Real Property Improvement Grants</td><td>N/A</td><td>N/A</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Job Creation Grants</td><td>N/A</td><td>N/A</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Total</td><td>506</td><td>$20,960,000</td><td>$20,960,000</td><td>$20,960,000</td><td>$21,000,000</td></tr>
</table>

Source: DHCD, 2004 Tax Year Annual Report of the Virginia Enterprise Zone Program

Businesses and Entities Affected

The proposed regulatory changes will improve zone effectiveness and efficiency, which will better stimulate business and industrial growth and will benefit the businesses and residents in localities where the enterprise zone is located.

On the other hand, under the new program, positions in local services, retail, food and beverage businesses will not be eligible for the Job Creation Grants, as they were under the previous program. According to the *2004 Tax Year Annual Report of the Virginia Enterprise Zone Program*, a total of 413 businesses requested incentives in tax year 2004, with 28% businesses from services and 14% from retail, and 148 businesses received the Job Grants. Assuming that businesses receiving Job Grants in tax year 2004 were distributed among industries in the same manner as those requesting any incentives, approximately 41 service businesses and 20 retail businesses received Job Grants in tax year 2004.[13]

[13] The number of businesses that will be affected will be much lower since this number includes businesses from all services, not just “local service” which is a business which provides services primarily within the city or county in which the business is located.

Localities Particularly Affected

The proposed regulations will apply to localities throughout the Commonwealth. However, since the proposed regulation are more targeted where there is a greatest need and the most potential for effective use of an enterprise zone designation, localities with more distress[14] will benefit more from the proposed regulatory changes. Also, since the maximum number of zone designations will be reduced from 60 to 30, less distressed localities will have fewer chances to have their application approved.

Projected Impact on Employment

The proposed regulation may have a negative impact on employment in local services, retail, food and beverage, while having a positive impact on employment from other industries. Under the new program, business in local services, retail, food and beverage will not be eligible for the Job Creation Grants, while they were under the previous Job Grants. According to the *2004 Tax Year Annual Report of the Virginia Enterprise Zone Program*, 3,548 net new full-time jobs were created by the 148 businesses that received the Job Grants. Assuming that the number of net new full-time jobs created was distributed among industries in the similar manner as the businesses requesting any incentives, approximately 993 net new full-time jobs were created in service and 139 created in retail in tax year 2004. The number of reduced net new full-time job creation from local services, retail, food and beverage may be lower because, on the whole, the nature of such businesses is that demographic and market factors are a stronger determinant of location and expansion decisions than the availability of financial incentives. In addition, any reduction in the number of jobs created in these types of businesses will likely be more than offset by the increase in employment from other industries as a result of improved zone effectiveness and efficiency.

Effects on the Use and Value of Private Property

All types of businesses, including local service, retail, food and beverage, may qualify for the Real Property Investment Grants and so the proposed regulation may have a positive impact on commercial, industrial and mixed use properties in localities where the enterprise zones are located. Also, the proposed regulatory changes will better stimulate business and industrial

[14] See note 11.

growth and will have a positive impact on the asset values of most businesses as well as the values of residential properties. However, as required by statute (59.1-547), positions in local services, retail, food and beverage businesses will not be eligible for the Job Creation Grants under the new program. This proposed change may reduce profits for these businesses and commensurately decrease their asset values.

Small Businesses: Costs and Other Effects

Small businesses in industries other than local services, retail, food and beverage will benefit from the proposed regulatory changes. While those in local services, retail, food and beverage may be adversely affected because they will not be able to apply for Job Creation Grants under the new program.

Small Businesses: Alternative Method that Minimizes Adverse Impact

As required by statute, the proposed regulations will establish rules for the provision of two new grant-based incentives, and make amendments to the provision of three existing incentives as well as language pertaining to designation, amendment, and administration of enterprise zones. The impact of these regulatory changes will be that zone designations are more targeted where there is the greatest need and the most potential for effective use of an enterprise zone designation, and zone incentives will be more targeted on businesses that are more likely to be influenced by financial incentives and that create a higher quality of job. The proposed regulation will increase zone effectiveness and efficiency and there will be no alternative that will have a smaller adverse impact.

Legal Mandate

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.H of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.H requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. Further, if the proposed regulation has adverse effect on small businesses, Section 2.2-4007.H requires that such economic impact analyses include (i) an identification and estimate of the number of small businesses subject to the regulation; (ii) the projected reporting, recordkeeping, and other administrative costs required for small businesses to comply with the regulation, including the type of professional skills necessary for preparing required reports and other documents; (iii) a statement of the probable effect of the regulation on affected small businesses; and (iv) a description of any less intrusive or less costly alternative methods of achieving the purpose of the regulation. The analysis presented above represents DPB's best estimate of these economic impacts.