Economic Impact Analysis
Virginia Department of Planning and Budget

13 VAC 5-111 – Virginia Enterprise Zone Program Regulations

Department of Housing and Community Development

March 1, 2004

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G 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. The analysis presented below represents DPB's best estimate of these economic impacts.

Summary of the Proposed Regulation

The General Assembly mandates in §36-137 of the Code of Virginia that the Board of Housing and Community Development make rules and regulations necessary to carry out its responsibility and repeal or amend these rules when necessary.

The proposed regulation (1) caps the amount of general tax credits that businesses with high investment but limited job creation capabilities can claim under the provisions of this regulation, (2) allows the state enterprise zone designation period to be extended to coincide with the federal empowerment zone designation, and (3) deletes references to metropolitan central cities and classifies localities only as cities, towns, or counties.

The regulation also proposes a number of administrative changes. It removes the requirement for localities to file a separate survey of zone business sentiment in the first year after establishment and instead requires the relevant information to be included in the first annual report submitted by the locality. It specifies the qualification process for firms located in enterprise zones whose designation is ending. The proposed change is in response to the scheduled expiration of the state's first enterprise zone designations. It removes language in the regulation dealing with the identification and sale of surplus land by the state and localities. According to the Department of Housing and Community Development (DHCD), it is common practice for the state and localities to identify and sell surplus land in an expedient manner, making these requirements unnecessary. It deletes the provision in the existing regulation requiring enterprise zone jurisdictions to examine their applications every five years and, if required, submit amendments to the original application. DHCD believes this requirement to be unnecessary as the agency already provides such guidance during the course of the annual assessment visit.

Finally, the proposed regulation includes a number of changes that clarify various aspects of the regulation (including its intent) and make the regulation consistent with current practice. It also updates the existing regulation (such as replacing the term family with the term household to reflect societal trends and replacing the phrase conduit entity with the phrase wholly owned pass through entity to reflect business and tax terminology) and removes unnecessary and outdated language.

Estimated Economic Impact

(1) The proposed regulation caps the amount of general tax credits that firms and businesses with high investment but limited job creation capabilities can claim under the enterprise zone program. Firms that make at least $50 million in zone investments and create 50 or fewer full-time permanent positions are defined as high investment/low job creation firms. Under the existing regulation, such firms are eligible for the general tax credit, the zone incentive grants, and the real property improvement tax credits. The proposed change is intended to limit the amount of general tax credits claimed by high investment/low job creation firms such as power companies under the enterprise zone program. According to DHCD, these firms base their location decision on specific infrastructure needs and other factors rather than on incentives provided by enterprise zones. Moreover, these firms tend not to create many jobs, but have large tax liabilities against which they can claim tax credits and incentives provided under the enterprise zone program. The proposed change limits the amount of general income tax credit these firms can claim by the amount of additional revenue the state expects to generate through

the creation of new full-time permanent positions in the following five-year period. The proposed change is mandated by Chapter 676 of the Acts of Assembly for 2003.

The proposed change is likely to have a net positive economic impact. Providing firms with incentives to locate in a specific area when they would have located in the area even without the incentive is a waste of state resources. The same level of investment and job creation would have occurred regardless of the enterprise zone incentives provided for under this regulation. Thus, by rewarding firms for actions they would have taken anyway, the existing regulation imposes additional costs on the state without providing any significant additional benefits. Moreover, high investment/limited job creation firms tend not to have a very large impact on employment, but by virtue of their large tax liability are eligible for large tax credits.

By capping the amount of general income tax credit that these firms can claim by the amount the state can expect to collect through increased tax revenues over the following five years, the proposed change will reduce the waste of state resources and ensure that tax credits and incentives provided under this program are commensurate with the investment, job creation, and tax revenue generating capabilities of the firm. The state can expect to recoup the cost of providing general tax credits to high investment/limited job creation firms through increased tax revenues in the five-year period following tax credits. Thus, the state will no longer have to bear the cost of providing these firms with unnecessary incentives in order to encourage them to locate to specific areas. Moreover, by capping the amount of general tax credit by the expected additional income tax revenue generated by the activities of high investment/limited job creation firms, the proposed change ensures that the tax credits are commensurate with the investment, job creation, and tax revenue generating ability of these firms.

In order to precisely estimate the magnitude of the net positive economic impact, it would be necessary to know how many firms fall under high investment/low job creation definition. According to DHCD, there are no reliable estimates of these figures available at this time.

(2) The proposed regulation allows the state enterprise zone designation period to be extended to coincide with the federal empowerment zone designation period (state enterprise zones have a designation period of 20 years). If an area is designated as a federal empowerment zone at the time of the scheduled expiration of the state enterprise zone designation, the state designation will continue until the federal designation expires. Under the existing regulation, the

state designation would expire regardless of the existence of a federal designation. According to DHCD, the proposed change is intended to maximize the resources available for encouraging investment and job creation in these areas. The proposed change is mandated by Chapter 763 of the Acts of Assembly for 2003.

The proposed change is likely to have a small net positive economic impact. According to DHCD, the proposed change will allow some state enterprise zone designations to continue for a few years longer. By increasing the number of years for which enterprise zone incentives are to be provided, the proposed change will impose additional costs on the state. These costs will be balanced by the additional benefit to firms located in these areas. However, to the extent that extending the state designation to coincide with the federal designation encourages continued operation, investment, and job creation by existing firms in these areas and provides an incentive for new businesses to be established in or locate to Virginia, it is likely to produce some additional economic benefits.

(3) The proposed regulation deletes references to metropolitan central cities and classifies localities only as cities, towns, or counties. Under the existing regulation, localities are classified as metropolitan central cities, towns and cities other than as metropolitan central cities, unincorporated areas of counties, and consolidated cities. Based on these classifications, the minimum and maximum size of enterprise zones is determined. The proposed change combines the combines two classifications, metropolitan central cities and towns and cities other than as metropolitan central cities, and establishes the minimum and maximum size of the enterprise zone as one-half square mile and one square mile, respectively.[1] According to DHCD, the existing classification was a source of confusion among localities applying for an enterprise zone designation.

The proposed change is likely to have a small net positive economic impact. Some areas classified as metropolitan central cities will be allowed to have smaller enterprise zones than currently required. Other areas classified as towns and cities other than metropolitan central cities will be allowed to designate enterprise zones larger than currently allowed. By increasing

[1] The size of enterprise zones in metropolitan central cities are currently required to be at least one-half square mile and at most one square mile or 7% of the jurisdiction’s land area or population. The size of enterprise zones in towns and cities other than metropolitan central cities are currently required to be at least one-fourth square mile and at most one-half square mile or 7% of the jurisdiction’s land area or population.

the flexibility available to localities in determining the size of the enterprise zone, the proposed change is likely to produce some economic benefits. Moreover, to the extent that the proposed change reduces confusion and uncertainty in implementation of the regulation, it is likely to produce some further economic benefits.

The proposed regulation also makes a number of administrative and other changes. These changes are not likely to produce a significant economic impact. The administrative changes are intended to provide additional guidance and reduce the administrative burden, on the state and on firms operating in enterprise zones, without compromising the intent and enforcement of the regulation. The remaining changes are intended to update the regulation, remove unnecessary and outdated language, clarify aspects of the existing regulation, and make the regulation consistent with current practice. To the extent that all these changes improve the understanding, implementation, and effectiveness of the regulation, they are likely to produce some small economic benefits.

Businesses and Entities Affected

The proposed regulation will affect businesses and entities operating in designated enterprise zones. The amount of general tax credit high investment/low job creation firms are eligible for will be limited by the additional revenues their activities are expected to generate in the five-year period following the claim. Firms operating in enterprise zones whose designation is extended to coincide with the federal empowerment zone designation will be able to receive enterprise zone incentives for a few more years. Increase in the maximum size of enterprise zones in areas previously classified as towns and cities other than metropolitan central cities could result in an increase the number of firms operating within these areas.

According to DHCD, the General Assembly has authorized the establishment of up to 60 enterprise zones. There currently are 52 enterprise zones in Virginia, with five enterprise zones having expired and three being held in reserve for areas with special needs.

Localities Particularly Affected

The proposed regulation will affect all localities in the Commonwealth, but especially those having or seeking enterprise zone designations. Some of these localities will now have additional flexibility in determining the area of an enterprise zone.

Projected Impact on Employment

As enterprise zones tend to be located in economically disadvantaged areas with high unemployment, the proposed changes could very well have a positive impact on overall employment in the state. Extending the state designation for a few years could have a positive impact on employment. Raising the maximum size of enterprise zones in areas previously classified as towns and cities other than metropolitan central cities could have a positive effect on employment by increasing the number of firms operating within these areas.

Effects on the Use and Value of Private Property

By capping the amount of general tax credit claimed by businesses classified as high investment/low job creation firms, the proposed regulation is likely to reduce after-tax profits and lower the asset value of these firms. By extending state enterprise zone designations to coincide with federal empowerment zone designations, the proposed regulation will allow firms operating in the affected enterprise zones to continue receiving benefits even after the 20-year designation period is over. This, in turn, is likely to have a positive impact on the asset value of these firms.