MANAGING THE CONSEQUENCES OF PROSPERITY A REPORT FOR THE INTER-REGIONAL PARTNERSHIP

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Prepared For

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EXECUTIVE SUMMARY

The imbalance between the location of jobs and housing in Santa Clara, Alameda, Contra Costa, San Joaquin and Stanislaus Counties has been building for over four decades. This imbalance has led to an extraordinary increase in the shortage of housing in some jurisdictions in the IRP and a lack of employment in others. As a result, firms in "job rich" jurisdictions are finding it more difficult to attract and retain employees due to the cost of housing, while "job poor" jurisdictions are becoming bedroom communities serving "job rich" jurisdictions in the five county area.

AB 2864 (Torlakson) established a five county Inter-Regional Partnership (IRP) to address the imbalance between jobs and housing on a regional basis. This bill recognized that "job rich" jurisdictions may loose businesses unless they significantly increase their housing stock. At the same time, "job poor" areas will continue to attract residential construction without commensurate increases in employment for new residents. AB 2864 calls for the IRP to identify economic development and housing incentives that can be used to address the imbalance. This report examines the potential use of incentives for economic development purposes and makes recommendations based on our findings.

The key finding in the study is that "job poor" areas would benefit most from incentives that 1) improve their competitive position in the marketplace by reducing the cost of off-site improvements, 2) improve the quality of the workforce and/or 3) reduce the time for processing local development proposals. Other incentives which would be helpful are those that have been made available to other "job poor" areas in the state with which IRP jurisdictions must compete, including, but not limited to, enterprise zones, redevelopment zones, local agency military base recovery areas, manufacturing enhancement areas, and targeted tax areas.

Funding for employment preparation is available through Workforce Investment Boards, local community colleges, Regional Occupational Programs, and other public and private sources. Although funding is limited, these organizations are in a position to help all "job poor" areas in the IRP. Addressing the permit process issue is a local matter that is under the control of IRP jurisdictions, even though state and federal agencies are involved in many development issues.

What is most lacking, according to economic development professionals, is funding for off-site improvements that are vital for making industrial and commercial sites marketable. Most "job poor" jurisdictions have an adequate inventory of industrial and commercial property. However, many of these communities are unable to secure funding for such improvements or to raise sufficient financing revenue within their jurisdiction. The State Infrastructure Bank has limited funding for this purpose, but many job poor" areas are finding it difficult to qualify. Bridging this gap would be the most effective use of AB 2864 incentive grants.

As noted in our previous report, there are hundreds of incentives that are available to local jurisdictions. Many of these incentives -- Industrial Development Bonds, for example -- can be used by any jurisdiction upon submission of a qualified proposal that meets the legal and administrative requirements of the State. Of course, the amount of funds available is limited, and competition is keen. However, tax credits for various purposes are also available to all jurisdictions and funding is virtually unlimited.

These incentives, which were identified in our inventory of incentive programs, are currently in use by many of the jurisdictions in the IRP. It is expected that their use will continue depending on the needs of individual prospects, on a case by case basis. Yet, these incentives are also available to all jurisdictions and so do not increase the competitive advantage of "job poor" areas in the IRP area.

To varying degrees, all incentives are useful, depending on the precise needs of the business prospect seeking a location. To be competitive, "job poor" jurisdictions require a comprehensive portfolio of incentives on which they can draw to meet the immediate interests and concerns of the prospective firm. What these interest and concerns may be is often difficult to ascertain with any certainty until active negotiations have begun. In light of this reality, a second key finding of the study is that incentives cannot be predetermined and should be generally available to all jurisdictions in the IRP for use when needed.

A third key finding is that housing incentives will be required in many, if not most IRP jurisdictions, including those that are determined to be "job poor." If housing incentives are not provided in these areas the overall price of housing in the IRP will continue to increase. The housing industry is not likely to create an oversupply of housing in any of the jurisdictions of the IRP. Therefore, some "job poor" areas will likely need housing incentives, not only to keep housing affordable for those taking the new jobs but also to ensure that a community's lower-income residents are not victimized by the impact economic growth is apt to have on the availability of affordable accommodations.

A fourth key finding of this report is that an improvement in the balance between housing and jobs can only be achieved through the development and implementation of a regional jobs/housing balance strategy adopted by member jurisdictions of the IRP. All past attempts to achieve a jobs/housing balance based on the imbalance found within local jurisdictions have failed. This method of analysis does not allow for the regional nature of the housing and job markets, which must be conceptualized at a less disaggregated level of analysis.

Based on these findings, we recommend that the IRP develop a jobs/housing balance strategy for the implementation of incentives throughout the IRP region. The strategy would quantify the imbalance in the region and thus permit a keener appreciation of how each jurisdiction might successfully address the job/housing imbalance as part of a regional solution. The jobs/housing balance strategy would need to be adopted by the IRP and the jurisdictions interested in participating in the use of incentives made available through AB 2864.

An important component of the regional jobs/housing balance strategy would be an analysis of the expected source of employment growth from among the various industrial clusters located in the five county region. This analysis would include an identification of the site-location requirements for each element of all industrial clusters including employment requirements. This would permit IRP members to better evaluate which companies in which industries their jurisdictions would be best advised to target.

Approval of the jobs/housing balance strategy would provide the basis for specific applications from all jurisdictions -- or a combination of jurisdictions -- within the IRP that are sincerely interested in utilizing incentives made available by AB 2864 for the purpose of addressing the imbalances that exists throughout the region. Because it would be more sensitive to fluid market trends, this approach would be substantially more effective than attempting to identify specific zones prior to the adoption of a comprehensive regional strategy. At the same time this process will meet the requirements in AB 2864 for the establishment of "jobs-housing opportunity zones" in the IRP.

Solutions to the jobs/housing imbalance will require the full support of the private sector. The regional strategy must clearly address the needs of private sector firms and demonstrate the utility of a regional approach. With private sector involvement and support local elected officials will be more capable of withstanding parochial pressures from interest groups that fail to see the fundamental relationship between the jobs/housing imbalance and retaining leading edge employers in the IRP region.

The ultimate solution to the imbalance of jobs and housing will come when employees can find housing near their work and homeowners can find jobs near their homes. Recognition of this simple fact might lead to incentives directed toward influencing these individual choices as well as making them more feasible through the location of jobs and housing.

SECTION 1

1. THE NATURE OF THE CHALLENGE

It is certainly no surprise to Californians that so much of their lives are dictated by the increasingly lengthy and time-consuming commutes they are obliged to make every workday between the neighborhoods where they live and the places where they work. Among the most palpable consequences are: traffic that is congested for longer and longer periods each day, costly shipping delays for California businesses, increased air and noise pollution, frayed nerves (and periodic outbursts of road rage), and a needlessly fatigued and dispirited workforce.

Historically, government leaders have sought to address this trip-to-work problem with transportation solutions — more roads and highways, expanded public transit systems, light-rail networks, and such "fixes" as car-pool lanes and metered freeway on-ramps. Unfortunately, though, these leaders have never seen fit to fund these programs at adequate levels. Nor have they sought to provide sufficiently imaginative transportation alternatives (e.g., first-class and second-class bus and rail services) that might tempt commuters to reconsider how they get to work. Indeed, California ranks near the bottom nationally in funding for transportation infrastructure.

Such remedies have also had limited success in changing market driven choices regarding the location of housing and jobs in large part because improved transportation facilitates the continued separation of employment and housing. As important as mass transit can be, its availability does make the increasing distances between home and workplace more palatable to commuters. At the same time, it substitutes for the hard decisions that local jurisdictions would need to make if they had explicitly sought to balance the development of housing and jobs throughout the region, thereby reducing the need for overt transportation solutions.

To directly address the jobs/housing equation, state and local economic development and housing policies need to be carefully coordinated at the regional level. To be sure, such coordination would require intervention in development decisions – one of the most sensitive political arenas policymakers can enter. To compound the policy predicament, the fiscalization of land use – such a prominent feature of the post-Proposition 13 era -- has led most California communities to emphasize commercial development over housing. As a result, countless communities in California have embraced policies that very much discourage the sensible coordination of housing programs and job-creation efforts.

Policy makers need to understand that commute times have increased not merely as a function of traffic congestion but because of the growing distances Californians are obliged to travel between their homes and their workplaces. In few areas of the state is this reality more evident than in the mountain passes leading from the Central Valley into the San Francisco Bay Area.

In recent years, cities and towns in Contra Costa, Stanislaus and San Joaquin Counties have been transformed into bedroom communities for workers employed in Silicon Valley and other Bay Area destinations where housing costs have risen to ludicrous levels. While this human migration may have been initially led by blue-collar workers and public employees being priced out of the housing markets where they work, this vanguard has been joined by middle-management and highly-skilled technical workers who have likewise been driven from the Bay Area by soaring housing costs.

Despite the considerable attention being given to the housing/jobs imbalance, its most serious consequence is seldom spelled out clearly.

> *There is a steadily mounting risk that California -- a state that historically has had one of the nation's poorest business retention records, ranking 49th in one recent national survey -- is poised to see a sharp rise in the number of companies opting to relocate and/or expand their operations elsewhere.*
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> *Unlike previous waves of out-of-state business migration, which typically saw the departure of struggling companies drawn from the mature industries of the Old Economy, this time around the exodus of businesses is apt to feature many of the most highly successful companies of the ascendant New Economy.*

The reason for this is not difficult to fathom. The longest period of uninterrupted economic expansion in the nation's history has given rise to broad-based prosperity throughout most of the state. At the same time, though, it has also created a unique set of economic and social challenges. Of these, certainly the most ironic is that recent economic success, by stressing the carrying-capacity of the state's major metropolitan areas, threatens to undermine California's future well-being -- specifically, our ability to remain host to some of the world's most advanced companies.

According to the Palo Alto based Center for Continuing Study of the California Economy (CCSCE), the state's ten largest concentrations of households, income and spending and the state's ten wealthiest counties in 2010 will be either in or on the fringes of four regions: the San Francisco Bay Area, Los Angeles, San Diego and

Sacramento." The quality of life for most Californians will be determined by how these large regions handle the growth pressures," warns Stephen Levy, the CCSCE's chief economist.

Yet these regions are already cursed with impossible traffic congestion, inadequate stocks of affordable housing, and a diminishing inventory of commercial real estate. Further economic growth will only send the cost-of-living and the quality of life in these areas in opposite directions -- long before massive new public works projects and housing programs will have any material impact in remedying deficiencies in transportation, housing, and overall infrastructure.

> *More than one regional economic study group has concluded: "We risk losing our high-growth manufacturers if we can't meet their expansion needs."*

Meeting the expansion needs of growing companies involves a good deal more than ensuring the availability of developed land suitable for commercial and industrial sites. It involves foremost the availability of industrially and commercially zoned property that is market-ready, i.e. has all of the offsite improvements necessary for immediate initiation of onsite improvements.

Secondly -- and increasingly more important -- is the availability of a workforce well-suited to the employment needs of targeted companies and industries and a pipeline of workers ready to meet the potential expansion needs of the firms that choose to expand or locate in the area.

Third, local jurisdictions must be prepared to "fast track" their development processes and procedures to insure that the "time to market" needs of commercial prospects are fully met.

In the San Francisco Bay Area, business groups have been fretting for years about the region's ability to attract and retain workers. But the situation has lately reached a crisis point, according to Keith Kennedy, chief executive officer of Watkins-Johnson, a major high-tech manufacturer: "We're able to entice workers for three to four years, but employees are leaving when they become most productive. We're training people for other areas like Austin, Colorado and Seattle' where housing costs are lower and the quality of life is better."

In the hub of Silicon Valley, Santa Clara County is building one house for every three jobs being created. In neighboring Contra Costa and Alameda County, the ratio one house for every 2.25 new jobs. Silicon Valley faces a shortage of 100,000 homes by 2010, according to a new study released by the Silicon Valley Manufacturing Group. With supply so constrained and stock-option wealth exploding, housing prices have been spiraling. Not surprisingly, less than 30 percent of households in the Bay Area can afford a home, in contrast to more than 50 percent of all households nationwide. Short of an abrupt collapse of the American economy, there is nothing on the horizon to suggest that this trend will ease in the near future.

Throughout California's major metropolitan areas, the inescapable consequence is that the fast-growing New Economy firms most in need of more physical space and more skilled workers will literally be squeezed out of their current locations and, quite possibly, out of California entirely. Bluntly put, California is in danger of floundering on its own prosperity. And nowhere within the Golden State is this more the case than in that portion of the San Francisco Bay Area colloquially known as Silicon Valley.

2. THE IRP PILOT PROJECT

What is to be done to prevent a hemorrhage of high-paying jobs and advanced technology? One solution that is gaining traction among political leaders at the State Capitol would encourage fast-growing firms to expand into some of the state's less congested rural areas or into its economically disadvantaged urban neighborhoods. To be sure, there is no intention of encouraging companies to move their headquarters operations or vital R&D work out of Silicon Valley. Still, whenever and wherever feasible, Silicon Valley firms would be urged to expand much of the rest of their activities to commercial and industrial sites in the neighboring communities of the "job poor" areas in the San Joaquin Valley, Santa Clara, Alameda and Contra Costa County, or sites in "job poor" neighborhoods within the Bay Area's urban core.

Likewise, new companies (either indigenous start-ups or those new to the region) requiring close supplier links with industry clusters centered in Silicon Valley would also be encouraged to establish facilities in Stanislaus and San Joaquin Counties as well as the "job poor" areas of Alameda and Contra Costa County.

AB 2864 (Torlakson) has emerged as the principal legislative vehicle articulating this approach to more balanced development of economic and housing assets. It is the explicit intent of the legislation creating the Inter-Regional Partnership (IRP) to encourage a cooperative and collaborative approach to address current imbalances in industrial development and housing availability throughout the five-county region that encompasses Alameda, Contra Costa, San Joaquin, Santa Clara and Stanislaus Counties. Clearly, one result of achieving the objectives of AB 2864 would be the reduction of traffic congestion and air pollution in the IRP.

To that end, the bill formally establishes the IRP as "a state-supported pilot project to test and evaluate a variety of policies and incentives designed to mitigate current and future imbalances of jobs and housing in the five-county area."

The bill also establishes the Jobs-Housing Balance Improvement Program that requires the California Housing and Community Development Department (HCD) to make grants to eligible local agencies from funds appropriated in the Budget Act of 2000 for assistance in attracting new business and jobs in so-called "housing rich" communities that lack an adequate employment base to match the amount and cost of housing in those communities; for the creation of economic development strategies to target and coordinate outreach to employers who may choose to locate within the community; and for specified capital outlay projects designed to encourage the construction of public infrastructure in support of economic development in "job poor" areas.

The issues addressed by AB 2864 are manifested daily in the lives of nearly every Californian. Many "job poor" IRP area communities expect to double or triple in size. But most will not be able to attract equivalent numbers of new jobs. Instead, tens of thousands of Central Valley and Contra Costa County residents are expected to continue to commute far into the Bay Area, often-driving two hours or more each way. The challenges to transportation, air quality, and quality of life are ominous. Projections estimate the current number of daily Altamont Pass commuters will more than double to 250,000 by the year 2020 unless an improved jobs housing balance is achieved.

To furnish the hard data needed for informed policy decisions, the San Joaquin Council of Governments (SJCOG) and the San Joaquin Partnership commissioned a survey of Altamont Pass commuters. The results of the survey, which was conducted in March 2000, were published in an October 2000 report.

The survey had two primary objectives:

> Identify the job skills of commuters traveling over the Altamont Pass to the San Francisco Bay Area as a first step in attracting more jobs to the San Joaquin County area and enabling residents to work closer to home; and
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> Determine the destinations, distances, and travel times reported by Altamont Pass commuters to allow SJCOG to refine its marketing of carpools, vanpools, and transit services.

A total of 4,654 survey responses were tabulated and analyzed. Of these, 84.9% (3,950) came from responding drivers, who themselves represented less than one-in-five of all drivers who had been mailed survey forms. Although this is a fairly high response rate for mail-out/mail-in questionnaires, the quality of the data on drivers is necessarily less helpful in defining the characteristics of this subset of commuters than the significantly more inclusive data derived from the parallel surveys of bus riders and ACE train commuters, both of which achieved considerably higher response rates.

The report's primary conclusions are largely based on the totality of survey responses, even though the characteristics of the three sub-categories of surveyed commuters differ significantly. Indeed, because the preponderance of survey respondents were drivers, the composite data cited throughout the SJCOG report very closely parallel and therefore replicate the characteristics of drivers who returned completed survey forms.

Given the underlying purpose of this survey, the optimal finding would be that a significant number of Altamont Pass commuters are employed by companies in the Bay Area's electronics/communications industry. Such a finding would be exceptionally useful in helping IRP area economic development officials assure targeted high-tech firms that the region already has a substantial resident workforce with the skills the electronics/communications industry typically requires.

The survey yields some evidence to support this contention. However, whether the data suggest that a migration of high-technology companies to the "job poor" areas will help alleviate traffic congestion in the Altamont Pass is quite another matter. The survey shows that those commuters who are most likely to be employed in a highly skilled professional or technical capacity by high-tech companies are SMART bus and ACE train riders. Luring companies that would provide suitable jobs closer to home for these workers is therefore not likely to have much impact in reducing traffic flows across the Altamont.

If anything, the survey suggests that a majority of Altamont Pass commuters may be employed by companies that are not normally targeted by economic development agencies or are employed by public agencies such as local government, police and fire departments in Bay Area communities where affordable housing is in exceedingly short supply. Thus, while economic expansion and population growth in the IRP area may eventually generate the kinds of jobs these commuters currently hold by requiring more extensive public services, such an outcome is generally an unplanned consequence of economic development.

The survey also indicates that workers in high-tech industries commuting from the Central Valley may be employed in the sales and administrative occupations in "job rich" areas of the IRP rather than the top technical occupations usually associated with the corporate headquarters of high-tech firms.

The geographic imbalance in housing and job growth in the IRP area is among the nation's most extreme. And, driven by continued employment growth in the Silicon Valley, it is predicted to worsen significantly in the coming years. The housing market in Silicon Valley is now the most expensive in the nation. At the same time, land being developed for housing in the "job poor" areas in the IRP area represents some of the highest quality agricultural soil in the world.

These growth-related issues cut across county and regional boundaries. The IRP is intended to provide a forum for neighboring jurisdictions governed by different units of government to deal in earnest collaboration with land use, transportation, and air quality issues that affect the five-county region.

> *If successful, the IRP pilot project will serve as an important example for other regions in the state in dealing with multi-jurisdictional problem solving and addressing land use planning across metropolitan borders.*

3. THE USE OF INCENTIVES

Successful implementation of the AB 2864 initiative will require a thorough conceptual shift away from planning's historical reliance on land use decisions which often have little bearing on the multitude of independent market decisions made by willing buyers and sellers. The fast-moving California economy working within the legal umbrella of land use planning is, in fact, responsible for the current imbalance. The challenges facing the IRP today are largely the products of prosperity and the market's failure to achieve equilibrium between the supply of housing and opportunities for employment. *Planning is not the problem. Planning is the solution.*

AB 2864 specifies that the goals of the IRP and the pilot project are to:

- encourage economic investment, including job creation, near available housing;
- encourage housing to be located near major employment centers;
- encourage development along corridors served by transit and near transit stations; and,
- encourage more sustainable and effective transportation between job and housing centers.

At first glance, this seems an eminently sensible approach to the challenge of retaining business in the Golden State. Even better, it is an approach that would also foster a more equitable distribution of opportunity and income among the state's various and highly diverse regions.

Nothing, however, is quite so complicated as an elegant solution. There are significant obstacles that would thwart the implementation of a strategy intended to channel industrial expansion into new areas -- not the least of which is that it runs counter to traditional ways of doing things. From its origins, the business of economic development has been intensely competitive, pitting neighbor against neighbor, region against region, and state against state. Attempts by officials of one city to entice a firm to move from another community are commonly regarded as poaching, a practice some local officials have sought to outlaw. One recent academic study found that the most intense competition for new job-creating enterprises occurs within metropolitan regions and not between distant jurisdictions.

Changing circumstances are demanding that public officials and economic development professionals throughout California -- at the state as well as the regional and local levels -- learn to restrain vestigial rivalries in favor of devising more cooperative strategies for ensuring prosperity for every corner of the state. As the California Economic Strategy Panel notes in a recent draft report: "Traditional political, organizational, and institutional forms and approaches are out of alignment with the new economy."

Incentives from the state are likely to be indispensable in helping local authorities avoid the failures of regional policymaking that are now forcing workers in Silicon Valley to find homes in the "job poor" sections in the IRP area. So long as public opinion resists the establishment of effective regional collaboration to cope with problems that spill across jurisdictional boundaries often established long-ago in a far different social and political milieu, the means must be found for persuading local leaders and civic planners to work much more cooperatively than has been their custom in the past.

There is no way around it: State government must assume a more active role in plotting a comprehensive economic development strategy for California. The heart of that strategy should be a clear, long-term commitment to take exceptional measures to achieve a more equitable distribution of economic opportunity and personal income throughout all of California. At the core of that strategy must be a more adaptive set of measures that provide local and regional officials with greater incentives to collaborate across jurisdictional lines. Merely praying for a burst of enlightened self-interest to foster a new sense of collective responsibility is not likely to produce the desired outcomes.

Fortunately, there are signs that a growing number of government leaders and local economic development officials have been taking a less combative approach to the prospect of greater regional cooperation in recent years. But it remains that any strategy aimed at redirecting commerce into some of California's less-developed regions also encounters important practical barriers. First, the physical infrastructure needed to accommodate new industry is often under-developed. Second, similarly absent in many instances is a workforce equipped with the skills the New Economy demands. Finally, the commitment of local jurisdictions to reform development processes and procedures is frequently lacking.

These facts suggest the extent to which the design and use of economic development incentives must be thoroughly reappraised. There exists a broad range of incentives that have been devised over the years largely with the purpose of luring employers to communities they might not otherwise consider. Many of these incentives will continue to be of importance. However, based on our research and on interviews with economic development officials and others in the IRP area, it is clear that the major thrust of incentives must be changed and that altogether new types of incentives must be devised.

Future incentives should be directed not toward enticing specific companies but toward enhancing a community's public assets such as basic infrastructure and a quality workforce. One reason for this is that any company that elects to expand in the "job poor" areas in the IRP area rather than in established employment centers of the Bay Area will automatically reap substantial economic benefits from cheaper real estate costs.

Indeed, for most of these technology-oriented firms, the most attractive incentives are not financial in nature but rather those incentives that facilitate their moves into new plants or offices.

These "facilitating incentives" comprise virtually any form of assistance that would ensure that a company can be up-and-running in a new location within its projected "time to market" schedule. On the ground, this frequently translates into having an inventory of commercial or industrial sites with existing off-site infrastructure already in place. It also translates into having a workforce with skills and training suitable to any new employer's requirements. Equally critical in luring new enterprise will be efforts to "fast track" local permit processes or to otherwise place these permitting processes on a timetable in closer accordance with the pace at which modern businesses are obliged to operate in an increasingly competitive world. From a political perspective, it is essential to emphasize how these facilitative incentives are directed toward enhancing a community's ***public assets*** — not at enriching individual companies.

Substantial new investments will be needed if the foundation for sustained economic growth is to be laid in the "job poor" areas in the IRP. By happy coincidence, the times seem unusually hospitable to those who fund these needs. According to mid-November projections released by the Office of the Legislative Analyst in Sacramento, California is expected to end the 2000-01 budget year with $6.9 billion in excess revenues--more than three times the surplus predicted in June, when the budget was adopted. Furthermore, the same report notes that revenues could exceed spending by $3.4 billion in the next fiscal year. Some portion of that $10.3 billion in surpluses over the next two years should be available to help finance significant improvements in infrastructure and workforce training.

Similarly, the climate for expanded investment in projects that would enhance the state's basic economic infrastructure is more favorable now than it has been in more than a decade. The case for 'smart' infrastructure projects has been advanced at the highest political levels in the state and the private sector is responding by supporting such public efforts, particularly those involving expanded budgets for all types of transportation improvements and more funding for housing and education.

The key variable, as always, is the willingness of state leaders to aim adequate funds at the problem and pull the financing trigger. Ever since the master-builder days of Earl Warren and Pat Brown, California's elected officials have grown accustomed to preaching public penury — even while they celebrate the state's stature as an economic powerhouse larger than all but a handful of nations. In the "job poor" areas in the IRP area, though, future economic prosperity will need more than a few quick fixes.

4. WHY INCENTIVES ARE NEEDED

To achieve the overall objective of reducing the IRP's jobs/housing imbalance, a broad range of incentives will be needed. In our preliminary report to the IRP in September, we referenced over 1,000 fiscal and non-fiscal incentives available today, many of which are in use in California. Both fiscal and non-fiscal incentives are available. Some are generally available for use by all communities while others are only available to specific designated areas and/or to meet specific public policy objectives -- such as hiring the disadvantaged or chronically unemployed.

The primary purpose of all incentives is to create a competitive advantage for one community over another. The more exclusive the incentive, the more valuable it is for creating competitive advantage. General incentives available to all communities may be valuable to the firm seeking the incentives, but it creates no competitive advantage for one site over another. Likewise, incentives targeted to meeting general public policy goals can be useful for that purpose. But, because all communities can make them available, they create no competitive advantage.

Conversely, incentives that are only available to selected areas, such as enterprise zones and redevelopment areas explicitly provide incentives that are not available in areas lacking such a designation. However, the more areas designated, or provided with a similar designation offering some of the same incentives, the less valuable the incentive is for creating competitive advantage.

Economic development professionals seek to level the playing field for their jurisdiction as much as possible so that their location can receive the same consideration as that of their competitors. Therefore, if competitors have an incentive that is not generally available, economic development professionals will seek to gain access to the same incentive, or one that could be more valuable. The stronger the competition, the more economic development professionals seek access to incentives.

The ultimate winners in this competition are clearly those firms that harvest the incentives. Indeed, firms often play one jurisdiction off against another seeking to gain greater concessions. This simply raises the ante for all and ultimately results in the losing jurisdiction seeking access to more incentives. In the heat of the negotiation process some jurisdictions have been known to "give away the store."

In addition, economic development professionals must have the broadest possible range of incentives in their portfolio to meet the often-unique demands of site location prospects. All firms are not interested in the same type of incentives. Careful research can narrow the type of incentive that might be useful to firms targeted for attraction and expansion by a jurisdiction. Still, during the actual negotiation process, firms will frequently request incentives that may not have been considered earlier. The more flexibility the economic development professional has the more useful he/she can be to their jurisdiction.

Many of these incentives are directed toward the attraction of a specific firm to a specific site and/or a specific community. These incentives often result in an expensive subsidy to a specific firm. It is presumed that this subsidy is more than offset by the new economic activity created by the location of the firm in the community i.e. personal income, sales by local serving businesses, tax revenue. Experience, however, often finds this not to be the case.

In the absence of demonstrable offsetting benefits to the community, there is little reason to provide a subsidy that benefits a specific firm. Various formulas have been developed for calculating the costs and benefits of a proposed subsidy, and "claw back" approaches are being incorporated into legal agreements to assure that the subsidy can be recovered in the event that the promised benefits do not materialize. However, these techniques are of little use when the firm gets into financial difficulty and/or files for bankruptcy, as is sometimes the case.

The value to the community of a direct financial incentive issued to an individual firm as a "quid-pro-quo" for making a location decision in their favor must be measured against the ability of the community to provide and maintain the public assets in the community that are the basis for continued prosperity. If the incentive impairs the ability of the community to provide the infrastructure and basic services expected by its citizens, it is not a good bargain.

A better approach for all communities, particularly in periods of sustained economic growth, is to invest in the transportation, housing, health, education and recreation systems in the community to insure that they are competitive for landing business attraction prospects, promoting the expansion of existing businesses, and encouraging new enterprise development. But "job poor" areas are often unable to provide the public assets offered by their competitors and must resort to incentives to level the playing field.

One example of a financial incentive that would contribute to a community's public assets is an incentive to reduce the cost of upgrading the physical infrastructure related to planned industrial and commercial development sites. Most "job poor" areas have an inventory of available industrial and commercial sites that are properly zoned for development. What they most often lack is the capital to make those sites market-ready.

Today's site location prospects are under considerable pressure to get a new facility up and running in the shortest possible time. This often means less than six months. If a community can't meet, or come close to meeting, that schedule then other incentives are of little use. More than ever before, time in today's economy is money.

A second financial incentive which creates public assets is the availability of a workforce in "job poor" areas that can meet the demands of today's high performance workplaces. There is near universal agreement among economic development professionals that the number one requirement of businesses seeking new sites is the availability of a trainable workforce. Firms are looking for a variety of skills, but the most important today are the ability to communicate, work in teams, learn on the job and write clear reports. It is also expected that all employees will be experienced in all aspects of telecommunications regardless of the type of business.

If the availability and quality of the labor force can't be demonstrated, it will be exceedingly difficult to convince companies in the more congested areas of the IRP region to select a "job poor" site to meet their expansion needs. The result may be that such firms will be forced out of the IRP region or, indeed, out of California entirely if the option of a near-by move is denied them because of an under-skilled or inappropriately skilled workforce.

Despite the broad range of incentives available to attract businesses to California communities, the funds available to address the enhancing public assets remain tightly constrained and insufficient. For example, the State Infrastructure Bank was initially created to meet the need for financing the infrastructure necessary for making industrial and commercial sites in "job poor" areas ready to market. But this program is seriously under-funded given the level of need and many "job poor" communities are having difficulty meeting the

financial requirements for participation. Yet these public assets are becoming more significant to businesses seeking new locations than are those incentives affecting the firm directly.

Similarly, significant changes made by the Federal Workforce Investment Act of 1998 make training universally available to all members of the labor force regardless of their income and employment status. The Act also permits training for currently employed individuals to up-grade their skills to increase their productivity in their current position. As valuable as these changes are, they are available to all communities in the state and can't be seen as an incentive to increase the competitive advantage of "job poor" areas in the IRP.

As a continuing consequence of Proposition 13, "job poor" jurisdictions across the state have found it necessary to significantly escalate development fees and charges to pay, not only for new developments, but for the operating costs of maintaining them long after the developers have moved on to other projects. These fees and charges were historically passed on to the owners of individual homes and the consumers of the products and services provided by industrial and commercial developments.

This practice has contributed significantly to the costs of businesses, many of, which are finding it hard to pass on the costs to consumers due to intense competition in the local, state and national economy. It also places "job poor" communities at a competitive disadvantage relative to their competition since most "job rich" communities have less need for using fees and charges to pay for development costs beyond those specifically attributable to the individual development.

In addition to reducing fees and charges in "job poor" communities, non-financial local incentives are often valuable to site location prospects. In many cases, these incentives will have more to do with speeding the process of bringing a business online in a new location than with offering tax credits or other traditional financial incentives. Among other things, the ability to offer such facilitating incentives will require an earnest commitment from county and municipal officials to further streamline permitting and approval processes so that they are more finely attuned to the timetables of private enterprise than with those of public bureaucracies.

Rather than focus on the financial and non-financial incentives to business as a way to address the jobs/housing balance issue, the IRP would do well to recognize the fundamental reason for the existence of "job poor" areas, which is a lack of competitive advantage. If all areas in the IRP were relatively equal in terms of what they can offer businesses to attract them to locate in their community there would be no "job poor" areas.

Therefore, the type of incentives that would be most useful to "job poor" areas would be those that enhance their competitive advantage. In today's economy reducing the overall cost of getting a new facility up and running is often <u>the</u> primary concern of most businesses. That includes the availability of a sufficient supply of labor to meet their recruitment requirements and "fast track" processing for development proposals.

Grants and low interest loans for fully servicing potential industrial and commercial sites making them market ready is the best way to reduce the start-up cost of a new facility and the time it takes to start bringing in a return to the business. Coupled with a well-trained workforce and "fast track" processing this would make many "job poor" areas in the IRP ready to compete.

5. FILLING THE INCENTIVE GAP

The success of "job poor" communities throughout California in attracting enough jobs to lessen the imbalance between jobs and housing in their respective regions will depend on an increase in their competitive advantage relative to "job rich" communities. This "pilot program" can focus attention on the causes of the jobs/housing imbalance in the IRP and test potential solutions. As this report has sought to emphasize, a lack of competitive advantage in major areas of the five-county region is the major cause of the jobs/housing imbalance the IRP confronts.

Fundamentally, it is that competitiveness differential that must be resolved. Everything else, by comparison, is merely symptomatic.

This report further concludes that the availability of financial incentives to specific firms, while important, is secondary to 1) the ability of the community to make all of its key industrial and commercial sites market-ready, 2) the availability of a quality workforce matching the skill requirement of the firms being recruited, and 3) "Fast track" processes that meet the rigorous development requirements of 21st century businesses. These are the essential variables for assisting "job poor" areas to gain an edge in the highly competitive game of business attraction and recruitment.

The so-called "job poor" communities in the IRP are enjoying some success in attracting businesses to their market-ready sites. Regrettably, there are relatively few sites in the relevant communities that are market-ready. Moreover, these "job poor" communities can never achieve their full potential so long as adequate funds are not made available for financing the necessary off-site improvements to their key industrial and commercially-zoned properties.

Clearly, grants and/or low-interest loans are needed for designated sites in the "job poor" areas of the IRP in order for them to make their most valuable industrial and commercial sites market-ready. Funding for these purposes should be from the $100 million made available from the Jobs-Housing Incentive Program. Counties in the IRP would need to designate their priority sites and provide the engineering studies required for making the sites market-ready.

In addition to these grants and/or low-interest loans, priority sites in IRP communities should be made eligible for any incentive programs currently available to any community under California law, including those currently available only to certain designated areas. This would permit "job poor" areas in the IRP to level the playing field in their competition with other communities both inside and outside the IRP region.

In addition to the financial and non-financial incentives that can be offered to commercial prospects, there is the question of how such incentives will conform to comprehensive community plans. To strengthen a regional collaborative planning process for solving jobs-housing balance problems, the California Department of Housing and Community Development (HCD), should require collaborative regional agencies such as the IRP to submit a regional economic strategy that clearly indicates how the initiatives planned will reduce and ultimately eliminate the jobs/housing imbalance in the region. Such a comprehensive strategy should be a necessary condition for receiving housing or economic development incentive grants. Absent such a strategy, regional policymaking bodies can exert little influence over issues in which local priorities often override the best of intentions.

Leaving key planning decisions with region-wide implications solely in the hands of local officials will not yield sound policy or sensible outcomes. The authors of a July 2000 report on a statewide survey of local planning officials by the Public Policy Institute of California (PPIC) found "notable" tensions between local officials and citizens. They concluded that, while municipal governments have been seeking to streamline their review process for housing proposals, city leaders are keenly aware that approving residential developments can be politically hazardous. Still, few city councils appear to support efforts to slow growth, and the planning officials who responded to the PPIC survey tend to think that their own cities' residential policies are appropriate.

Neighborhood pressure and citizen initiatives are seen to affect residential policymaking in a sizeable minority of communities, although the actual number of cities experiencing "ballot-box planning" is relatively low. Ultimately, the survey found that higher-density, apartment, and affordable housing proposals have the most difficult time gaining approval.

The PPIC report concludes that "it is fair to say that there is a strong reservoir of support for residential growth in California's *city governments*, but also that planners perceive a powerful undercurrent of resistance to new housing on the part of many *residents*." These tensions are likely to be particularly strong during periods when growth is rapid but the demand for housing at affordable levels far outstrips the supply.

Recent ballot measures, however, make it clear that housing developments are not the only developments that are being opposed by local residents. The desire to preserve open space and prime agricultural land has led many of its supporters to seek modifications in industrial and commercial developments as well as residential developments.

The IRP's ability to deal constructively and strategically with the jobs-housing imbalance was dealt something of a setback November 7 by the passage of a number of ballot measures that sought to restrict growth in several IRP communities.

Such votes were not unique to the five-county IRP, however. The November 7 election was the most crowded land-use ballot in California since November 1990. Statewide, according to statistics compiled by *California Planning &Development Report*, 22 of 34 slow-growth measures appearing on local ballots passed. At the same time, 13 of 22 pro-growth measures were defeated. In total, slow-growth forces won 35 of the 56 races.

Still, it was in the San Francisco Bay Area and in adjoining counties where nearly half of the state's growth-control measures were decided and where the anti-growth sentiment was most in evidence.

The most sweeping outcome involved passage of Measure D in Alameda County. This initiative, backed by the Sierra Club, excludes the county Board of Supervisors from the development business, strengthens existing urban limit lines around Livermore, Dublin and Pleasanton, and requires voter approval for all future changes. It also effectively prevents county approval of a 12,500-house development planned for North Livermore.

Meanwhile, voters in Tracy passed Measure A, which restricts the number of housing units per year to 750 and thus cuts planned housing development by half. The same measure was barely defeated in March. This represents the first time a IRP area community has enacted a growth restriction in response to the migration of Bay Area residents seeking more affordable housing.

Other victories for slow-growth forces came in Dublin where voters adopted or strengthened urban limit lines intended to contain sprawl; in Danville where residents passed a measure requiring a public vote if the town's elected leaders plan to rezone agricultural or farmlands for development; and in San Jose, where voters overwhelmingly approved Mayor Ron Gonzales's request to lock in the city's "greenline" with a voter-approval requirement.

It is worth stressing that opposition to growth is not limited to congested urban areas. Ballot measures in "job poor" areas that in effect slow all types of development will decrease the ability to attract new businesses or facilitate the expansion of those already there. In any case, "job poor" areas are not always "housing rich," and these areas will need to continue expanding their housing in order to accommodate the hoped-for growth in jobs. Likewise, some "housing poor" areas are still in need of employment growth and are subject to the same limitations being imposed by slow growth proponents.

These findings are hardly surprising. Whatever their specific (and often unacknowledged motives) current residents tend to group their concerns about further growth under the popular rubric of 'quality of life.' Longtime residents of a community understandably possess a nostalgic view of their community and wish to protect its softly remembered essence. Newcomers, meanwhile, are reluctant to see the circumstances they only recently fled replicated all too quickly in their new communities. All homeowners meanwhile have a self-interested stake in restricting the supply of new housing in order to promote the further appreciation of the value of existing homes.

Housing subsidies and other housing construction incentives should be directed primarily at alleviating the plight of the region's less advantaged citizens, especially those whose conditions are worsened by policies the IRP may embrace which have the effect of directing more economic activity to the "job poor" areas in the IRP area. The fact is there are no "housing rich" communities in Stanislaus and San Joaquin Counties or communities in parts of Alameda, Contra Costa and Santa Clara Counties. There are no cities and towns with surplus housing units waiting for occupancy by new residents moving to the area. What these communities generally do offer -- at least for the time being -- is housing that is more affordable to more people than is housing in the San Francisco Bay Area. However, the cost of housing in the "job poor" areas in the IRP area will most assuredly continue to bid up prices as more people move to the area seeking not only cheaper housing but also new jobs.

Given mounting opposition to growth in "job poor" as well as "job rich" areas, it is highly unlikely -- all other things being equal — that housing developers will be able to keep pace with growing demand. As a result, prices of both new and existing units will increase (as they already are), and the poorer residents (who are largely renters) of "job-poor" communities will be forced out into uncertain circumstances.

The challenge set down by AB 2864 will not be one easy to overcome. Neither, however, is it a challenge that can be avoided. In the final analysis, meeting the goal of more equitable balance between employment growth and the availability of affordable housing begins with a new attitude toward collaborative planning at both at the local and regional levels and in state government. Practices that appear to have worked in the past are seldom of much help in negotiating a very different future. With each passing day, California's economy is less and less insulated from the outside world. Other nations and not merely other states are vying to take business away from California, just as companies from elsewhere in the U.S. and, increasingly, from around the world, are being drawn to California's leading edge industrial clusters. If there is an overall trend in corporate location strategy today, it is that more and more decisions are being made in light of global economic competition. As California's economy becomes further integrated into global production and distribution networks, state and local economic development officials have no choice but to evolve new strategies for business expansion and attraction. Ultimately, this will require California to marshal all of its assets and resources — not just those currently located in Los Angeles and the Bay Area.

Whatever specific policies are eventually adopted, there must also be a commitment to the patient application of those policies. The disjuncture between the political world and the real world is nowhere more apparent than when it comes to time-frames. Elected officials understandably want to see tangible progress within election cycles because, at least tacitly, that's what voters also expect. The problem, of course, is that progress in dealing with monumental challenges generally occurs very slowly and is sometimes accompanied by setbacks. Overcoming the widespread poverty of the Central Valley will not come within the terms of those now holding office. For one thing, the new UC Merced campus will not begin to have a significant impact on the "job poor" areas in the IRP area economy for many years to come.

Still, there must be a commitment, beginning now, to a lengthy process that will see adversity as well as accomplishment. It is a process and a commitment that must endure despite the ups and downs the California economy will experience in the years to come.

The end result, if the process is managed well, can be a state known not merely as an avatar of the New Economy but also as a state celebrated for the way in which it ensured an equitable distribution among its various regions of the fruits of economic progress. Handled poorly, the outcome could herald a nightmarish downward spiral in the quality of life for large numbers of Californians.

6. RECOMMENDATIONS

To carry out the Legislative intent of AB 2864, the pilot project must develop and test a variety of incentives for improving the balance between housing and jobs within the five County IRP area. This is a daunting task. The existing jobs/housing imbalance is the product of decades during which broad market forces were permitted to operate without much heed to the inevitable consequences. Resolving the asymmetry will therefore require more than the adoption of a set of economic development and housing incentives from among the thousands available or the creation of special entitlement zones. Overcoming the history of housing and employment growth patterns in the region will take concerted action and imagination. It is not a situation that welcomes the timid.

As previously noted in this report, the imbalance is now not only an inconvenience to individuals that must commute unreasonable distances to work. It is more than a source of increasing infrastructure costs. At root, it is a problem that threatens the very future of the economic base in the entire five-county IRP area with the potential relocation of major employers to other states or nations. While desperately needed, compensatory transportation solutions will not likely come in time to satisfy commuting needs that are growing exponentially. The basic structure of the housing and employment base of the IRP must be changed for meaningful balance to be achieved.

AB 2864 urges the identification of specific initiatives to redress the geographic asymmetry between jobs and housing in the IRP area. This report advises against such a restrictive course of action. To deal with the root cause of the region's jobs/housing imbalance, incentives must be available on an "as needed basis" to meet the often unique requirements of a business prospect interested in a specific site-location. What is needed is a broad "portfolio" of incentives that can be selectively used by IRP negotiators to present the best possible package to specific firms with specific needs. **Therefore, the IRP should be eligible for any and all incentives that have been made available to other "job poor" areas of the State**. "Job poor" areas will remain job poor as long as they are at a competitive disadvantage relative to other areas in the IRP or elsewhere in the state. To counter the powerful economic forces that produced the imbalance in the first place, the IRP should seek legislation to make the five-county area eligible for any and all incentive programs authorized for other "job poor" areas of the state. Along with existing incentives, new ones should also be developed as novel circumstances warrant. For example, a year ago, no one anticipated the severe electricity-supply crisis that is today causing companies to begin pondering California's viability as a place to do business. Funds to companies to help defray energy costs could therefore be a powerful incentive in luring new enterprises to "jobs-poor" communities in the IRP region.

It would similarly be unwise to pre-designate zones in the five county area to be eligible for incentives under the program. Market conditions demand the maximum amount of flexibility in site-selection. To predetermine areas eligible for incentives would lead to unnecessary rigidity in comprehensive planning. Moreover, the designation process, by inviting an unproductive competition among all the jurisdictions in the IRP region, would defeat the goal of earnest collaboration needed to address the region's jobs/housing imbalance.

The distinction between housing incentives and economic development incentives is also unwarranted. Many, if not most, of the "job poor" areas in the IRP will also be "housing poor." It is the nature of the housing development system to build behind the market not in front of it. Therefore the development of housing stock in excess of demand is rare and avoided by housing developers whenever possible. Both economic development and housing incentives should be used appropriately to reduce the imbalance between jobs and housing and should be judged on their effectiveness in doing so -- regardless of their designation as "job poor" or "job rich."

> *Therefore, It is recommended that the IRP develop, adopt, and implement a comprehensive strategy with the specific goal of reducing the imbalance between housing and jobs in the five-county area.*

Prior attempts to deal with the jobs/housing balance have failed in part because they have been based on achieving a balance within each separate political jurisdiction. This does not permit sufficient flexibility for encouraging a better balance between housing construction and employment development throughout the region. Further, the effort to bring about a finer balance between housing and jobs should recognize that many people will always commute some distance to work.

In addition, a regional strategy will be able to take advantage of the diversity of industrial clusters in the area to identify those specific industries within each cluster that could be targeted for expansion throughout the area. By adopting this focus, the location requirements of individual firms can be determined and incorporated into the jobs/housing balance strategy. The entire strategy, to be successful, must be based on the retention and expansion of existing businesses in the region rather than relocation.

The strategy must also go beyond traditional economic incentives to included a careful examination of the employment requirements of industrial clusters located in the IRP. Fortunately, the Workforce Investment Act of 1998, which is in its first year of implementation in California offers an opportunity to collaborate with the local Workforce Investment Boards in the five-county area to incorporate their resources into the jobs/housing balance strategy.

The IRP job/housing balance strategy would quantify the imbalance for each jurisdiction in the five county area as a benchmark on which to invite specific proposals. All jurisdictions would be eligible to submit proposals. The proposals would be site specific and indicate how much the jobs/housing imbalance in the five county area would be reduced by the activities undertaken. They would also describe in detail how the applicant jurisdiction would review and revise development processes and procedures to facilitate "fast track" development.

The IRP would review all applications and make final decisions regarding the use of the flexible grant funds made available under the jobs/housing incentive grants to be made available by the State Department of Housing and Community Development. Selection would be based on the level of reduction in the jobs/housing balance expected to be achieved by the activities proposed and on the ability of local jurisdictions to expedite the local development process.

This process will result in the establishment of "jobs-housing opportunity zones" in the IRP meeting the requirements of AB 2864 for establishment of such zones.

ATTACHMENT A

RESULTS OF LAND-USE BALLOT MEASURES ON THE NOVEMBER 2000 IN THE FIVE IRP COUNTIES

Alameda County

Voters approved the Sierra Club's urban growth boundary initiative drawing a tight urban limit line around Dublin, Pleasanton, Livermore, Sunol and Castro Valley. Voters rejected the competing Tri-Valley Vision 2010 measure, a less-restrictive UGB placed on the ballot by the Board of Supervisors.

Measure D (Sierra Club initiative): Yes, 56.5%
Measure C (Vision 2010 plan): No, 56.9%

<u>City of Dublin</u>

Voters approved a City Council-sponsored measure to establish an urban limit line on the city's western boundary and require an initiative for growth outside the boundary during next 30 years

Measure M: Yes, 59.1%

Contra Costa County

<u>City of Clayton</u>

Voters rejected a CAPP (Citizen Alliance for Public Planning) initiative that would have required voter approval if development involved 10 houses, 2 acres of open space or 1,000 square feet of commercial construction.

Measure O: No, 55.2%

Clayton voters also decided on two measures placed on ballot by City Council. In an advisory vote, they approved of building a park on a 1-acre downtown site that the city bought in May. But they rejected a 2.4% utility tax to fund park construction and maintenance.

Measure Q (park): Yes, 55.7%
Measure P (tax): No, 72.8%

<u>City of Danville</u>

Voters approved both a CAPP initiative, which requires an election for any development of at least 10 units, and the City Council alternative, which requires voter approval for general plan amendments involving agricultural land, open space, parks, and public or semi-public recreational land. The City Council's alternative takes effect because it received more votes.

Measure R (CAPP): Yes, 52.9%
Measure S (City Council measure): Yes, 74.3%

San Joaquin County

City of Lathrop

Voters backed a modified development agreement between Califia (nee Gold Rush City) and the city to allow construction of 8,500 homes before theme parks and other commercial areas that the developer had promised to build first.

Measure D: Yes, 56.2%

City of Tracy

An initiative from the Tracy Region Alliance for a Quality Community that cuts the annual number of housing permits in half won favor after narrowly losing eight months earlier.

Measure A: Yes, 56.1%

Santa Clara County

City of San Jose

Mayor Ron Gonzales' proposal to strengthen the urban growth boundary, known as the "greenline," by requiring voters to approve any changes to it was overwhelmingly popular.

Measure K: Yes, 81.3%

City of Saratoga

Voters extended a moratorium until March 15, 2002, on residential development of lands zoned "Retail Commercial," "Professional Administrative," "Gateway Landscaping," or "Planned Development."

Measure G: Yes, 73.6%

SECTION 2

AN ANNOTATED INVENTORY OF ECONOMIC INCENTIVES

INTRODUCTION

The use of economic incentives to influence business location decisions has had a long and controversial history dating back at least four centuries to the reign of France's King Henri IV (1594-1610), who ceded ownership rights to undeveloped land in Paris to private parties willing to help finance construction of new infrastructure (bridges, streets, parks) and residential housing to accommodate the city's expanding population. Here in the United States, local governments have long devoted a portion of their borrowing ability and infrastructure spending to activities beneficial to private industry. However, the first example of a publicly sanctioned economic incentive by a state government was Mississippi's creation in 1936 of its Balance Agriculture with Industry Program. In that case, the specific incentive was the issuance of industrial development bonds. Whatever hesitance there may have been about using public assets to encourage private enterprise to locate in selected locations began to fade rapidly during the 1960s as the nation more aggressively confronted the issues of rural poverty and inner-city blight under a range of programs spawned under the auspices of the Great Society. Prompted by the federal government's lead, state legislatures began authorizing an array of incentives to enable communities to attract businesses to expand their revenue base and to create new jobs for their residents.

1. RECENT TRENDS IN THE USE OF STATE FINANCIAL INCENTIVES

The ensuing decades have seen a proliferation of such incentives, most of them financial in nature. A 1998 national survey of 940 state-funded programs revealed that approximately 40 percent of the existing incentive programs marketed by states are directly related to tax credits, exemptions, abatements, or deferrals. In that year alone, the fifty states allocated an estimated $4.6 billion in foregone state tax revenues (tax expenditures) for these incentive programs. An additional $6.3 billion was allocated in 1998 for non-tax incentives, including loans, grants and guarantees provided directly to businesses or indirectly to communities. These two categories do not include one-time allocations for individual mega-projects (such as Alabama's enticements to Mercedes-Benz) that typically require approval at a state's highest political levels.

Of the 940 incentive programs identified in the most recent directory of economic

development incentives compiled by the National Association of State Development Agencies (NASDA), sixty percent offer direct and indirect non-tax financial assistance to businesses as the program's

intended beneficiary. The remaining forty percent are tax incentives. Based on a comparison of data from NASDA'S 1994 and 1998 directories, tax incentives and Industrial Development Bonds continue to be the most widely offered and most common way that individual incentives are offered by states. Data from the NASDA directories suggest that tax incentives are being used in an increasingly targeted fashion, often focusing specifically on employment growth or being directed to special circumstances, such as targeting of distressed areas through enterprise zone programs. Tax incentives are now commonly being offered to offset the costs of pollution prevention, job training, and hiring disadvantaged workers.

While the number of tax incentives has grown over the years, non-tax incentives have grown even more. For the most part, states are trying to meet an ever-broader array of business needs while minimizing the expenditures needed to do so. Thus, the number of direct financing programs is increasing as these programs encompass a wider range of increasingly specialized objectives. These non-tax incentives are designed to be more responsive to the common needs of industry, especially the requirements of small and medium-sized businesses for trained workers, infrastructure and new technologies. At the same time, creative initiatives such as linked-deposit programs, secondary market operations, and loan funds are expanding the options of companies to access financing with limited investment of public funds.

For most incentive programs, policymakers have set eligibility criteria to ensure sound investments in achieving predetermined public policy goals. Accountability measures and clawback provisions are built into the programs. For example, a Minnesota statute requires that any business obtaining state or local economic development assistance must create a net increase in jobs within two years of receiving the assistance. The statute further requires that the state development agency establish wage level and job creation goals to be met by businesses receiving the assistance. A business that fails to meet the goals must repay the assistance to the agency. States and communities are beginning to add these clawback provisions as a standard element of their incentive offers to companies. Almost every incentive is geared toward one or more aspects of a company's cost of doing business. Subsidies are provided through direct cash payments, assistance with relocation or expansion costs, income tax credits, or credits to the firm's payroll tax. Many incentives are designed to reduce specific business costs taxes, cost of capital, land, facility financing, worker training, and up-front operating costs.

A distillation of NASDA's 1998 *Directory of Incentives* yields three principal categories of incentives: (1) direct financial incentives; (2) indirect financial assistance; and (3) tax-based incentives or rewards.

Direct Financial Incentives

Direct financial incentives are defined as programs that provide direct monetary assistance to a business from the state or through a state-funded organization. The assistance is normally provided through grants, loans, equity investments, loan insurance and guarantees. These programs generally address business financing needs but also may be invested in workforce training, market development, modernization, and technology commercialization activities. Cash grants provide the greatest flexibility and immediate benefit to the company by reducing capital outlays. However, loans, bonds and equity financial are often used to make resources available with an expectation that the dollars will be returned for future investments. An important subcategory of direct financial incentives is the offering of training subsidies. Other forms of direct financial incentive include revolving loan funds, product development corporations, seed capital funds, and venture funds. These programs directly supplement market resources through public lending authorities and banks.

Indirect Incentives

Indirect incentives include grants and loans to local governments and community organizations to support business investment or development. The recipients include communities, financial institutions, universities, community colleges, training providers, venture capital investors, and childcare providers. In many cases, the funds are tied to one or more specific business location or expansion projects. Other programs are targeted toward addressing the general needs of the business community, including infrastructure, technical training, new and improved highway access, airport expansions, and other facilities. Funds are provided to the intermediaries in the form of grants, loans, and loan guarantees. Indirect incentives may also be used to leverage private investment in economic development. For example, linked deposit programs in which state funds are deposited in a financial institution in exchange for providing capital access or subsidized interest rates to qualified business borrowers.

Tax Incentives

Tax incentives are widely used as a strategy for leveraging business investments. Policymakers and practitioners alike view them as a means of reducing the cost of doing business and "leveling the playing field" in the competition with other states and communities. Generally, tax incentives can be classified into five subcategories: (1) credits; (2) abatements/reductions; (3) exemptions; (4) refunds; and (5) other special tax treatment to encourage business investment. States usually focus their incentives according to their tax codes, though many states stipulate local tax incentives that are designed to generate economic development. Tax credits provide a reduction in state income tax, franchise tax or other state taxes to reward businesses for a variety of actions such as creating jobs, investing capital in equipment or research and development, training workers, recycling, or providing childcare. Abatements reduce or decrease the assessed valuation of *ad valorem* taxes, which include real property or personal property, to foster investment by certain industries, such as “clean" manufacturing, or in certain activities such as holding business inventory. Tax exemptions provide freedom from payment of a variety of taxes -- including corporate income, corporate franchise, state sales or use, or other taxes -- normally applied when, for example, a company purchases air or water pollution control equipment.

One of the more popular economic development tool utilizing tax incentives to attract new enterprise to targeted neighborhoods or industrial/commercial areas involves the creation of **enterprise zones**. Found in more than 40 states, enterprise zone programs provide a mixture of different tax credits, abatements, and other incentives targeted to distressed urban and rural areas. The most common provisions are capital investment incentives including property tax, income tax, and sales and use tax credits or refunds. These capital investment incentives make up about two-thirds of state enterprise zone incentives nationally. However, the level of these incentives varies from state to state. Some programs rely principally on locally provided incentives in enterprise zone areas. In a few cases, zone programs are being used to target ‘non-tax' programs as well.

Despite the increasingly widespread use of economic development incentives in the past three decades, there is little conclusive evidence as to their effectiveness. A task force convened in 1998 by the National Conference of State Legislatures found:

Individual states spend tens of millions to hundreds of millions of dollars annually on economic development programs. Few states know the exact amount they spend to support economic development initiatives. No state knows how effectively the money is spent. Academics and policymakers continue - as they have for years - to debate fundamental questions. Do state incentives aid or hinder growth of the national economy? Do state tax incentives really have an effect on state economic growth? And new questions continue to emerge, especially concerning recent international trade agreements such as NAFTA and GATT.

Part of the problem of assessing whether incentives merely procure results that would have occurred in any case stems from negotiating dynamics. Businesses typically reveal as little as possible about the factors being weighed in site location decisions. For their part, state and local economic development officials are understandably eager to claim credit for any positive outcome, regardless of how influential incentives really were in bringing that outcome about. Still, the greatly expanded use of economic incentives in recent years indicates they are popularly viewed as indispensable economic development tools.

2. THE INTER-REGIONAL PARTNERSHIPS' UNIQUE CHALLENGE

In recent decades, there has been much academic research into the effectiveness of economic incentives to lure companies from one region to another. There has also been some research involving competition within metropolitan areas. For the most part, the latter research has focused on factors that drive business from the core to the periphery. The goal of these studies has been to identify ways of restoring health to blighted downtown and inner city neighborhoods.

The area encompassed by the Inter-Regional Partnership presents some distinctive economic development challenges that are likely to require an array of novel solutions. Historically, most economic development incentives have been designed to cope with the fact that industries have migrated from inner-city precincts toward the peripheries of metropolitan areas, often leaving the center blighted as a result. In the case of Silicon Valley, the core industrial area has remained remarkably vibrant (and will probably continue to be so). However, due to high housing costs and traffic congestion, all but the most essential (and best compensated) "intellectual" and administrative talent will increasingly be forced to migrate to communities in adjacent counties. What is emerging, therefore, is a growing geographic imbalance between the location of employment opportunities and the stock of affordable housing.

There is, of course, general agreement that steps are needed to promote a more equitable balance of jobs and housing. Achieving that goal will necessitate the building of more housing units in closer proximity to existing employers. It is also apt to require that business expansion be steered toward those communities to which skilled workers have already begun to migrate. Bringing about the desired balance will demand a degree of regional cooperation that has hitherto not been achieved.

3. ECONOMIC DEVELOPMENT INCENTIVES IN CALIFORNIA

Targeted Tax Incentives

California employs a variety of targeted tax incentives to attract new enterprises, retain existing businesses and encourage business expansion, often in specifically designated areas of the state. Not all of the incentives described below are appropriate to the needs of every community or every industry.

<u>Manufacturer's Investment Credit</u>

Certain qualified manufacturers operating in California are eligible for a 6 percent manufacturers' investment credit (MIC). This credit is generally unlimited. The manufacturers' investment credit can be used to offset income or franchise tax based upon the purchase or lease of manufacturing and related equipment which is "depreciable" under certain federal regulations and has California sales or use tax paid on its purchase. The credit also includes certain capitalized "direct" labor costs. In addition "special purpose buildings and foundations," (i.e. clean rooms) for certain electronic manufacturers, semiconductor equipment manufacturers, commercial space satellite manufacturers, custom or prepackaged computer software manufacturers, and property related to specified pharmaceutical activity are eligible for this credit. The credit can be claimed against the bank and corporation tax. Any unused credit can be carried forward for eight years. Specified taxpayers get carry forward 10 years. It is important to note that the MIC can be coupled with enterprise zone credits discussed elsewhere in this inventory.

Partial Sales or Use Tax Exemption

California also provides "new" or start-up companies the option of a 5 percent partial sales/use tax exemption on all qualifying manufacturing property purchased or leased, generally during the company's first three years of operation. Purchases eligible for an exemption include tangible personal property used in manufacturing, processing, refining, fabricating or recycling. Research and development activities as described in Section 174 of the Internal Revenue Code and property used in maintaining, repairing, measuring or testing the above noted property are also eligible. Tax imposed above 5 percent remains due. "Special purpose buildings" and leases of tangible personal property that are subject to tax measured by rentals may qualify. If qualified, the partial exemption is applicable for a period of six years from the date of inception of the lease. The partial sales tax exemption is available as an option to the MIC on an item-by-item basis. Commercial aircraft parts, maintenance and related labor are now exempt from sales tax.

In-Lieu Sales or Use Tax Refund

A company might prefer to claim an in-lieu sales or use tax refund equal to the MIC available for the current year. Under this program, the company can elect to file a claim for refund equal to the amount of MIC that the company could have used to offset current year franchise or income tax liability (and can be claimed no sooner that the MIC could have been claimed).

Research and Development Tax Credit

Designed to encourage companies to increase their basic research and development activities in California, the research tax credit allows companies to receive a credit of 12 percent for qualifying research expenses (research done in-house) and 24 percent for basic research payments (payments to an outside company), making it the highest in the nation. To qualify, research must be conducted within California and must not include research for the purpose of improving a commercial product for style, taste, cosmetic, or seasonal design factors.

Net Operating Loss Carryover

California tax law allows businesses that experience a loss for the year to carry this loss forward to the next year in order to offset income in the following year. New businesses can carryover 100 percent of their losses over eight years if the loss is in their first year of operation, 100 percent over seven years if in their second year of operation and 100 percent over six years if in their third year of operation. Existing

California businesses can carryover 50 percent of their losses for five years.

Enterprise Zones

California's enterprise zone program is a partnership of state government, local government and private businesses. The enterprise zone program encourages business development in 39 designated areas through special zone incentives. Companies situated within enterprise zones can take advantage of state and local incentives and programs not available to businesses outside the enterprise zone. Tax credits and benefits available to companies locating in enterprise zones include:

(A) Tax credits for sales or use taxes paid on up to $20 million of qualified machinery purchased per year. Qualified machinery includes machinery or machinery parts used to manufacture, process, fabricate, or otherwise assemble a product, produce renewable energy resources, or control air or water pollution. In addition, qualified property is data processing and communications equipment, including, but not limited to, computers, computer-automated drafting systems, copy machines, telephone systems and faxes, and motion picture manufacturing equipment central to production and post-production, including, but not limited to, cameras, audio recorders, and digital image and sound processing equipment.

(B) A hiring credit of $26,894 or more for each qualified employee hired;

(C) A 15- year carryover of up to 100 percent of net operating losses;

(D) Expensing up to $40,000 of certain depreciable property;

(E) Lender income deductions for loans made to zone businesses; and

(F) Preference points on state contracts.

In addition, local incentives may be available that include reduction or elimination of local permit and construction-related fees; expeditious processing of plans and permits; reduced utility rates; reduced land costs; assistance in employee hiring; low-cost financing and low-interest revolving loans.

Local Agency Military Base Recovery Area

Local Agency Military Base Recovery Areas (LAMBRAs) were created to stimulate job creation in areas experiencing military base downsizing and closure. There are currently three military sites which are fully designated under the state's LAMBRA program including Mare Island Naval Shipyard in Vallejo, Castle Air Force Base in Merced, and George Air Force Base in Victorville. Alameda Naval Air Station in Alameda and the Tustin Marine Corps Air Station in Tustin were conditionally designated in 1997. In 1999, McClellan and Mather Air Force Bases in Sacramento were conditionally designated as a single LAMBRA, as was Norton Air Force Base in San Bernardino.

LAMBRA designations are similar to enterprise zones. The designations allow communities to extend the aforementioned California tax credits to companies locating in a LAMBRA zone. In no notable case, Pacific Telesis established a Customer Call Center at Castle Air Force Base that involved an investment of more than $20 million to refurbish two existing buildings and employment of 850 workers.

Local incentives may also be available including reduction or elimination of permit and construction-related fees, expeditious processing of plans and permits, reduced utility rates and low interest revolving loans.

Manufacturing Enhancement Area

The Manufacturing Enhancement Area (MEA) was drafted to stimulate job creation in areas experiencing triple the State of California's unemployment in a Border Environment Cooperation Commission Region. Special state and local incentives encourage business investment and promote the creation of new jobs. The purpose of the program is to provide tax incentives to businesses and allow private sector market forces to revive the local economy. Program Benefits for companies located in MEAs include: streamlined local regulatory controls; reduced local permitting fees; and $26,894 or more in state tax credits for each qualified employee hired. All manufacturing businesses that are engaged in those lines of business described in Codes 2011 to 3999, inclusive of the Standard Industrial Classification (SIC) and located in the MEA are eligible for program benefits. There are 2 MEAs located in California. They are the Cities of Brawley and Calexico. Each community is located in Imperial County. A MEA designation lasts until December 31, 2012.

Targeted Tax Area

The Tulare Targeted Tax Area (TTA) is a program very similar to Enterprise Zones. Targeted Tax Area (TTA) incentives are only available to companies located in the TTA and engaged in a trade or business within the following Standard Industrial Codes: 2000-2099 Food Processing, 2200-3999 Certain Other Manufacturers, 4200-4299 Trucking and Warehousing, 4500-4599 Air Transportation and 4700-5199 Transportation Services, Communications and Wholesale Trade. TTA State incentives include: tax credits for sales and use taxes paid on certain machinery, machinery parts, and equipment; tax credits for hiring qualified employees; fifteen year net operating loss carry-forward; and accelerated expensing deduction.

Childcare Tax Credit

Employers who pay or incur costs for the start up of a child care program or construction of an on-site child care facility are eligible for a credit against state income taxes equal to 30 percent of its costs, up to a maximum of $50,000 in one year. Excess credits may be carried over to succeeding years.

Joint Strike Fighter Income Tax Credits

California recently created two entirely new income tax credits for businesses involved in the Joint Strike Fighter program. They are 1) a hiring wage credit and 2) a property credit. These credits apply to taxpayers under initial contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter. The credits are available for taxable years beginning on or after January 1, 2001, and before January 1, 2006. Any excess credit can be carried forward for up to eight years. No credit would be allowed unless the bid upon which the Joint Strike Fighter contract or subcontract is based is reduced by the credit amount. The taxpayer is required to provide, at the request of the Franchise Tax Board, all references to the credit and ultimate cost reductions incorporated into any successful bid that was awarded a Joint Strike Fighter contract or subcontract. The hiring wage credit is a specified sliding scale percentage (50 percent for 2001, 40 percent for 2002, 30 percent for 2003, 20 percent for 2004, and 10 percent for 2005) of employee wages that are treated as direct costs under Section 263A of the Internal Revenue Code (IRC) allocable to property manufactured in this state for ultimate use in a Joint Strike Fighter. The wages can be paid to new or existing employees whose services for the taxpayer are at least 90 percent directly related to the contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter. The credit is limited to $10,000 per year, per employee, and must be prorated for partial years.

The property credit is generally patterned after the Manufacturer's Investment Credit (MIC). It is a credit of 10 percent of the cost of qualified property. Qualified costs are those upon which California sales or use tax has been paid and is capitalized. Qualified property means tangible personal property (IRC Section 1245(a)(3)(A)), and capitalized labor costs that are treated as direct costs under section 263A of the IRC allocable to that property, used by a taxpayer primarily in activities to manufacture a product for ultimate use in a Joint Strike Fighter.

The credit must be recaptured if, within one year of being placed in service, the property is sold, moved out of state or used for purposes other than manufacturing a product for ultimate use in a Joint Strike Fighter. The taxpayer would not be allowed to take this credit and the MIC for the same item of property. However, the taxpayer *can* take this credit and the Enterprise Zone Sales and Use Tax credit for the same item.

4. EMPLOYEE TRAINING PROGRAMS

California offers a spectrum of services to help businesses recruit, screen and train quality workers on or off-site. Once a company has decided to utilize these services, a single point of contact will be available to coordinate the provision of services.

<u>Job Referral and Placement</u>

The Employment Development Department (EDD) provides services that include statewide job searches, recruitment, pre-screening, compilation of labor forecasts and labor market data specific to employers' needs. EDD is able to access the state's entire workforce as well as coordinate recruitment activities with local community-based organizations that target a specific group of unemployed individuals. Additionally, EDD will assist a private business in customizing on-site training, focused recruitment, relocation and placement of pre-qualified workers, referral to testing and assessment as necessary to match a business's requirements.

EDD Job Service

In its main function as an employment service, EDD's Job Service uses the latest computer technology to serve the needs of employers and job seekers. This automated system, called CalJOBS, matches qualified job applicants electronically with employers' job openings. Highly skilled Job Service specialists expertly screen the top-ranked computer selection and refer those most closely matching the specification of the job listing. Through its CalJOBS system, Job Service offers a statewide network that provides an instant link between employers and job seekers anywhere in California. This network provides employers with quick access to the largest available pool of job ready applicants.

Working with Business

EDD's Job Service works with Employer Advisory Groups, which operate in most California communities. These organizations of local business people help Job Service stay responsive to the changing needs of the community. Together, Job Service and the Employer Advisory Groups sponsor employer seminars, job fairs and other events which provide valuable information and guidance for job seekers and local businesses. Each California Trade and Commerce Agency regional office has an EDD specialist to assist businesses in accessing these services.

Additional services for employers offered by EDD include: current labor market information in planning for business expansion, relocation and future hiring and training needs; focused recruitment campaigns for new business ventures or facilities needing a large number of specialized workers in a hurry; and statewide search using CalJOBS to find specialized workers.

Employment Training Panel

The Employment Training Panel (ETP) assists businesses in acquiring and retraining a highly skilled workforce with expertise in very specific fields in order to increase competitiveness and productivity. The ETP is supported by California employers through a small contribution to the California Employment Training Fund. It is the only program designed to train the existing workforce. Employers choosing to participate in the program can utilize the reimbursements provided by ETP to offset the costs of developing and implementing customized training for their new or existing employees. Training can be done on site by the employer or through other training organizations of their choice.

Reimbursements are made to the company for each employee that completes training and remains on the job for 90 days.

Eligibility for the program is open to all companies that contribute to the state's Employment Training Fund; face out-of-state competition and need to retrain current employees; and/or need to upgrade workers in areas where there are skills shortages; and/or hire and train unemployed workers eligible to receive unemployment insurance; and/or have special, unique training needs in areas such as defense conversion or emerging technologies. Eligible trainees can include existing employees or the hiring of new employees that meet the program's requirements.

Since its inception, the ETP has provided $550 million in funding to over 27,000 California businesses for the training or retraining of 280,000 workers. Each California Trade and Commerce Agency regional office has an ETP specialist to assist businesses in applying for funds.

5. FINANCING ASSISTANCE

Several state-sponsored financial assistance programs are available to firms wanting to locate, expand or modernize facilities in California. The types of assistance available can be grouped into three broad categories: business financing, environmental loans and public infrastructure financing.

Business Financing

Business Financing is provided directly to companies undertaking various projects. Each program has its own specific requirements for qualification and terms for approval. Listed below is an overview of each program and the basic requirements.

<u>Industrial Development Bonds</u>

California cities, counties and state government have the authority to offer low interest financing to businesses locating in their communities through the use of tax-exempt industrial development revenue bonds. An eligible bond project can be the construction of a new plant, or replacement of all or part of an existing plant. Industrial activities eligible for financing include assembly, fabrication, manufacturing and processing. The primary advantage of industrial development bonds is that the financing provided bears an interest rate significantly lower than conventional methods (the lower interest rate is the result of the tax exempt status of the securities), the bonds are long term 15-30 years maturity, and may be assumable.

Companies taking advantage of industrial development bond financing receive approval for a project through a local industrial development authority (IDA), a joint powers authority, or the California Infrastructure and Economic Development Bank. The project must also receive private activity bond allocation from the California Debt Limit Allocation Committee.

To qualify for industrial development bonds a borrower needs to meet certain eligibility criteria: 1) the firm must be engaged in a manufacturing, processing or value-added industry, 2) the total project cost should be at least $2 million and may not exceed $10 million, 3) the borrower must secure a letter of credit for 100 percent of the bond issue from a bank with a substantial credit base, 4) the capital expansion must provide a public benefit such as creating new jobs; and 5) the project must have city or county support.

The proceeds from a bond issue can be used to pay for virtually all costs incurred by the company for its project including the financing of land acquisition, building construction, machinery and equipment, and other incidental costs as well as a portion of the expenses associated with the financing and issuance of the bonds.

<u>Pollution Control Financing</u>

The Pollution Control Financing Authority, located in the State Treasurer's Office, provides businesses in California with an affordable method of financing pollution abatement equipment, waste disposal and resource recovery facilities for the management of environmental pollution hazards. The Authority offers tax-exempt or taxable bonds and loan portfolio insurance to businesses seeking financing for qualified pollution control projects. The entire cost of a pollution control project, including land and buildings attributable to the project, equipment, engineering fees and related financial and administrative expenses, can be funded by the program.

<u>Small Business Loan Guarantee</u>

The Small Business Administration's loan guarantee program promotes job retention and creation and encourages small business entrepreneurship particularly among minority, women, and disabled persons. A "small business" is a manufacturer of 500 employees or less, or a retailer with gross international sales ranging from $3.5 million to $14.5 million depending on the industry. The State of California's Small Business Loan Guarantee Program differentiates itself from the U.S. Small Business Administration's programs by providing a niche in guarantee financing on revolving lines of credit, small loans and agricultural loans.

Businesses applying to the program receive funding from a private lender. This loan is guaranteed by one of 12 nonprofit regional development corporations organized under the California Corporations Code.

All loan proceeds must be used in California and the proceeds cannot be used for entertainment enterprises or speculative purposes. To qualify a borrower must not be able to obtain credit based solely on his or her own financial condition, but must demonstrate reasonable capacity to repay the loan. The maximum guarantee is 90 percent of the loan value not to exceed $350,000 and the maturity of the guarantee is not to exceed seven years. Interest rate and loan origination fees are negotiated by the borrower and the lender.

<u>SBA 504 Loans</u>

SBA (Small Business Administration) 504 loans are marketed, processed, closed and serviced by Certified Development Corporations (CDC) throughout California. Through the SBA 504 Program, CDC's provide 90 percent real estate financing with a special emphasis on rural areas and distressed urban areas. The second mortgage, long-term, fixed-rate financing nature of the program allows banks to participate in the business's expansion by reducing their risk on real estate exposure. The benefit to the businessperson is the lower downpayment requirement (10 percent) and the longer-term, fixed-rate second mortgage which translate into reduced monthly payments.

Accredited Lender Program CDC's provide streamlined loan processing/servicing and receive accelerated credit decisions from SBA. Premier Certified Lender Program CDC's accept financial responsibility for loans they underwrite and need only limited review from SBA. One full time equivalent job for every $35,000 of SBA funds is desired within two years of project funding. Individual job goals can be somewhat compromised if the CDC’s overall portfolio meets these requirements. At that point, community impact and public policy goals come into play.

Eligible 504 loan proceeds include the purchase of land, existing buildings, new construction, and the acquisition of machinery and equipment with a ten-year useful life. The private sector participant takes 50 percent of project cost and takes a first lien on assets pledged as collateral. The SBA takes a second lien on assets and takes 40 percent of project cost, up to $1 million in some cases. Owners inject 10 percent in the form of cash or equity in real estate.

<u>California Capital Access Program</u>

The California Capital Access Program (CalCAP) encourages banks to make loans to California small businesses. The State Treasurer's Office, through the California Pollution Control Financing Authority (CPCFA), has committed to provide "loan loss" guaranty accounts to participating banks willing to make loans to small businesses with higher than conventional risk. Since April of 1994 participating banks have made CalCAP loans and lines of credit available to thousands of California businesses in amounts ranging from $100,000 to $2.5 million. Banks give extra weight to the most recent year's results of a business instead of a several-year average. This benefits the most profitable and fast-growing companies. With CalCAP's flexible guidelines, business assets and personal guarantees are acceptable as collateral when other collateral is not available.

A business's primary location must be in California with the business activity generated from the loan created and retained in California. Businesses must have fewer than 500 employees with more than 50 percent of the employees working in California and have at least 25 percent of its sales derived from a CalCAP eligible industry. Eligible SIC codes exclude most service and retail businesses.

<u>California Technology Investment Partnership Program</u>

The mission of the California Technology Investment Partnership Program (CalTIP) is to accelerate the development of new, globally competitive technology-based commercial products and services from California firms and consortia. The CalTIP program provides matching grants and technical assistance to California-based businesses, consortia, nonprofit organizations and public agencies for projects qualifying for federal funds through cost share technology-based projects from a variety of federal agencies.

The Regional Technology Alliances (RTAs) have primary responsibility for evaluating and ranking the proposals from their designated geographical areas. If a proposal is statewide in nature, or if no RTA has been designated for a geographical area, applications may be sent directly to the California Trade and Commerce Agency's Division of Science Technology and Innovation for evaluation and ranking.

Following the evaluation and ranking of proposals by the RTAs, the Division of Strategic Technology convenes a peer review panel to recommend state funding commitments or endorsements by the California Trade and Commerce Agency. The peer review panels are composed of industry representatives and technical experts, nonvoting representatives from each RTA and other members.

All applications, which receive a positive endorsement from the Division of Science Technology and Innovation peer review panel, are presented to the Secretary of the California Trade and Commerce Agency.

Proposals are evaluated based on immediate and measurable ability to create jobs, clearly identified product line and market, inclusion of a training component for workers associated with the project, demonstrated links with other applicable programs, and whether the proposers and partners are small businesses.

California Export Finance Loan Guarantees

The California Export Finance Office (CEFO) helps small and medium-sized California companies finance their export sales by providing working capital loan guarantees to financial institutions. CEFO guarantees cover up to 90 percent of an export loan, allowing for a maximum guarantee of $750,000 and a loan of $833,000. CEFO offers the following export loan guarantees in support of short term (up to 18 months) transaction-specific working capital loans for:

- Pre-Shipment and Post-Shipment Working Capital;
- Letter of Credit financing;
- Purchase Order financing;
- Open Account financing;
- Standby Letter of Credit financing for Performance Bonds;
- Easy access to Foreign Credit Insurance through government and private insurance agencies.

Through co-guarantee agreements with both the U.S. Small Business Administration (SBA) and The Export Import Bank of the United States (Ex-Im

Bank), CEFO can double its guarantee capacity to provide the exporter with a guaranteed loan of up to $1.6 million. Also, as a City/State Partner for Ex-Im Bank, CEFO has the authority to administer their loans, guarantees and insurance products for California companies.

Old Growth Diversification Revolving Loan Program

The Old Growth Diversification Revolving Loan Program provides capital lending to the creation and retention of jobs in areas of California affected by timber harvest reductions, and sawmill and related plant closure. Emphasis is placed on value-added wood products and other resource related manufacturing, and on business ventures that diversify the local economy. Preference is given to those projects which employ displaced timber workers. Businesses engaged in expansion as well as start-up ventures will be considered. Eligible counties include Del Norte, Glenn, Lake, Humboldt, Mendocino, Shasta, Siskiyou, Tehama and Trinity. Loan amounts between $25,000 and $100,000 are available at an 8 percent fixed interest rate. Proceeds can be used for purchase of land and existing buildings, machinery and equipment, working capital and lines of credit.

A minimum of 25 percent of total project financing must come from either equity contributed by the applicant or other nonfederal funding sources. Additionally, there must be a reasonable assurance of the applicant's ability to repay the loan. Loans will be packaged and funding through one of three regional Economic Development Corporations (EDCs) located in the target area.

6. ENVIRONMENTAL LOANS

California has a small number of loan programs to help companies clean up the environment and implement environmentally friendly programs. These include:

Underground Storage Tank Loans

Loan proceeds must be used to repair, replace (includes acquisition and installation) or upgrade underground petroleum tanks only, with an allowance for ancillary equipment required by current regulations. The maximum loan amount is $750,000. Loans can be given for up to 100 percent of the total project cost.

Hazardous Waste Reduction Loans

These loans assist small businesses to reduce waste generation or to reduce the hazardous properties of waste generated. Proceeds can only be used to finance hazardous waste equipment acquisition, installation and processes. The California Department of Toxic Substance Control, Pollution Prevention and Technology Development Division, must determine that the equipment or processes to be financed qualifies for this program. Direct loans for up to 100 percent of the project's costs with a maximum loan amount of $150,000 are available. The maximum term of the loan is seven years.

Recycling Market Development Loans

Any business or local government agency located in a Recycling Zone utilizing post-consumer or secondary waste material in their production process may apply for a recycling loan. Private businesses may borrow funds for acquisition of real property, equipment, leasehold improvements, working capital, or refinancing of onerous debts. Local government may apply for funds to finance public works infrastructure which directly supports these businesses. Each eligible business or local government agency may borrow up to 50 percent of the cost of any project with a maximum of $1 million.

Public Infrastructure Financing

Several public infrastructure financing programs exist to provide financial assistance to cities and counties for public infrastructure projects. Although not directly available to individual businesses, cities and counties can obtain public infrastructure financing to assist qualified businesses locating in their areas.

California Infrastructure and Economic Development Bank

The California Infrastructure and Economic Development Bank (CIEDB) exists to promote economic development and the revitalization of California municipalities. Through the issuance of loans, the sale of bonds, and the provision of credit enhancements, the Bank provides vital financing to local government entities.

Eligible applicants for CIEDB loans include any local government subdivision, such as: cities, counties, departments, agencies, commissions, non-profit-corporations (formed on behalf of applicant), special districts, assessment districts, and joint powers authorities.

Eligible projects include: city streets, state and county highways, public transit, drainage and flood control, educational facilities, environmental mitigation, port facilities, sewage collection and treatment, solid waste collection and disposal, public safety facilities, water treatment and disposal, water treatment and distribution, defense conversion, parks and recreational facilities, power, and communications facilities.

Rural Economic Development Infrastructure Program

The Rural Economic Development Infrastructure Program (REDIP) is designed to promote the economic revitalization of rural California by financing public infrastructure improvements which lead to the creation or retention of permanent, private sector jobs through the retention, expansion and attraction of businesses in rural areas. The purpose of REDIP is to provide financing for the construction, improvement or expansion of public infrastructure with the intent of creating jobs in rural cities and counties with an unemployment rate either equal to or above the state's average unemployment rate.

Financing is available for publicly owned infrastructure required for the construction or operation of a private development. Eligible infrastructure projects include the construction, rehabilitation, alteration, expansion, or improvement, including but not limited to, sewer and water facilities, street storm drains, bridges, railroad spurs, utility connections, wastewater treatment plants, other public facilities or other infrastructure improvements necessary for industrial or commercial activity.

The maximum loan amount available per project is $1 million, at an interest rate equivalent to the True Interest Cost (TIC) of California General Obligation Bonds (approximately 5 percent) amortized over 20 years. Funding is available on a continuous basis.

Community Development Block Grants

The over-the-counter program component of the state Community Development Block Grant (CDBG) program allows qualified local governments to apply for grants toward the creation or retention of jobs for targeted income groups. To qualify, a local government must be a rural county in an unincorporated area with a population of less than 200,000 or an unincorporated city with a population of less than 50,000. Local governments apply to the California Department of Housing and Community Development on behalf of a business or developer. Eligible activities include land, building, or working capital loans, loan guarantees and grants for publicly owned infrastructure.

USDA Rural Development Programs

Rural Development is the lending arm of the U.S. Department of Agriculture. The program's goal is to enhance the quality of life for all rural Americans by providing leadership in building competitive businesses and cooperatives that can prosper in the global trading marketplace. The key financial services of the programs are:

> Water and Waste Loans/Grants - construction and improvement of water, sewer, solid waste systems and storm drainage.
>
> Business and Industry Guaranteed Loans - up to 90 percent guarantees of a commercial loan on the purchase of land, buildings, machinery and equipment, supplies or working capital up to $25 million.
>
> Rural Business Enterprise Grants - to facilitate development of small and emerging businesses in rural areas with revolving loan programs, technical support, working capital, equipment, real estate, infrastructure and utilities.
>
> Intermediary Re-lending Program - to fund revolving loan programs that finance rural businesses up to $150,000 per ultimate recipient in communities of less than 25,000 population.
>
> Rural Technology Development Grants - research, development and commercialization of products, processes or services using uniquely rural resources.

Rural Economic Development Loans - zero interest loans up to $750,000 for 10 years to rural utilities service borrowers to promote job creation projects.

Business and Industry Direct Loans - up to $10 million per borrower available to those who cannot obtain credit from traditional sources.

7. OTHER INCENTIVES

Electric Industry Restructuring

Since April 1998, California consumers from all customer classes (residential, commercial, agricultural and industrial) are able to buy electricity from the electric service provider (ESP) of their choice. The goals of a competitive electric industry are consumer choice in electric services and competition among utilities and other electricity generators to reduce electric rates in California. Pacific Gas & Electric (PG&E), Southern California Edison (SCE), and San Diego Gas & Electric (SDG&E) currently deliver 70 percent of the power in California.

Companies may purchase electricity from the traditional supplier or choose to buy from ESPs based solely on service options and price. Companies may also contract with a city, county, an association, a broker or an aggregator to purchase electricity.

The California Power Exchange (CalPX) determines the price of electricity from the competitive spot market hourly or half-hourly according to demand for and supply of electricity. It publishes the price of electricity so consumers can shift their energy use to times when it is less expensive.

PG&E, SCE and SDG&E continue to own their transmission facilities but have turned the operation of these facilities over to an Independent System Operator (ISO). The Federal Energy Regulatory Commission regulates the ISO. The ISO, functioning like an air traffic controller for energy, operates the state's transmission system to ensure electricity flowing into it reaches all customers when they need it so they continue to have reliable service. The ISO ensures that all generators have equal opportunity to send their electricity through the transmission system to their customers. Generators who ship electricity through the system pay a fee to cover system costs.

Utilities continue to have the "obligation to serve the public" and they continue to deliver electricity to your business even if you purchase electricity from a nontraditional provider. Distribution lines link your business to the transmission system. PG&E, SCE and SDG&E operate distribution lines and are responsible for reliable, safe delivery of electricity to your business. The California Public Utilities Commission regulates their transmission and distribution rates using performance-based, rather than cost-of-service ratemaking.

PG&E, SCE and SDG&E must sell their power to the Power Exchange until March 31, 2002. If they wish to, municipalities, independent power producers, irrigation districts, and out-of-state producers may also sell power to the Power Exchange.

Small Business Development Centers

California Small Business Development Centers (SBDC) are a collaborative network of 42 regional service centers and over 60 outreach offices. The SBDC network engages a team of over 1,000 business advisors, staff, faculty, contractors and volunteers, to coach entrepreneurs in growing and improving their businesses.

SBDCs are a partnership of the California Trade and Commerce Agency, the U.S. Small Business Administration, the Chancellor's Office of the California Community Colleges and local host organizations. Confidential consulting services are provided free of charge in a variety of areas including business plan development, marketing, personnel, financial analysis, legal assistance and access to capital.

The programs recognize that people learn differently, have constraints on time and need real-world solutions. The service centers therefore customize training courses in a mix of formats, flexible time schedules and hands-on learning. To defray the cost of training, nominal fees are charged.

In addition, the service centers are linked together electronically and utilize the particular strengths of each service center as well as specialized service centers and programs for export, patents and intellectual property, high technology and manufacturing to serve business.

Golden State Capital Network

The Golden State Capital Network (GSCN) addresses the critical funding needs of entrepreneurial ventures, which typically do not meet the investment criteria of most established large institutional funding sources. GSCN matches growing companies in need of funding with appropriate investors in search of opportunities with a focus on Northern California and under-served rural areas of the state. GSCN does not become involved in the discussion or negotiation process between the parties, differentiating itself from financial intermediaries or investment brokers.

GSCN provides a quick and cost-effective way for entrepreneurs to expose their companies to a variety of investment sources, most of which they would never have reached otherwise. Investors in turn benefit from the increased number of opportunities they receive in a timely, selective and confidential manner. By entering into financing agreements with promising ventures, investors can leverage the innovation and fast market response of small companies to their mutual advantage.

GSCN is a not-for-profit organization within the Tri-County Economic Development Corporation (TCEDC). TCEDC is also a federally recognized Economic Development District affiliated with the U.S. Department of Commerce, Economic Development Administration. The network has offices in Sacramento and Chico.

Manufacturing Extension Centers in California

The three Manufacturing Extension Centers (MECs) in California are not-for-profit organizations created to deliver state-of-the-art engineering, marketing, and human resource consulting services to the state's small and medium-sized manufacturing enterprises. The California Manufacturing Technology Center (CMTC) serves the Los Angeles basin, the Sacramento Valley and San Joaquin Valley. The Corporation for Manufacturing Excellence (Manex) serves the ten counties in the San Francisco Bay Area, and the San Diego Manufacturing Extension Center (SanMEC) serves the San Diego region.

These three California MECs provide a variety of services and technical assistance to manufacturers. These include:

- Quality management and ISO 9000 certification.
- MRP and MRP II production scheduling.
- Marketing services, including new product introduction and business planning.
- Capital equipment selection and installation.
- Environmental assistance.
- Plant layout and modernization.
- Process improvement and cycle time reduction.
- Business assessment to improve profitability.
- Process re-engineering.
- Computerized process simulation.
- Product design.
- Work force development to strengthen productivity-driven manufacturing.

In addition to offering services and assistance to manufacturers, the MECs link with other elements of the supporting infrastructure in California such as educational institutions, complimentary service providers, local experts, industry groups, various state/local government agencies, as well as a national network of over 70 MECs.

Health Insurance Plan of California

The Health Insurance Plan of California (HIPC) is a state-sponsored insurance pool that offers affordable access to nearly two-dozen different insurers and 28 different health care options for companies with three to 50 employees. Once enrolled, the employer can remain with HIPC up until they grow to over 100 employees. HIPC is able to offer discounted rates by pooling the premiums of participating companies. To date, over 8,000 companies and 110,000 employees are part of the program.

Recycling Zones

Recycling Market Development Zones were developed by the California Integrated Waste Management Board (CIWMB) to make aid available to communities and businesses that use recycled materials such as paper, newsprint, plastic, tires and green waste in the manufacture of goods. Businesses locating within these 40 zones can take advantage of low-interest loan packaging, local permit streamlining and reduced permit application fees, elimination of business license fees, other site location incentives (including low-cost land and infrastructure improvements), job training assistance, discounted utility rates, technical assistance and information sharing.

8. LOCAL INCENTIVE OPTIONS

Economic Revitalization Manufacturing Property Tax Rebates

Section 5108 of California Property Tax Law permits local governing bodies to rebate some or all of the property tax revenue that local agencies would receive from "economic revitalization manufacturing property" for a period of five fiscal years from the date the property was placed in service. Tangible personal property must be directly involved in the manufacturing process, the project must lead to the creation of 10 new full-time manufacturing jobs, the company must pay wages of at least $10 per hour and those jobs must be in continuous existence for the duration of the rebate. Local agencies include cities, the county, city and county, and special districts - except for school districts. These provisions sunset on January 1, 2003, unless extended by the Legislature.

Capital Investment Incentive Payments

In 1997, California initiated a program that permits cities and counties to negotiate property tax rebates with high-tech manufacturing companies. Under the new law, local governments could cap the taxable value of any new high tech manufacturing plant at $150 million annually for up to 15 years. Local government would then charge the manufacturer an annual "community services fee" of about $2 million. This program commenced in the 1998-99 fiscal year and can only be activated by a majority vote of the local governing body. The California Trade and Commerce Agency certifies that the capital investment exceeds $150 million and is a qualified manufacturing facility. Businesses described in Standard Industrial Classification (SIC) Codes 3500 to 3899 are eligible for the program. Special districts and school districts may also participate in the payment of capital investment incentive payments, although they may not make payment of an actual allocation.

A Community Services Agreement (CSA) dictates community service fee remittances, in amounts equal to 25 percent of the capital investment incentive amount calculated for that proponent for that fiscal year. This fee shall not exceed $2 million in any fiscal year. Employees at the facility specified in the CSA must be covered by an employer sponsored health benefits plan and the average weekly wage, exclusive of overtime, shall not be less than the state average weekly wage. The "state average weekly wage" means the average weekly wage paid by employers to employees covered under unemployment insurance, as reported to the Employment Development Department for the four calendar quarters ending June 30, 1997.

Local Financing Redevelopment Agency

Various forms of financial assistance are available through redevelopment agencies in California. Business may benefit through direct financial assistance, land assemblage and the construction of public improvements. California redevelopment law defines the degree of economic or physical blight each redevelopment area must contain. Redevelopment is funded through incremental property tax revenue increases that are a direct result of increased property values. Assistance may be in the form of fee reductions, infrastructure improvements, land cost write-downs, mortgage interest write-downs and utility tax rebates. Recent legislation enables the Redevelopment Agency to provide financing for manufacturing projects under certain conditions. Capital financing or long term operating leases may also be permitted.

Local Revolving Loan Funds

Enterprising communities throughout California have recognized that revolving loan funds (RLF) are important economic development tools. RLF's are typically capitalized by the United States Economic Development Administration, Department of Agriculture and Housing and Urban Development's Community Development Block Grant Program. Their proceeds often provide critical capital to deserving small businesses which in turn, provide needed jobs in urban and rural areas throughout California.

Certain businesses may be targeted for assistance and most often the loan will be provided as part of an overall package in the form of gap financing. RLF's are guided by policies that outline loan or loan guarantee sizes, uses, rates, terms, special conditions and participation levels. The goals, objectives and priorities of the program are weighed against the portfolio's requirements and loans are approved or denied by a Loan Administration Board. Conventional lending is required with the RLF taking a second or third position. Personal and/or corporate guarantees are required.