CENTER *for* RURAL POLICY *and* DEVELOPMENT

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The Job Opportunity Building Zone Program: Moving Forward in Times of Uncertainty

I. Introduction

In January 2004 the State of Minnesota initiated its new Job Opportunity Building Zone Program, now commonly known as JOBZ. The program, an adaptation of similar programs in both Michigan and Pennsylvania, provides a broad range of state and local tax relief to qualified businesses that agree to create jobs and make capital investments in selected areas of rural Minnesota. The Minnesota program offers these tax incentives for up to 12 years for qualified businesses.

Earlier in 2005 the Center for Rural Policy and Development released a Year 1 progress report for the JOBZ program. During the past 12 months, however, several events and changes have occurred that have created a sense of uncertainty for the program.

Starting in the fall of 2004, the Office of the Attorney General released an "Advisory Letter" regarding the relevance and application of Minnesota's prevailing wage statute on JOBZ projects. Established years ago, the prevailing wage statute was created to ensure contractors engaged in public infrastructure projects such as roads, bridges and building construction paid appropriate wages to their workforce on these public projects. There was confusion, however, as to whether the application of this statute applied to private business development projects that were receiving public tax incentives (i.e., JOBZ). At first, local economic development professionals were informed that this statute was not applicable to the JOBZ program; however, months after the program began, the Attorney General's Advisory Letter was contradictory to this belief.

Later, during the 2005 Legislative session, there were several changes proposed to the JOBZ program, including one piece of legislation proposing to terminate the program. While the program was not terminated, several changes were made to the program, again creating some uncertainty about its long-range stability.

Finally, in March 2005 a lawsuit was filed in Ramsey County arguing that the JOBZ program as it is constructed violates provisions in both the Minnesota and U.S. constitutions, as it "surrenders" the power of taxation to a state agency, i.e. DEED and local economic development professionals. While the court has yet to rule on the merits of this case, it again may create a heightened level of uncertainty among business

The Center for Rural Policy and Development, based in St. Peter, Minn., is a private, not-for-profit policy research organization dedicated to benefiting Minnesota by providing its policy makers with an unbiased evaluation of issues from a rural perspective.

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executives as well as local economic development professionals regarding the long-term future of the program.

Accordingly, given both the changes and the impending threats to the JOBZ program that have emerged in the past 12 months, the purpose of this policy brief is learn how this increased level of uncertainty has affected the performance and application of the program. Are businesses that generally seek a stable policy environment less likely to pursue participation in the JOBZ program? How do local economic development professionals address questions regarding this uncertainty? And what do both businesses and local development professionals think about these changes?

II. Methodology

To answer these questions, two sets of data were utilized. First, we examined the database of subsidy agreements completed in the first 21 months, or seven quarters, of the program (January 2004 through September 2005). Given that much of this perceived uncertainty emerged after the first 12 months of the program, one may be able to discern patterns by examining the number, size and location of these agreements across this time frame.

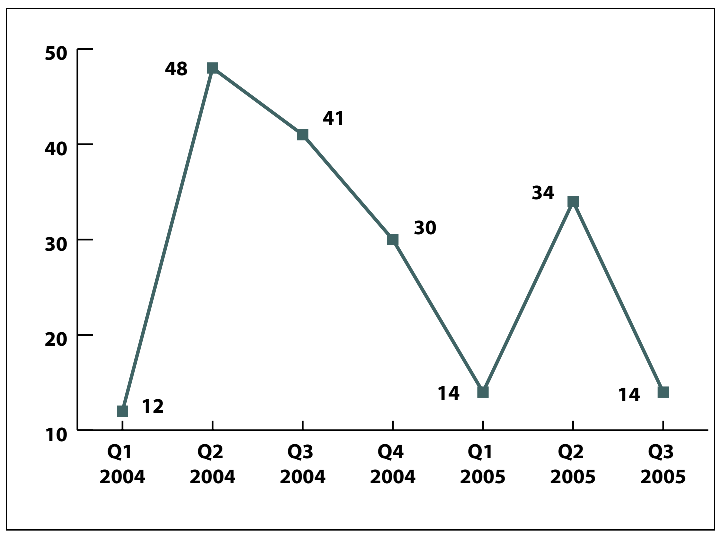
The second set of data was collected through telephone interviews conducted with the JOBZ Subzone Administrators who successfully completed at least one business subsidy agreement in 2004. These Subzone Administrators are generally the local economic development professionals in their respective rural communities and are responsible for putting together these business agreements. In 2004 there were well over 100 business subsidy agreements completed through the JOBZ program facilitated by 82 Subzone Administrators. It was these 82 Subzone Administrators that we sought to interview for this report. The response rate from these Subzone Administrators was outstanding, with 80 of the 82 administrators participating in the study (97.6%).

It should be noted that the public accessibility of the data concerning the number of JOBZ deals, the number of new jobs and capital investment being pledged, and even the names of the businesses involved speaks to the high level of accountability that is being placed on this program by program administrators. In March 2003 when we were seeking similar data from the state offices in Michigan and Pennsylvania, such information was nearly impossible to obtain.

III. By the Numbers

Chart 1 documents the number of signed business subsidy agreements through the JOBZ program for its first seven quarters. Within this timeframe a total of 193 business subsidy agreements were formally signed, but as the chart shows, the number of JOBZ agreements signed each quarter is far from uniform. If anything, it appears that there may be somewhat of a seasonal pattern emerging, with few agreements being signed in the first quarter of the year (i.e. winter), followed by a significant increase in activity in the spring of both 2004 and 2005. Clearly, the overall number of agreements signed in 2005 for the first three quarters was significantly lower than in 2004, possibly suggesting that some of the program uncertainty discussed above may be having an impact. However, such a conclusion would be no more than speculative.

Chart 1: Number of deals completed 2004-2005.



The Department of Employment and Economic Development categorizes all of the JOBZ deals into four categories. These categories include *New Start-ups*, where businesses are established that were not previously doing business prior to the JOBZ deal; *Expansions*, where existing businesses add capacity to their physical plant and/or workforce in the JOBZ zone, while maintaining their existing operational capacity; *Relocation*, where existing businesses cease operation in their existing plant location to relocate and add capacity in the JOBZ zone; and finally *Move-*

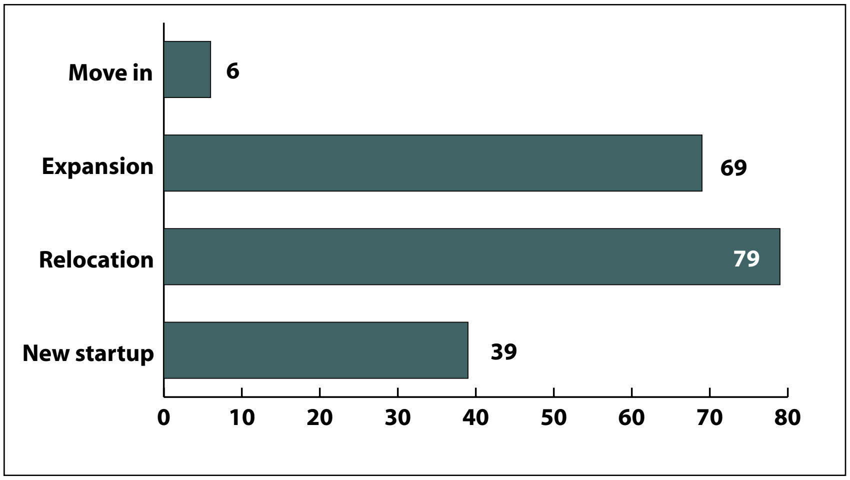


Chart 2: JOBZ deals by type.

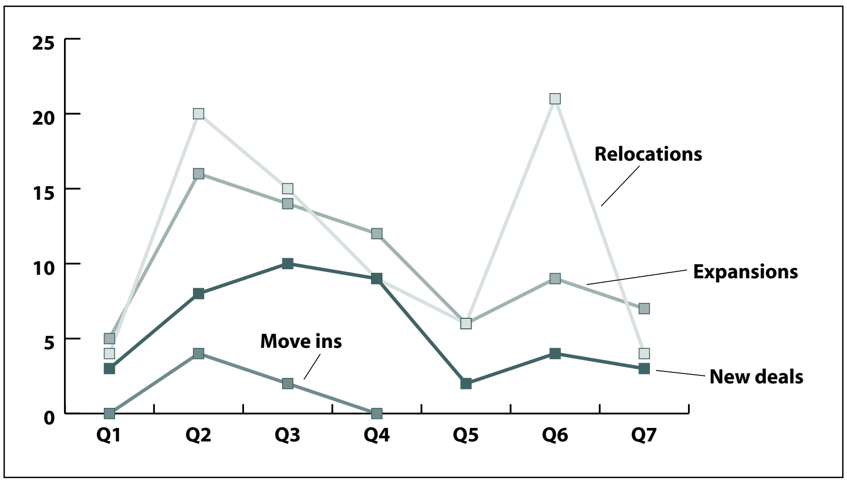


Chart 2a: JOBZ deals by type per quarter.

ins, where existing businesses that currently do not have a presence in Minnesota locate facilities in one of Minnesota's JOBZ zones. In such cases the existing business may or may not continue its operations in other states. Rather, what is unique here is that an operation "moves into" Minnesota through an expansion or relocation.

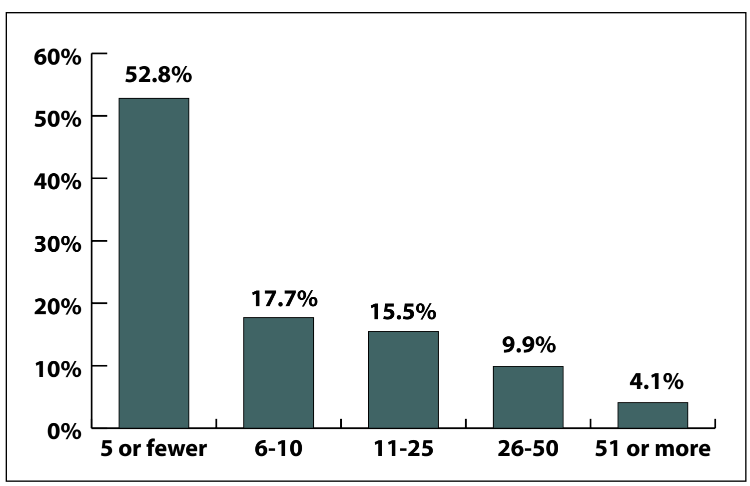
Chart 2 shows that the majority of the JOBZ deals to date are existing Minnesota businesses that are either relocating to the JOBZ zones (79 deals) or expanding into the zones (69 deals). Approximately 20 percent of the deals (39) involve the start-up of new businesses and only six deals (3%) were out-of-state businesses that were moving into Minnesota.

Chart 2a documents the number and types of deals completed for each of the seven quarters from January 2004 through September of 2005. The seasonal pattern noted earlier appears to hold somewhat with relocations and expansions; however, agreements around new businesses as well as move-ins appear to be significantly lower in 2005 than in 2004.

Similar to findings that we documented in our Year I progress report (February 2005), the JOBZ deals signed through September 2005 continue to reflect a pattern where a large percentage of the deals generate a small number of new jobs and a small percentage of deals generate a large number of new jobs. This continuing pattern is best demonstrated on Chart 3, which shows that approximately 53 percent of the JOBZ deals actually generate five or fewer new jobs. On the other side of the continuum, 14 percent of the deals generate 25 or more new jobs; and 4 percent of the deals generate 50 or more new jobs.

In an effort to reduce the large number of JOBZ deals that generate a small number of new jobs, the Minnesota Legislature in 2005 passed an amendment to the JOBZ legislation requiring that all new JOBZ business subsidy agreements that involve relocations must document the creation of at least five new jobs or

Chart 3: JOBZ deals by number of jobs created.



a 20-percent increase in relocated employment (whichever is greater).

Chart 4 examines the average wages paid in association with the 193 signed JOBZ business subsidy agreements. Similar to the distribution of new jobs created, the distribution of average wages paid is also skewed. As the chart shows, approximately 36 percent of the JOBZ deals created jobs that paid an average wage of $10 per hour or less, and 38 percent of the deals paid an average wage between $10 and $12 per hour. The remaining 25 percent of JOBZ deals created jobs that paid an average wage of more than $12 per hour, with 11 percent of deals paying wages of more than $14 per hour. In addition, recent 2005 legislative changes in the JOBZ program now require participating businesses to pay employees at least 110 percent of the federal poverty rate annually adjusted for a family of four.

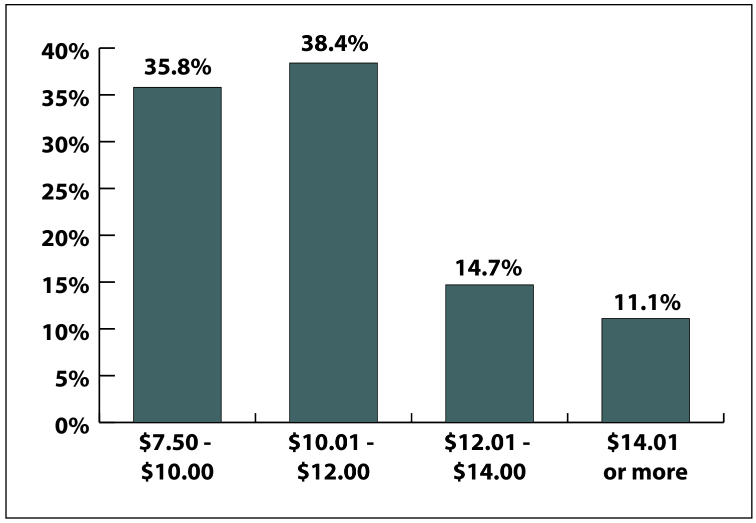


Chart 4: Average wages.

Overall, a review of the secondary data suggests that the program will not be quite as active in 2005 as it was in 2004 but that the structure and size of deals associated with expansion and relocation projects in 2005 appear to be quite similar to those of the year before. However, data in the most recent quarter suggests that this too may be changing. In fact, in examining all of the deals, one finds that the median number of new jobs created per deal is five and the median wages paid per job was $11 per hour. However, in the seventh quarter (July 1 through September 30, 2005) the median number of new jobs created per deal jumped to 8.5 and the median wages paid increased to $12 per hour. This increase in the quality of the deals signed in the last quarter of the study may reflect some of the legislative changes made to the program, or may be a statistical artifact. Time will certainly tell.

IV. Voices from the Field

To further address this issue of uncertainty and its effect on the implementation of the JOBZ program, we interviewed those JOBZ Subzone Administrators who successfully completed a business subsidy agreement in 2004. In fact, while there are more than 300 JOBZ subzones throughout the state, only 82 of these local Subzone Administrators successfully completed a business subsidy agreement in 2004. Accordingly, these Subzone Administrators were the local economic development practitioners that we believed were best able to provide perspective on the impact of these changes.

In these interviews we specifically asked about three issues and how they affected the way they approach businesses or respond to businesses when such issues arise. These issues were (1) the application of the prevailing wage statute to the JOBZ program; (2) the pending lawsuit that argues that the JOBZ program is unconstitutional; and (3) changes in the program made by the legislature.

The Prevailing Wage Issue: As noted earlier, in the fall of 2004 the Office of the Minnesota Attorney General released an advisory letter stating that the prevailing wage statute should apply to private development projects that are receiving tax incentives through the JOBZ program. Up until the time that the opinion was released, economic developers believed that the prevailing wage statute only applied to public projects (e.g., roads, bridges, school construction, etc.). Further, there was a concern that the application of the prevailing wage clause may be problematic as it would increase the construction costs of these development projects. Accordingly, we asked these Subzone Administrators how problematic they perceived the application of the prevailing wage clause to be in their promotion of the JOBZ program.

Respondents were asked to rate the size of the problem on a scale from 1 to 10, with 1 representing "no problem" and 10 representing "a very large problem." The resulting median response was 6.5, suggesting that they viewed this issue to be a significant problem. In Chart 5 the responses are partitioned in equal increments of 2, meaning that scores of 1-2 were labeled as “no problem,” while scores of 9-10 were labeled as a “very large problem.” With 50 percent of the respondents in the range of 7-10, we found that their perceptions were definitely skewed toward viewing the prevailing wage clause as problematic.

We then asked the respondents if they have had any businesses withdraw from any previously signed business subsidy agreements due to the application of the prevailing wage clause. While many of the developers perceive the prevailing wage clause as a problem, only 6.3 percent actually reported that businesses that had previously signed JOBZ subsidy agreements dropped projects due to the application of the prevailing wage clause.

Finally, local developers were also given the opportunity to comment as to why they believed that the application of the prevailing wage statute was problematic. Three comments were heard repeatedly:

1. That the application of the prevailing wage clause increased construction costs to a point where it could become cost prohibitive for businesses.

2. That the method by which prevailing wage rates are calculated did not appear to actually reflect what they believed to be average wages in their area for such construction work.

3. That tying the prevailing wage clause to the JOBZ program undermines the intent and advantages of the program.

With that being said, it is important to note that several of the Subzone Administrators interviewed expressed concern about the prevailing wage clause simply because they did not have enough information on it. And finally, some respondents also made a point of reporting that the prevailing wage clause was not a problem for them, as they strongly supported what they described as a “living” or “humane” wage.

The Pending Lawsuit: As mentioned above, in March 2005 a lawsuit was filed in Ramsey County arguing that the JOBZ program violates the Minnesota and U.S. constitutions. The primary argument of the suit is that by making decisions regarding which businesses may or may not receive tax exemptions, the program surrenders the right of taxation to a state agency (DEED) and local economic developers. Regardless of the merits of this argument, such a suit creates a level of uncertainty that may be problematic for businesses.

An example of the consequences of this was recently found in Waseca County, where a business was planning the development of one of the state’s largest ethanol plants. Earlier in 2005 the business requested that the proposed ethanol plant receive JOBZ program benefits; in August, however, the developers dropped their request, opting rather for direct property tax abatement from the Waseca County Board. Accounts of this new request in the local newspapers reported that the uncertainty of the JOBZ program led the project developers to request the local tax abatement, which they perceived as more stable.

Approximately one-third of the Subzone Administrators interviewed reported that prospective businesses made comments about the pending lawsuit.

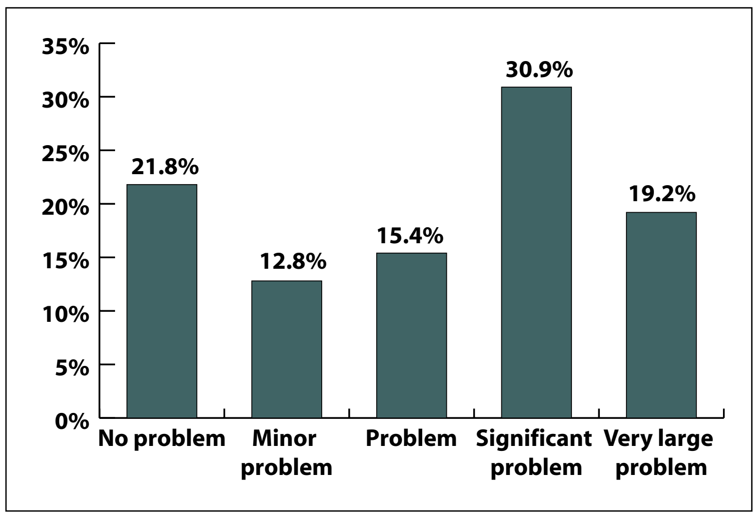


Chart 5: Percentage of Subzone Administrators who see the prevailing wage provision as problematic.

When respondents were asked what types of comments they generally received from business representatives, the most common response was simply that businesses wanted more information about the lawsuit. In fact, only five respondents (6%) suggested that businesses were actually worried about the lawsuit. And when asked how they as development professionals respond to these requests for further information, the majority report that they note that they take a “business as usual” perspective. Further, they do their best to provide as much information as they have regarding the lawsuit. However, a few of the respondents noted that the lawsuit does present a modest barrier to using the JOBZ program.

Legislative Action: As noted earlier, during the 2005 legislative session there were several proposals to amend the JOBZ program in addition to one Senate bill to completely eliminate the program. We asked the Subzone Administrators whether businesses often ask questions or make comments about the potential elimination of the JOBZ program. To that question respondents overwhelmingly reported that very few businesses made comments about these legislative proposals. In fact, they reported that only 20 percent of businesses ever commented about any of these legislative proposals.

However, while businesses may not have made comments regarding these legislative proposals, it does not mean that the subzone administrators themselves were not without comment. Toward the end of the survey we gave respondents the opportunity to express their concerns or comments regarding the JOBZ program, and 65 percent of the respondents provided such comments.

A brief review of all the comments allows us to categorize the majority into several groups:

1. The largest group of comments, expressed by 48 percent of those who responded, was a simple expression that JOBZ is a good tool, especially for small rural and border communities.

2. The second largest group of comments was far more specific, providing suggestions as to how to improve the program, or reduce problems in the administration of the program:
    - A concern that the JOBZ program appears to be more beneficial to rural regional centers than the smaller rural communities it was intended to benefit.
    - There needs to be greater flexibility in assigning of JOBZ acres across communities.
    - There needs to be better training so they can help businesses ensure that they are keeping the correct types of records as time goes on.
    - A continuing concern regarding the impact of the prevailing wage clause on future JOBZ development projects.

3. Another group of comments simply reflects the desire of the subzone administrators that the state legislature not "tinker" with the program. While they generally see the need to modify the program from time to time, they believe that not enough time has yet passed to engage in that modification process.

V. Summary & Conclusions

An examination of the JOBZ database between January 2004 and September 30, 2005, shows the signing of 193 business subsidy agreements, pledging 2,800 new jobs throughout rural Minnesota. While it appears that the overall number of deals signed in 2005 is somewhat lower than in 2004, one could speculate that as the benefit shifts from a 12-year tax exemption to an 11-year exemption (and so on into the future), the likelihood of a lower number of deals might be expected. Further, as speculated above, the impact of the heightened degree of uncertainty surrounding the JOBZ program in 2005 is difficult, if not impossible to gauge.

When one looks at the number of JOBZ deals by the type of deal, it is evident that while business expansions and relocations appear to be somewhat cyclical, the actual reductions in new start-up businesses and those that have moved in from other states has fallen off significantly in 2005. Again, whether this will be a continuing trend or simply a year-to-year fluctuation cannot be determined at this time. However, it is certainly worth watching.

The overall composition of the JOBZ deals has not changed significantly, with slightly more than 50 percent of the agreements creating five or fewer jobs and a median hourly wage of $11. However, we do expect this to change over time, and we in fact may have already begun to witness some of these changes. As noted earlier, in 2005 the Minnesota Legislature made some modifications to the JOBZ program that will greatly reduce the number of JOBZ deals that produce five or fewer new jobs. While the DEED Commissioner will still have the authority to waive these requirements and permit JOBZ agreements that create five or fewer new jobs, one would expect that such waivers would become the exception rather than the rule.

As noted earlier, this appears to be happening when one examines the JOBZ activity in the quarter immediately following the passage of these legislative changes, where the median number of new jobs created per deal increased to 8.5 and the median hourly wage increased to $12. Equally important, none of the deals in this last quarter created fewer than five new jobs.

The argument or suggestion that the heightened level of uncertainty surrounding the program is having an impact on the number of business agreements signed is not completely without merit. While the data presented does not suggest that a majority of businesses are overly concerned with the changes and possible elimination to the JOBZ program, Subzone Administrators interviewed do provide some interesting evidence. First, it is clear that the application of the prevailing wage provision to the JOBZ program has created some barriers to project development. Not only do a majority of Subzone Administrators report the prevailing wage provision as problematic, 50 percent suggest that it is either a "significant problem" or a "very large problem." Further, 6 percent of our respondents report that previously signed business agreements were subsequently terminated due to the application of the prevailing wage provision. Of course, whether this is perceived as a large percentage or small percentage is truly in the eye of the beholder.

Subzone Administrators provided us with an interesting insight into this issue through their comments as to why the prevailing wage clause was so problematic. In essence, while a significant number stated that it increased the costs of construction for these projects, a much larger number professed difficulty with the method used to calculate the prevailing wage in their area. Simply put, they believe that the calculated prevailing wage rate is far in excess of what average wages paid for similar work in their community or region actually are. Accordingly, one might suggest that a review of the current methodologies used to calculate prevailing wage rates, including the possibility of new methodologies, might be in order.

Finally, the uncertainty surrounding the pending lawsuit in Ramsey County as well as changes in the program enacted by the Minnesota Legislature appears to be a minor concern to businesses contemplating the JOBZ program. Subzone Administrators report that approximately one-third (35%) of the businesses they meet with bring up the lawsuit, and that a protocol of "business as usual" continues. However, they themselves have some concerns about the application of the JOBZ program and were given the opportunity to voice their concerns and comments. Those concerns and comments generally reflect views that have been voiced previously in a variety of settings: that the program has not really advantaged the smaller rural communities as originally designed, but rather has been of greater benefit to larger rural communities and regional centers. In addition, Subzone Administrators voiced their desire for greater flexibility in assigning acres and the general administration of the program. And finally, they suggest the need for more information to assist their local businesses in keeping adequate records in terms of follow-up and annual reporting requirements as the program progresses.

Overall, the program does appear to be on track. While the number of agreements that will be signed by the end of 2005 will likely be lower than in 2004, there will still be more than 200 agreements signed within the first 24 months of the program. Further, as noted earlier, data from the last quarter of the study suggests that the quality of the deals appear to be improving, as the number of new jobs created per deal as well as the median wages paid per job both increased significantly in the last quarter. As noted above, only time will tell if this trend continues.

And while there is some degree of uncertainty about the program, there is no compelling evidence directly connecting this uncertainty to the overall performance of the program. However, two areas of concern certainly warrant further follow-up. First, the number of agreements for businesses that are either new start-ups or businesses moving into Minnesota from out of state has clearly declined in 2005. In fact, there has yet to be a single business classified as a "move-in" from out of state participating in the JOBZ program this year (all six of the move-ins occurred in 2004).

Second, it is evident that the overwhelming number local economic developers believe that the application of the prevailing wage provision is a barrier to the implementation of the JOBZ program. Interestingly, though, many of our respondents appear to be more concerned with the calculation of the prevailing wage rate than the application of the provision itself. Accordingly, a thorough review of the methodology calculating regional prevailing wage rates might be in order.

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