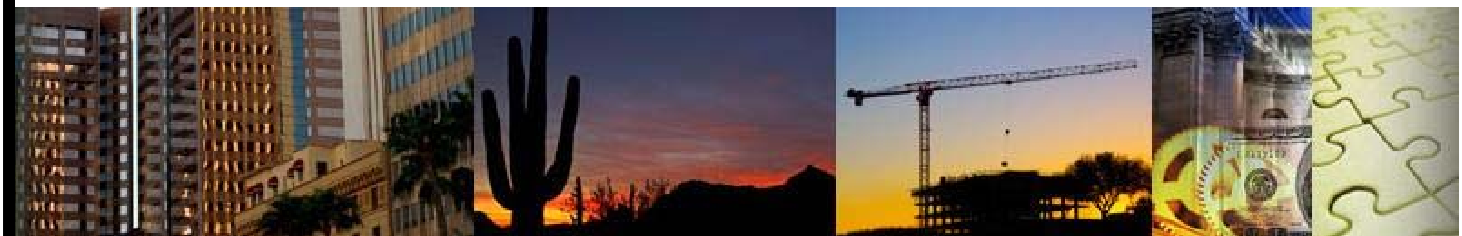
The Job Recovery Package for the State of Arizona



Prepared for:

The Speaker of the House of Representatives, State of Arizona

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Purpose of the Job Recovery Package

The State of Arizona should strive to not just grow, but to *grow well*. Unfortunately, the State's economic performance could be lackluster for some time to come. The current downturn has exposed the weaknesses in the State's economic composition including an overreliance on growth, a relatively uncompetitive tax structure, and a lack of targeted economic development programs. Forecasts identify 2014 as the year that the State returns to the employment levels of late 2007. Population growth is currently anemic and per capita personal income (a measure of standard of living) remains on a general downward trend compared to the rest of the country. Without some policy action the State risks the further decay of its standard of living compared to the U.S. as a whole.

During previous decades the State benefited from specific opportunities that changed the momentum of the economy for the better. One primary example includes the movement of military operations away from the coasts both during and following WWII (which facilitated the development of the local aerospace and semiconductor industries). Strong political leadership also facilitated economic expansion in earlier decades. Unfortunately, there have been few successful attempts at the local level to further diversify the State's economic base during the last couple of decades.

The purpose of this report is to provide a list of recommendations that could assist in this effort and also result in the creation of high quality jobs for Arizona residents. The State's tax code was reviewed for select areas that could be improved upon. The report does not recommend a complete overhaul of statute though. Scores of economic development programs from all parts of the country were also reviewed in order to identify a list of best practices for diversifying the State's economic base. A review of both tax policy AND economic development programs is key to improving the State's economy.

Since many of the recommendations contained in this report have already gone through the "experimental" phase in other states, the level of risk associated with implementation is reduced. However, no recommendations will result in the creation of jobs and the betterment of the State's economic base without the political will to become more competitive. *The goal is not to reinvent the wheel; the goal is simply to bring the wheel to Arizona.*

What Makes an Economy Tick?

One needs to first understand how different types of businesses impact the economy before recommendations can be made. Not all companies are alike. "Base" (a.k.a. export) industries are those that export their products out of a region, and result in the importation of money into that region. The issue of importing dollars into the State is a crucial economic development concept. Once a dollar makes its way into the State, it flows from person to person as demanded products and services are supplied. These local goods and services are provided by "domestic" sector companies. Eventually some money leaves the local economy when products (and some services) are provided by companies outside of the State.

Base industry operations can be considered the engine that drives an economy. The ghost towns of the Old West further illustrate their importance. Once the local mine ran out, the railhead moved, or a drought caused agriculture to no longer be viable, many communities ceased to exist because monies were no longer flowing into the community.

Examples of base industries include the manufacturing sector, export-related business services, tourism, retirement, and federal government employment. Some base industries are high paying while others are relatively low paying. Also, some base industries such as tourism and retirement require marketing but do not require incentives for operations (i.e. they are more captive to the State). The key is to encourage higher value added/higher paying base industry development. Base industry companies also tend to be more capital intensive, and/or utilize skilled labor (not in every case though, i.e. tourism, federal government). As local capital investment improves and as more high skill workers are employed, productivity increases. This also leads to higher incomes and a higher standard of living for employees in these industries.

The aforementioned local serving industries provide goods and services to the local population. Activities include most retail operations, construction, and local service banks, to name a few. The existence of base industries creates demand for these local serving industries. *Without base industries, there is no means of supporting local serving businesses.*

Local serving employment created as a result of export activity is often referred to as "indirect and induced" employment. These are also called multiplier effects. "Indirect" jobs are those created by businesses that provide goods and services to the export-oriented business/industry. "Induced" jobs are created as a result of the spending by direct and indirect employees in the local economy on such things as food, housing, transportation, etc. Many forget that when the higher paying base industries are pursued, new job opportunities arise for all levels of employment from the highly skilled to those with basic skills. Therefore, base industry promotion actually serves all Arizonans. Higher wages in base industry operations directly enhances the multiplier effects in terms of job creation and salaries.

No public policy measure, no matter how well crafted, can result in an immediate and significant change in a large community's economic composition. However, if the proper tools are made available, public policy can indeed begin to attract individual base industry companies to a region rather quickly. Policymakers will not only need to provide these tools but will need to continue to be aggressive about economic development for many more years. This will allow for a gradual improvement in per capita personal income among Arizona residents.

How does Arizona Recover?

The State's economy will recover in time. Even with no new public policy measures, job growth and population growth may again be among the top five in the nation. Those sectors that grew rapidly during the last decade (i.e. construction and other industries related to growth) will generate many jobs. However, the goal of policymakers should be to direct attention to the higher value added industries that tend to pay higher wages, export their product, and generate new economic activity within the State. We can no longer rely on untargeted growth as the State's primary economic driver.

The attraction, retention, and internal growth of these base industries will not only result in higher income levels, but will also result in *__more government tax revenue__* *and will improve upon the standard of living.* Diversifying the State's economic base will also mitigate the ill effects of future downturns. Therefore, in order to recover from the current economic downturn the State must become more focused and competitive in terms of its economic development policies.

Arizona's Competitiveness Today

For decades, Arizona's economic development strategy loosely consisted of its quality of life, sunshine, good transportation system, affordable workforce, and pro-business governments, just to name a few. These factors primarily facilitate the expansion of lower value added industries such as tourism, retirement, and labor intensive operations such as customer service and call centers.

Times have changed and Arizona finds itself several years behind the curve when it comes to strategic economic development across the State. Today, more is needed to lure higher value added industries to the State. Other states (mostly east of the Mississippi River) are providing *limited and* *__very__* *targeted* economic development tools designed to have an immediate influence on business decisions. In combination with aggressive and strategically targeted business development efforts, these incentive tools have been implemented to respond to a company's primary concern of finding the best overall net economic opportunity. Arizona is considered by many as being uncompetitive in this regard. This view can change though as modifications in public policy and how elected officials view economic development practices improves.

Specific Policy Recommendations for the Recovery

As previously noted, there are two components to economic growth that are addressed in this report: 1) the provision of a competitive tax structure, and 2) the provision of competitive economic development programs. Many studies have been written on how tax policy impacts an economy. However, most exclude the necessary economic development component. Competitive tax policy that targets base industry operations gets you "in the game", but competitive economic development policy "closes the deal." This entire report can be reduced down to a singular question: How can policymakers best facilitate the closing of such deals and create higher paying base industry jobs while diversifying the economic base and stabilizing the revenue base?

Job growth and retention is achieved through the attraction and retention of base industry companies and through the internal growth of companies from within the State. There are multiple options for identifying these base industries in statute. States across the country have utilized a combination of industry classification, wage level, percentage of sales outside of the state, and economic & fiscal impact. Specific examples, by program, are provided in the body of the report.

The following recommendations were derived in consideration of this point and place additional weight on the attraction of base industry operations. The recommendations are separated into various types. Some items will have an immediate impact on the State and also do not require a monetary appropriation to implement. Other items could require a legislative appropriation for enactment, at least in the initial stages of the program. In these cases, it is recommended that policymakers first use any remaining federal stimulus monies.

A more complicated problem arises related to focused business retention. The Arizona aerospace industry is of particular importance in this example. A "saved" job is just as valuable as a "created" job. In fact, the level of incentive needed to retain a current job is often less than the level of incentive needed to create a new job. However, current jobs are already contributing monies to the State General Fund. If an industry such as aerospace expands, and the expansion otherwise would not have occurred absent some economic development or tax law policy change, then *redirecting a portion of the related new tax revenues for use on economic development will come at "no-opportunity-cost". This means the State will not lose any tax revenue that otherwise would be here.*

If a program instead focuses on retaining jobs that are already here, then redirecting a portion of the related tax revenues could cost the State when compared to current collections. In these cases, some tough decisions must be made related to the appropriate use of current funds. On the other hand, *if a business is confirmed to be leaving the State absent some incentive program, the incentive can also be considered a no-opportunity-cost provision.* Job retention should be considered, along with both benefits and costs, when adopting the recommendations contained in the following sections. Unfortunately, it is very difficult to identify those companies that are truly considering leaving versus those that are making threats for financial gain.

The following tax policy modifications and economic development programs should be considered during the 2010 Regular Legislative Session and would not require an immediate appropriation except for possible program management or, in select cases, targeted job retention.

- Create a new business real and personal property classification with an assessment ratio equal to the residential ratio of 10%. This class will be available on a discretionary basis to base industry operations only. "Base industries" will be difficult to identify in statute and careful wording must be incorporated into any proposed legislation. Property tax sub-classes that distinguish between a building's precise operational use may be a good starting point. Absent political support for a new property tax class, it is recommended that the legislature continue to lower the assessment ratio on commercial property.

- Create a "Quality Jobs" program that provides incentives for the creation and retention of high paying jobs at base industry companies. This type of a program is typically funded through withholding taxes that otherwise would not be collected absent the new business location and new job creation. Job *retention* could have a cost unless the "retained" job would have left the State absent the incentive provision. This is not always easy to verify. In this specific case, the retained job can be treated as new for analysis purposes.

- Create a new Job Training program to replace the one that was recently suspended. This program would also be funded through net new withholding taxes instead of the previous legislative appropriation and separate business tax. The same issues related to job retention also apply here.

Incentives for the Quality Jobs and Job Training programs are designed to be primarily revenue neutral or positive in relation to new business development. Any incentive benefits paid to a qualifying company are directly funded from a percentage of employee personal income tax revenue (i.e. withholding taxes) that the new target company contributes. For one example, if incentive benefits are equal to 50% of employee personal income tax revenue, the State collects 50 cents and the Company collects 50 cents for every $1 of net new tax collections. These percentages can vary from program to program. In addition, the State's net benefit can be increasingly positive with the potential generation of net new State sales taxes, unemployment taxes, and corporate income taxes. This would be enhanced further as “spin-off” multiplier jobs are created and the State collects the associated revenues. This basic design effectively requires no cost to the State (except for program management; see recommendations below) and, under the right program details, could produce excess revenues that could seed or fund other economic development programs *such as job retention.*

The next set of policy recommendations are of similar importance as those above and may require an appropriation for enactment. Again, discretionary federal stimulus monies would be of proper use or any net new revenues to the State from the implementation of other economic development programs. The second option will require accurate economic modeling prior to funding.

- Create a “deal closing” fund to provide financing/grants for individualized investment that may be required to attract a particular base industry company. The fund may require an initial endowment of discretionary stimulus dollars or an initial appropriation but could be designed to be self sustaining in the longer term as a result of new businesses locating in Arizona along with their associated tax liability. Too long of a delay in providing seed money for the fund could dampen economic development prospects and high-quality job creation in the State.

- Reduce the corporate income tax rate from 6.968% to 5.0%. This will make the State more competitive in terms of the visible, up front tax rate. This will allow for better marketing of the area and will be in closer alignment with the State’s top individual income tax rate. It should be noted the State’s effective corporate income tax rate is not overly oppressive on those businesses that fuel the economy, but it is high enough to make the State appear less competitive in terms of business relocation or expansion decisions. Only a moderate rate reduction is recommended and must be combined with enhanced marketing of the State.

The final set of policy recommendations require additional study to strategically implement for purposes of achieving the State’s economic development goals and still may be considered in 2010. Appropriations may also be necessary in certain cases.

- Modify the State’s Enterprise Zone Program to be base industry oriented and to better target new growth. Currently, to receive the designed property tax assessment ratio of 5%, a company must first meet certain criteria that typically do not apply to export industry businesses. The businesses are already eligible for corporate income tax relief though. The current program design is of limited economic development value and needs to be enhanced. The appropriate vehicle for this modification could be through a broader review of state economic development programs and tax credits by legislators and economic development professionals to ascertain what programs/credits work and which programs/credits need to be modified or eliminated altogether.

- Adequately fund a State entity that promotes economic development along with improvements in branding. All successful business recruitment states rely on an adequately funded *state* entity to serve as the primary point of contact to coordinate with the State's economic development entities. One recommendation is that any new or modified State entity must utilize a seasoned economic development director that is appointed by individuals from the private sector for a limited term. The main point is to limit political influence when it comes to economic development. Other public/private partnering options may also be viable.

- Commission a State economic development strategy that *focuses on coordinated marketing and branding.* The successful business recruitment states also have a specific focus when implementing economic development policy. These documents also outline how the economic development entities utilize each other's services. To date, the documents produced by the State on economic development have been relatively weak in terms of this kind of proactive effort and not in full consideration of site selection and economic facts. Overall, the State currently does not tell its economic story very well.

Many of the above items have not been considered in recent years by State policymakers so additional education is in order. Very detailed justification for these items is included in the body of this report. Ideally, the above eight recommendations should serve as the starting point in the development of an *economic package* that focuses on job creation via base industry growth. However, politics is not always ideal. Given the current economic environment, there is a concern among policymakers about the need to provide broad-based business relief to Arizona employers.

There have also been tax policy and economic development program changes that have indeed been considered recently and appear to have political support. These items are likely to be more familiar to the legislature and legislative analysts. It is well known by now that Arizona has historically been kind to households but tough on businesses regarding tax policy, as noted throughout this report. While the following items are not part of this report's formal recommendations specifically related to base industry development, they have addressed issues related to excessive business taxation and the desire to assist in internal economic growth. These items are listed for reference purposes only but are likely to be considered by policymakers again in 2010.

- Eliminate the State Equalization Tax. While not a targeted approach, such a business tax reduction would address the issue of Arizona being kind to households but overly tough on businesses. Both base industries as well as local market industries would receive this reduction in tax burden.

- Flatten or enact a truly "flat" individual income tax. Arguments have been made that a reduction in the higher income tax brackets may result in enhanced, long term small business development. This relates to the issue of improving the State's ability to grow from within. It is possible to do this with no net cost to the State General Fund. This policy issue would have less of an impact on out-of-state business relocations though.

Longer Term Issues:

- Establish tax increment financing (TIF) legislation. There are issues related to whether or not this would be constitutional based on previous legal interpretations and would likely require the expenditure of some political capital to implement. However, Arizona is the *only* state that does not utilize this tool and policymakers should be open to at least considering such a program with adequate public debate. Properly designed TIF programs can be revenue positive.

- Track immigration reform. It is not appropriate to ignore current laws regarding immigration policies as many politicians suggest. However, agricultural communities have already realized problems related to worker supply and have realized reductions in production and a shifting of food processing out of their areas. The next worker shortages will be realized within the tourism and construction industries after the economic recovery is in full force. This could result in wage inflation and may have negative economic consequences. This issue is beyond the scope of this report but policymakers will need to pay attention to any related Federal reform on this topic.

Current State Tax Structure

Many have recently argued that the current State tax code is outdated and, as a result, has produced record budget deficits. Unfortunately, this may be an oversimplification of the facts. The recent deficits are the direct result of a very harsh economic downturn, the State's dependence on growth, and poor decisions that were made by policymakers. These are deficiencies that can change over time.

One well publicized point that may not be accurate is the State is overly reliant on the sales tax. Basic economic theory finds that a tax on consumption (i.e. a sales tax) is far less disruptive than a tax on production (i.e. an income tax). Furthermore, a simple review of historical tax collections data identifies that the sales tax is actually far less cyclical than the income tax and is also easier to predict based on economic variables. Finally, the current deficits could have been more manageable with proper fiscal policy through recent years including the maintenance of an adequately funded Budget Stabilization Fund and spending constraints. However, a review of additional tax law changes as it relates to fiscal stability would still be a worthy endeavor. This is beyond the scope of this particular report.

As previously noted, one point that is indeed accurate is that Arizona has historically been kind to households but tough on businesses. The State appears to be non-competitive in its corporate income tax rate and also in its business property taxes. The property tax issue is the foremost economic development concern. Business property is assessed at twice the rate of residential property. The aforementioned modifications to the business real and personal property taxes, as they relate to base industry development, are a critical component of any State economic recovery package. This modification could serve as a business expansion/relocation/retention "deal closer." The corporate income tax modification is the type that would get us "in the game" more often but would need to be paired with aggressive marketing of the State and the enactment of other economic development tools. This tax cut would benefit both base and local market industries but the negative consequences in this particular case are likely to be offset by the positive effects of being more competitive in terms of overall tax rates.

Keep in mind that Arizona cannot be "number one" in every economic development category. A State cannot be first in low tax rates and also be first in education and infrastructure spending. Having a competitive tax structure, adequate spending in those areas that impact economic development, along with very focused and efficient economic development programs, will have a far greater impact on the State's economic health than leading the nation in any one area.

State Business Climate Rankings

There are both positive and negative points that can be made of state ranking articles. Some articles are written by individuals that are doing nothing more than pushing a personal agenda. For this reason it is important to be selective in what documents are used. For some perspective, a set of very select ranking articles were reviewed to identify any consistent facts. Unfortunately, the findings indicate that Arizona is far from competitive.

Company executives, economic development agencies, and site selection consultants actually keep a close eye on a state's business climate ranking. Whether to confirm a perception or satisfy curiosity, business climate rankings tend to be one of the first items of business when considering new locations for operations. A number of business climate rankings are periodically published by Site Selection Magazine, Business Facilities, CNBC, Forbes, Chief Executive Magazine, and IBM Global Business Services, just to name a few. The validity of the methodologies used in each business climate ranking survey can certainly be argued. However, right or wrong, the typical CEO tends to rely on these rankings at face value. Arizona's ranking in these surveys should not be the primary focus of a state's economic development policy, but it is important to recognize the perceptions among the general business community. A top 10 ranking in the major categories should certainly be attainable for Arizona.

State Business Climate Rankings

	2009 Business Climate Rankings	2009 Top Ten Competitive States	2009 Top States & Provinces in North America	2009 Best & Worst States for Business	2009 America's Top States for Business	2009 The Best States for Business	2009 Top 10 States for Business Climate
	Site Selection Magazine	*Site Selection Magazine*	*IBM Global Business Services*	*Chief Executive Magazine*	*CNBC*	*Forbes*	*Business Facilities*
1	North Carolina	Ohio	Ontario	Texas	Virginia	Virginia	Texas
2	Texas	North Carolina	Virginia	North Carolina	Texas	Washington	South Dakota
3	Virginia	Michigan	Ohio	Florida	Colorado	Utah	Wyoming
4	Ohio	Pennsylvania	South Carolina	Georgia	Iowa	Colorado	Utah
5	Tennessee	Kentucky	Pennsylvania	Tennessee	Utah	North Carolina	Florida
6	South Carolina	Texas	Quebec	Nevada	Minnesota	Georgia	Delaware
7	Alabama	Tennessee	North Carolina	Virginia	Kansas	North Dakota	Washington
8	Georgia	Alabama	California	Arizona	Massachusetts	Texas	Montana
9	Indiana	Indiana	Illinois	South Carolina	North Carolina	Nebraska	Oregon
10	Kentucky	South Carolina	Indiana	Colorado	Georgia	Oregon	New Hampshire
Arizona	**24**	**--**	**--**	**8**	**18**	**36**	**--**

Source: Elliott D. Pollack & Company; Site Selection Magazine; IBM Global Business Services; Chief Executive Magazine; CNBC; Forbes; Business Facilities.

What Drives Business Locations?

Site Selection Magazine conducts an annual survey of corporate real estate executives from a broad array of industries. This survey asks each executive to list the main site selection factors they consider when evaluating a location decision. Infrastructure, workforce, and tax climate are on the top of the list. Following these items are availability and cost of real estate, and regulatory concerns. Economic incentives tend to be one of the final factors in a location decision. Again, a competitive tax structure (and an adequate supply of affordable or skilled labor, etc.) may get us on the list of considered sites, but the incentive programs tend to separate the winners from the losers. In some cases, such as in the recommendations included in this report, improving workforce skills can be part of the incentive package (Quality Jobs Program) as can infrastructure improvement or the offsetting of start-up costs (Deal Closing Fund, etc.).

Top Site Selection Factors
2009 Corporate Real Estate Executive Survey

1	Transportation infrastructure
2	Existing workforce skills
3	State and local tax scheme
4	Utility infrastructure
5	Land/building prices & supply
6	Ease of permitting & regulatory procedures
7	Flexibility of incentives programs
8	Access to higher education resources
9	Availability of incentives
10	State economic development strategy

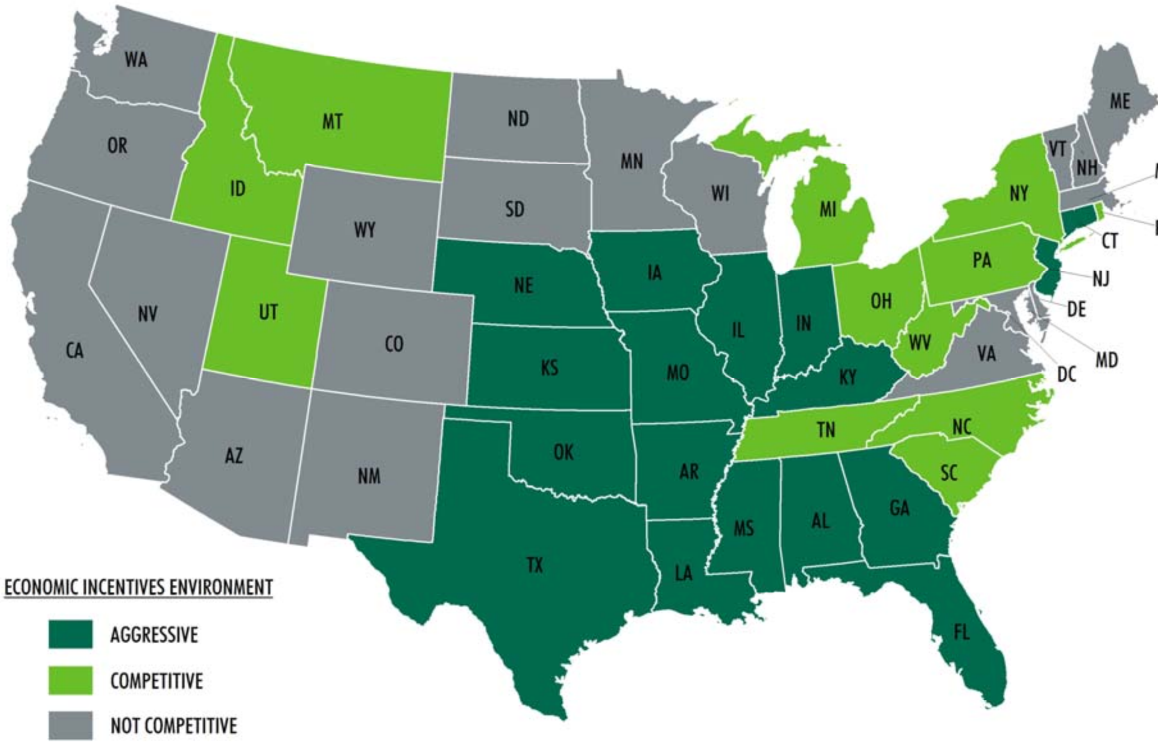
Source: Site Selection Magazine

The results of the Corporate Executive Survey provide a practical and realistic picture of site selection today. Based on a fifteen year history of site selection engagements conducted by the CBRE Labor Analytics Group and Economic Incentives Group, the availability and cost of adequate labor, land, and facilities are usually the most important initial site selection factors. *Incentives become more decisive when competing markets have relatively similar labor costs, tax structures, employee skill levels, etc. Again, being broadly competitive in terms of tax rates gets us in the game, but the economic development packages close the deal.*

How Competitive is Arizona with Economic Incentives?

All things considered (including geography, transportation infrastructure, supply chain, labor cost and availability, and other factors), economic incentives play a critical role in recruiting and retaining strong economic development prospects across the U.S. The following map illustrates each state's relative competitiveness with economic incentives. This map is produced by CBRE's Economic Incentives Group and is based on the Group's extensive experience with economic incentive negotiations across the U.S. during the past five years, each state's main economic incentive programs, and recent precedence for offering discretionary incentives. Arizona is currently considered "Not Competitive" in this particular assessment. *Keep in mind that the map does not highlight a state's economic health or ability to grow. It highlights those states that have implemented economic development programs that are likely to have a significant impact on their ability to create new, higher wage jobs over time.*

Economic Incentives Environment in 2009



Source: CBRE Economic Incentives Group

Case Study: A General Comparison of Incentives by State

All 50 states have a number of economic incentive programs. These programs vary by type, availability, target industries, performance metrics, and methods of payment. For purposes of comparing Arizona to each state and for simplicity, the following example is limited to six incentive programs available for general commercial and industrial businesses. Exclusions to this analysis are direct business financing, municipal grants & loans, local incentive programs, and other state programs not directly available to economic development prospects.

Job Tax Credit:

- 38 of 50 states offer job tax credits;
- *Arizona – Limited: Enterprise Zone Program*
- These programs provide corporate income tax credits based on job creation and/or retention. Tax credits are issued upon employment verification on an annual basis, allowed to cover between 50% and 100% of tax liability in any given year, and permitted to be carried over to future tax years should tax liability not be sufficient to cover the earned tax credits. Some states allow tax credits to be transferred/sold to third parties. A few states allow these tax credits to be refunded.

Investment Tax Credit:
- 32 of 50 states offer investment tax credits;
- *Arizona – Limited: Renewable Industries ("Solar" legislation)*
- These programs provide corporate income tax credits based on capital investment in real and/or personal property. Tax credits are issued upon investment verification, allowed to cover between 50% and 100% of tax liability in any given year, and permitted to be carried over to future tax years should tax liability not be sufficient to cover the earned tax credits. Some states allow tax credits to be transferred/sold to third parties. A few allow tax credits to be refunded.

Job Training Grant:
- 49 of 50 states offer job training grants;
- *Arizona - Inactive*
- These programs provide grants to offset a portion of a company's training costs. Grants typically cover a defined list of eligible training costs and are typically paid out on a reimbursement basis. These costs include trainer salaries, travel costs, books, materials, training facility rent, and other items. Few states allow reimbursement of trainee wages.

Payroll Rebate:
- 9 of 50 states offer payroll rebates;
- *Arizona - None*
- Payroll rebates involve annual or quarterly cash refunds of a proportion of new annual payroll generated by an approved business. Payroll rebate benefits are expressed as either a percent of gross taxable wages or a percent of withholding taxes. Refunds are typically approved for 3 to 10 years.

Cash Grant / Closing Fund:
- 19 of 50 states offer cash grants or closing funds;
- *Arizona – Inactive/Previously limited (CEDC Fund)*
- Cash grant funds are discretionary incentive programs that provide upfront cash to qualified businesses whose operations have a significant economic and fiscal impact on a State. These cash grants are typically paid upon receipt of full government approvals of an economic development agreement, prior to certificate of occupancy, or within two years. State deal closing funds are part of this category.

Sales/Use Tax Exemption or Rebate:
- 19 of 50 states offer sales/use tax exemptions or rebates;
- *Arizona – Limited (i.e. Film Tax Credit)*
- Sales/use tax exemptions allow for full or partial abatements of sales or use taxes due on purchases of construction materials, equipment, and/or utility usage. Most sales/use tax exemption programs are limited to certain industries, types of operations, or performance metrics (i.e. job creation or capital investment).

Other Tax Exemptions:
- 19 of 50 states offer sales/use tax exemptions or rebates;
- *Arizona – Limited: Government Property Lease Excise Tax*
- Miscellaneous tax exemptions are offered by states to offset burdens of sales taxes, income taxes, use taxes, local property taxes, and fuel taxes just to name a few. These programs

generally are not applicable to the typical economic development prospect. Most other tax exemption programs are limited to certain industries, types of operations, or performance metrics (i.e. job creation or capital investment).

Inventory of State Economic Incentive Programs

(Most widely used economic development programs)

State	Job Tax Credit	Investment Tax Credit	Job Training Grant	Payroll Rebate	Cash Grant / Closing Fund	Sales/use tax exemption or rebate	Other Tax Exemptions
Alabama	X	X	X			X	X
Alaska			X				
Arizona	**X**	**Renewable**	**Suspended**				**X**
Arkansas	X	X	X	X	X	X	
California	X		X				X
Colorado	X	X	X			X	
Connecticut	X	X	X		X		X
Delaware	X		X	X			
Florida	X	X	X		X	X	
Georgia	X	X	X		X		X
Hawaii	X	X	X				X
Idaho	X	X	X			X	
Illinois	X	X	X		X	X	
Indiana	X	X	X				X
Iowa	X	X	X		X	X	
Kansas	X	X	X	X	X	X	X
Kentucky	X	X	X				
Louisiana	X	X	X	X	X	X	
Maine		X	X			X	
Maryland	X	X	X		X		
Massachusetts		X	X				
Michigan	X	X	X				
Minnesota	X		X			X	X
Mississippi	X		X	X			
Missouri	X	X	X	X		X	X
Montana	X	X	X		X		
Nebraska	X	X	X			X	
Nevada			X			X	
New Hampshire			X				
New Jersey	X	X	X	X		X	
New Mexico	X	X	X		X		
New York	X	X	X			X	X
North Carolina	X	X	X	X	X		
North Dakota	X		X				X
Ohio	X	X	X				X
Oklahoma		X	X	X			
Oregon			X		X		X
Pennsylvania	X		X		X	X	X
Rhode Island	X	X	X				X
South Carolina	X	X	X		X		X
South Dakota			X				
Tennessee	X		X				X
Texas			X		X	X	
Utah	X	X	X		X		
Vermont	X	X	X			X	
Virginia	X		X		X		
Washington			X				X
West Virginia		X	X		X		X
Wisconsin	X		X				
Wyoming			X				

Source: CBRE Economic Incentives Group.

Best Practices of Economic Incentive Programs

In consultation with the CBRE Economic Incentives Group, a review was conducted on all 1,300+ economic incentives programs in their database to find the most effective, flexible, targeted, and financially significant state programs across the U.S. These best practices are considered the most effective at recruiting and retaining businesses. The benefits, eligibility thresholds, and funding mechanisms should serve as the basis for any new economic incentive program in Arizona.

Job Training Grant Programs

Forty-nine out of 50 states (Arizona being the exception) currently have an active State job training grant program. Most job training grant programs across the U.S. are funded by general appropriations and reimburse a limited proportion of actual training costs incurred by businesses. Eligible training costs tend to include trainer salaries, books, materials & supplies, travel costs, curriculum & development, and some portion of rent for a training facility.

Iowa, Kansas, and New Mexico have the most effective State job training grant programs in the U.S. according to CBRE. These job training grant programs have unique funding mechanisms and have evolved beyond the standard program to include reimbursement of trainee wages.

Payroll Rebate Programs

Nine out of 50 states offer some type of payroll rebate incentive program. A payroll rebate mostly involves annual or quarterly cash refunds from a state based on a percentage of either new gross wages or new withholding taxes. This type of incentive is designed to be pay-for-performance. Incentives are directly tied to new payroll generation and job creation. Upon payroll generation and remitting withholding taxes to a state, the company is eligible for a cash refund. A state's motivation for offering a payroll rebate incentive is two-fold. First, the periodic refunds directly motivate an eligible company to create new jobs and generate new payroll. Second, the refund is delivered in the form of cash rather than tax credits or tax exemptions.

Beyond the marketing benefits, a well-designed payroll rebate program can be inherently revenue neutral or positive. Cash refunds are only paid out when payroll and withholding taxes are received. Cash refunds will not exceed incoming tax revenue. Arkansas, Kansas, Louisiana, Missouri, and Oklahoma have the most effective payroll rebate programs in the U.S.

Deal Closing Funds

Nineteen out of 50 states offer some type of deal closing fund or cash grant program. A deal closing fund involves upfront cash grants and/or forgivable loans only in highly competitive situations and only for projects with a substantial economic and fiscal impact to a state and community. Deal closing funds are mostly financed through periodic general fund appropriations.

The Texas Enterprise Fund is the most plentiful, active, and highly marketed deal closing fund among the states. Arkansas, Florida, Louisiana, North Carolina, and Virginia have established deal closing funds and have been actively funding projects during 2009, according to the CBRE Economic Incentives Group.

Retention Incentive Programs

Nearly all statutory and discretionary state incentive programs are designed to subsidize the creation of new jobs, new payroll, and new capital investment. These programs inherently cannot support the retention of major employers and their corresponding on-going generation of tax revenues in a state. Even the payroll rebate and deal closing fund programs previously discussed focus on net new business recruitment.

According to the CBRE Economic Incentives Group, there are only six state incentive programs specifically designed to target business retention. These best practices are found in Illinois, Indiana, Kentucky, Michigan, New Jersey, and Ohio.

Business Personal Property Tax Exemption

Recognizing the need to help reduce a company's total cost of doing business, about 10 states have statutorily eliminated ad valorem taxes on business personal property for commercial and industrial uses. This means that neither a municipality, county, or school district accrue property tax revenue from business personal property. The statutorily exempt states include Delaware, Illinois, Iowa, Kansas, Minnesota, New York, New Jersey, Ohio, North Dakota, and South Dakota.

Tax Increment Financing

Forty-nine states and the District of Columbia have enabled the use of Tax Increment Financing (TIF) for qualified economic development opportunities. Arizona is the only state without a tax increment financing law.

Tax Increment Financing allows cities to help offset a company's start-up investment by capturing increased property tax revenues generated by economic development projects. These tax revenues are used to pay back city funds (with interest) injected at the front end of the development of new industrial or commercial facilities. TIF may be used to offset the cost of public improvements and utilities that will serve the new private development, to finance direct grants or loans to a company, or to provide the local match for federal or state economic development assistance programs. TIF has been an effective economic development tool because infrastructure improvements do not leave if a company chooses to leave. Infrastructure improvements funded by TIF are a perpetual benefit.

Final Points

Arizona's competitive disadvantage regarding its economic development programs lies in three primary areas: 1) the lack of strategic focus within its economic incentive programs; 2) the marketing of those programs and location successes; and 3) the perceived lack of leadership and overall economic governing strategies.

Policymakers must propose the creation of new, self supportive economic development programs *along with* accompanying tax law modifications and then provide support with a long term commitment to quality growth in the State. Any new incentive program that is dependent on business investment and job creation needs to be closely monitored.

Monitoring programs is critical. If a business does not perform as expected, "clawback" provisions should be used to recoup a portion of State incentive expenditures. The new programs should also be reviewed on a regular basis to ensure that they are working as intended and providing a benefit to Arizona. Therefore, sunset review provisions are also recommended. Since multiple programs are being recommended, it is also critical to assure that no "double dipping" of incentives occurs. In other words, in some cases, the relocating or expanding company may need to select only one program to utilize. It may also be worth while to design some form of a cap on select programs until they are later evaluated for effectiveness.

1.0 Introduction

1.1 Purpose of Study

Elliott D. Pollack and Company was retained by the Speaker of the Arizona House of Representatives to serve as a special economic consultant with the primary responsibility of assisting with the development of the Job Recovery Package for the State of Arizona. The mission statement associated with this effort is:

"To immediately improve the State's economic potential by encouraging job creation through business location and retention while also improving the long term potential of the State by encouraging growth from within our own borders."

A review of State spending policies and broad based tax policy reform is beyond the scope of this report but needs to be considered by the Legislature and Governor during the 2010 legislative session.

The State should strive to not just grow, but to grow well. The following report examines a number of *tax law* modifications and *economic development programs* that should be considered to achieve this goal. Tax policies and economic development programs from all parts of the country were reviewed in order to identify a list of best practices for diversifying the State's economic base. Since many of the recommendations contained in this report have already gone through the "experimental" phase in other states (i.e. they have already been utilized successfully, for many years in some cases), the level of risk associated with implementation is minimal. ***The goal is not to reinvent the wheel; the goal is simply to bring the wheel to Arizona.***

In most cases, the recommendations contained in this report will have no direct cost to the State's General Fund. This is because the recommendations are funded from new business activity that otherwise would not have occurred. If a financial incentive is designed to be less than a company's net new tax contribution, then the incentive can be referred to as having "no-opportunity-cost".

In addition to focusing on no-opportunity-cost recommendations, the authors of this report purposely limited the set of recommendations to just a few items that: 1) would offer the greatest immediate benefits, and 2) actually have a chance of becoming law. Unlike previous efforts, such as the Citizens Finance Review Commission, that included dozens of statutory recommendations, this report includes only a few practical items for consideration.

The authors of this report want to be clear that the purpose is not to identify additional tax revenues or budget cuts to help balance the State's current budget deficit. However, if the accompanying economic development recommendations are implemented properly, enhancements to economic activity will indeed occur which will translate into job creation and more tax revenue at both the State and local levels. *Therefore, the proposed programs may actually mitigate the negative economic consequences of any budget balancing options that are being considered at the State Capitol.*

It should also be made clear that the recommendations contained in this report will not bring stability to State tax revenues. *There is no tax structure that is resistant to the ebb and flow of the business cycle despite some assertions to the contrary.* This means that policymakers will need to think beyond their election cycle when implementing budgets. Deficits have occurred during past recessions and will occur again in the future. However, if proper public policy can encourage some additional diversification within our economy the down periods may not be as severe as what were recently witnessed.

As a final introductory point, there is likely to be some debate over the fact that the accompanying recommendations, if implemented, will target a particular type of employer (i.e. "base" or export related industries; discussed extensively in Section 2.0). Furthermore, the recommendations include both tax law changes as well as the creation of economic development programs. This approach is different than what many tax policy advocates have pursued in the past. However, in this particular case, job creation and retention has become very competitive and Arizona's economic future is more at risk than during prior decades. The recommendations contained in this report have been proven to boost local economies in other states and encourage economic diversification.

This report tries to present practical ideas, albeit some that will require difficult choices. No preconceived political or economic positions were considered in the drafting of this report.

1.2 Acknowledgements

A number of tax and economic development professionals from across the State and nation assisted with the development of the accompanying recommendations. Their insight proved to be invaluable. The authors of this report also wish to specifically thank Mr. John Lenio from CB Richard Ellis Economic Incentives Group for his extensive input, research, and guidance on nationwide best practices regarding corporate site selection, business attraction, recruitment, and economic incentives. All CBRE input and figures included in this report are current as of the fall of 2009. Additional thanks and appreciation is extended to Mr. Alan Maguire who similarly assisted with the thoughtful development of the report's recommendations.

Additional thanks is also extended to those individuals that reviewed the document prior to completion and provided critical feedback on economic development policy. The individuals are:

Ms. Ioanna Morfessis, Io, Inc.
Mr. Scott Powell, Town of Florence
Mr. Kent Ennis, Economist
Mr. Dave McAlindin, City of Glendale

It is recommended that the State's policymakers proactively engage the local economic development community throughout the 2010 legislative session to assist in developing the statutory details that will be required to give the recommended programs the best possible chance of being implemented.

2.0 Arizona's Economy and Method of Taxation

Section Synopsis: Arizona was impacted by the recent recession much more so than most other states around the country due to its overreliance on growth. While financial oversight issues and overly aggressive investment activity certainly played a role in the financial meltdown of late 2008, it is the excesses that occurred in the housing industry that propelled the country and State into recession. Overextended consumers, federal government policy, and problems in commercial real estate will indeed depress the pending economic recovery.

Arizona will be best equipped to deal with the problematic recovery by making a few changes to its tax and economic development policies. Based on research conducted in preparation of this report, it was found that a competitive tax policy assists states in making the short list in business location decisions while economic development policies later close the deal. This section of the report primarily addresses current economic conditions and tax policy while Section 3.0 addresses economic development programs.

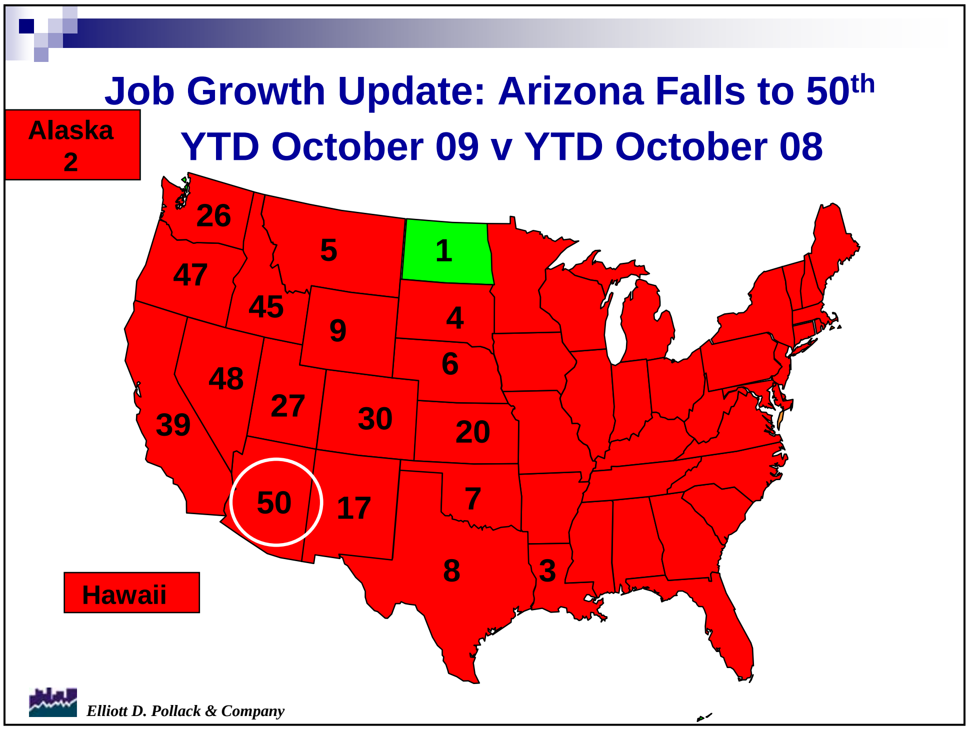
Regarding taxation, Arizona has historically been kind to households but tough on businesses. This is most evident in property taxes and, to a lesser extent, in corporate income taxes. The following text explains why the State is non-competitive in these two taxes and concludes with specific recommendations related to eliminating this particular barrier to economic development and local job creation.

2.1 The Current Economic Environment

2.1.1 What Got Us Here?

History has shown Arizona (and Greater Phoenix in particular) to have been among the nation's fastest growing areas in terms of population and employment. However, during the current downturn, Arizona has been negatively impacted much more than the nation as a whole. This is due in part to the national economic recession, local overbuilding in both the single family and commercial real estate sectors, and also due to an overreliance on growth as an economic driver. Housing downturns have happened before but not to this extent, especially within the single family market.

For some discouraging perspective into the State's economic troubles, as of October 2009, Arizona ranked 50th in the country in terms of year-to-date job losses. Statewide, job losses have exceeded 300,000 since the peak and losses are projected to continue through an extended portion of 2010. Population inflows have also weakened to the point where local experts now believe that overall growth was negligible for all of 2008 and is likely to be the same in 2009.

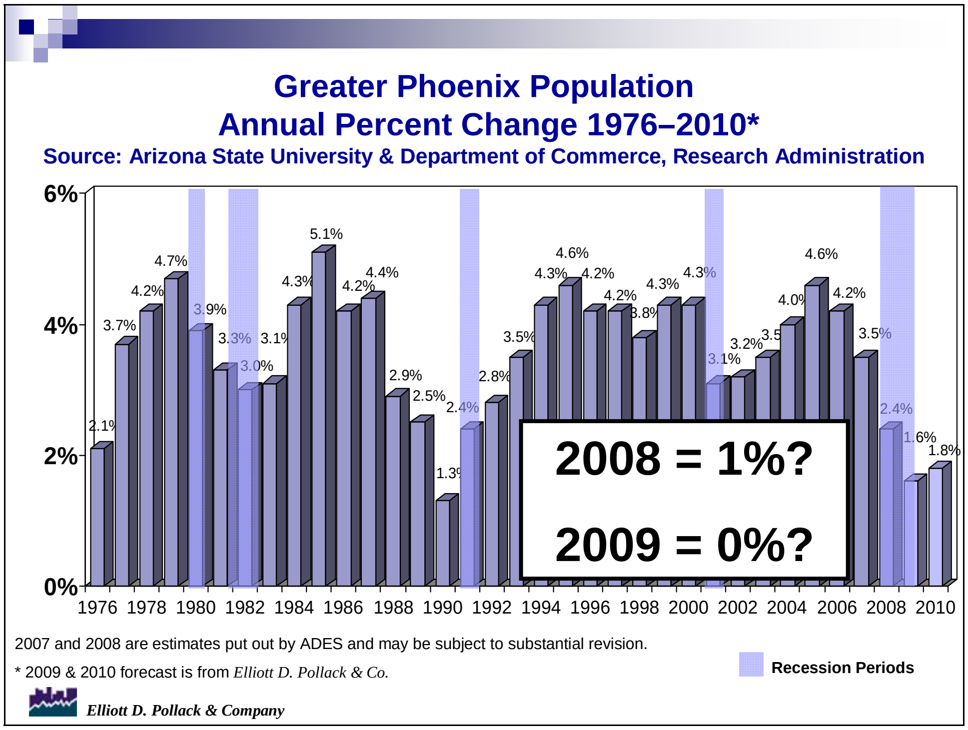


<u>A Review of Basic Indicators</u>

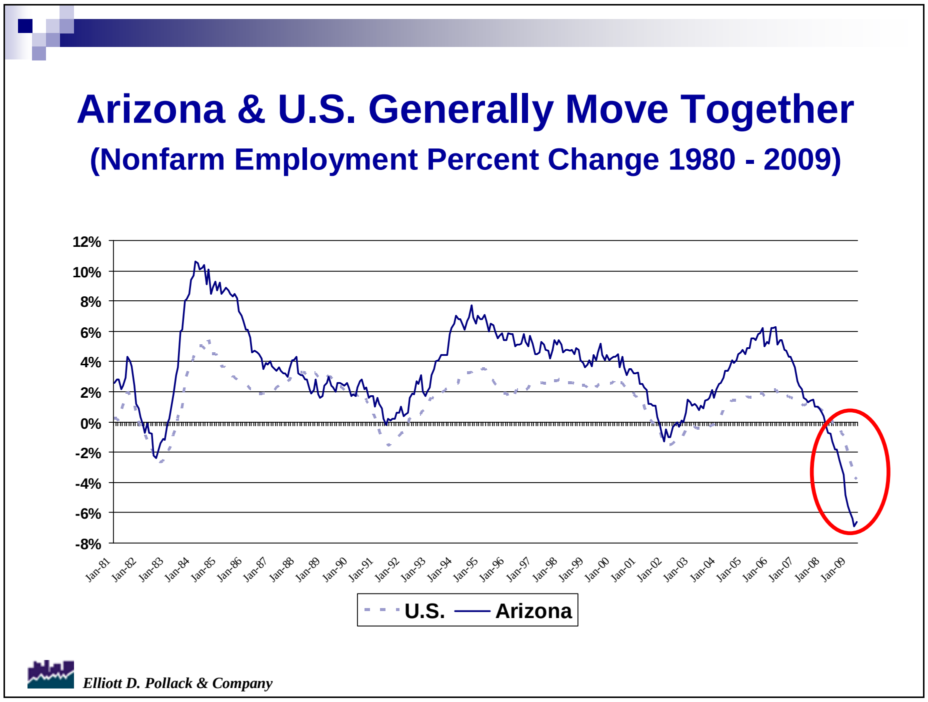
When studying the economy, there are scores of economic indicators that can be reviewed. In this case, the health of the local economy comes down to three basic factors: population growth, job creation, and per capita personal income.

Regarding population growth, as an example, since 1976 the rate at which population grew in Greater Phoenix was never less than 1.3%. In 2008, official government estimates reveal a more modest growth rate of 2.4%. Some speculate that this figure may be overstated, but the extent is unknown. Official forecast estimates are benchmarked based on this higher “official” number and are similarly unreliable. The authors of this report believe that population growth in 2008 was no more than 1.0% and in 2009 was flat. This assertion appears somewhat validated in the recent release of official 2009 Arizona population estimates which show a statewide population increase of only 0.8%.

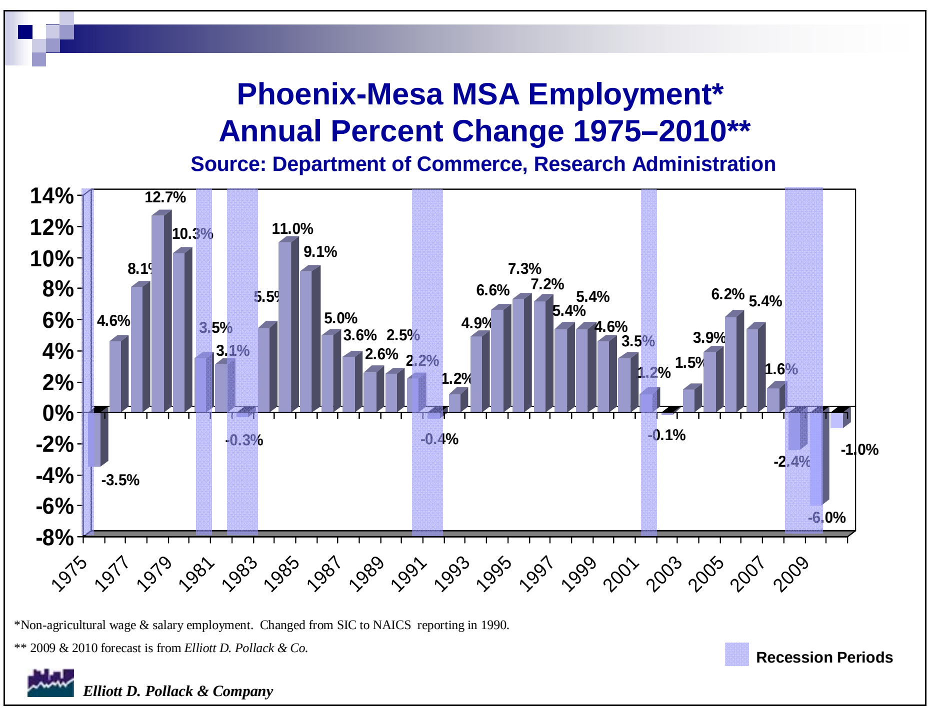
There are many reasons why population growth is likely near zero. Part of this weak showing has to do with basic economic conditions, and part has to do with the out-migration of illegal immigrants. People are having a hard time selling their homes in other states and cannot relocate. Others are putting off retiring and relocating to Arizona until their level of wealth improves. Others simply cannot relocate without finding a new job.



Regarding jobs, the State historically outperforms the nation as a whole in times of expansion and recession. This time is different. Primarily due to the significant job losses associated with the real estate and construction industries, the local economy is performing more poorly when compared to the nation as a whole. This can be deemed a transitory event. Because of its sound economic fundamentals, job growth in Arizona will once again be expected to exceed that of the U.S. once the economy stabilizes, likely by a significant degree. ***However, job growth will continue to be dominated by lower value added sectors such as construction, local services, and hospitality. Without further action, diversification of the economy into higher value added sectors is unlikely and the State will continue to be at risk.***



Historically, job market declines that are realized during periods of recession in Arizona tend to be mild. Using Greater Phoenix for more perspective, in both 1991 and 2001 (the previous two recessions), job declines were minimal and only went slightly negative for a short period. Job losses in 2008 (totaling nearly 47,000) were dominated by the construction industry and those sectors that support housing development. In 2009, the job losses will occur in all employment categories. Currently, the year-to-date losses are approximately -7.0% compared to 2008. If this trend is to continue or even slightly improve, job losses will still easily top 100,000 for the year.



What occurred in Arizona, as well as in some other markets throughout the country, is that real estate development that normally would have occurred in the latter parts of the decade was advanced into the earlier parts of the decade. To get near the historical growth rate ratio by the end of the decade, the State's economy would have to under-perform relative to the U.S. by a significant degree, implying that less must be built during the next two to three years.

Even if the excesses of the recent housing market "frenzy" had not occurred to the degree that was realized, the local economy would still be feeling some pains associated with an economic downturn. However, the overbuilding and related financial turmoil that occurred in Arizona and many other states across the nation turned a potentially mild downturn into a severe recession. Again, as of the writing of this report nearly every employment sector is losing jobs.

Phoenix-Mesa Employment

Source: Arizona Department of Commerce, Research Administration

Sectors in Decline		Sectors Increasing	
Mining	-15.8%	Health Services	0.1%
Construction	-24.6%		
Manufacturing	-8.6%		
Trade	-5.9%		
Transp. & Utilities	-9.4%		
Information	-5.1%		
Financial Activities	-6.0%		
Prof. & Bus. Services	-9.3%		
Other Services	-11.1%		
Educational Services	-0.3%		
Leisure & hosp svcs	-2.4%		
Government	-5.3%		

Elliott D. Pollack & Company

*Oct. 2009/Oct. 2008

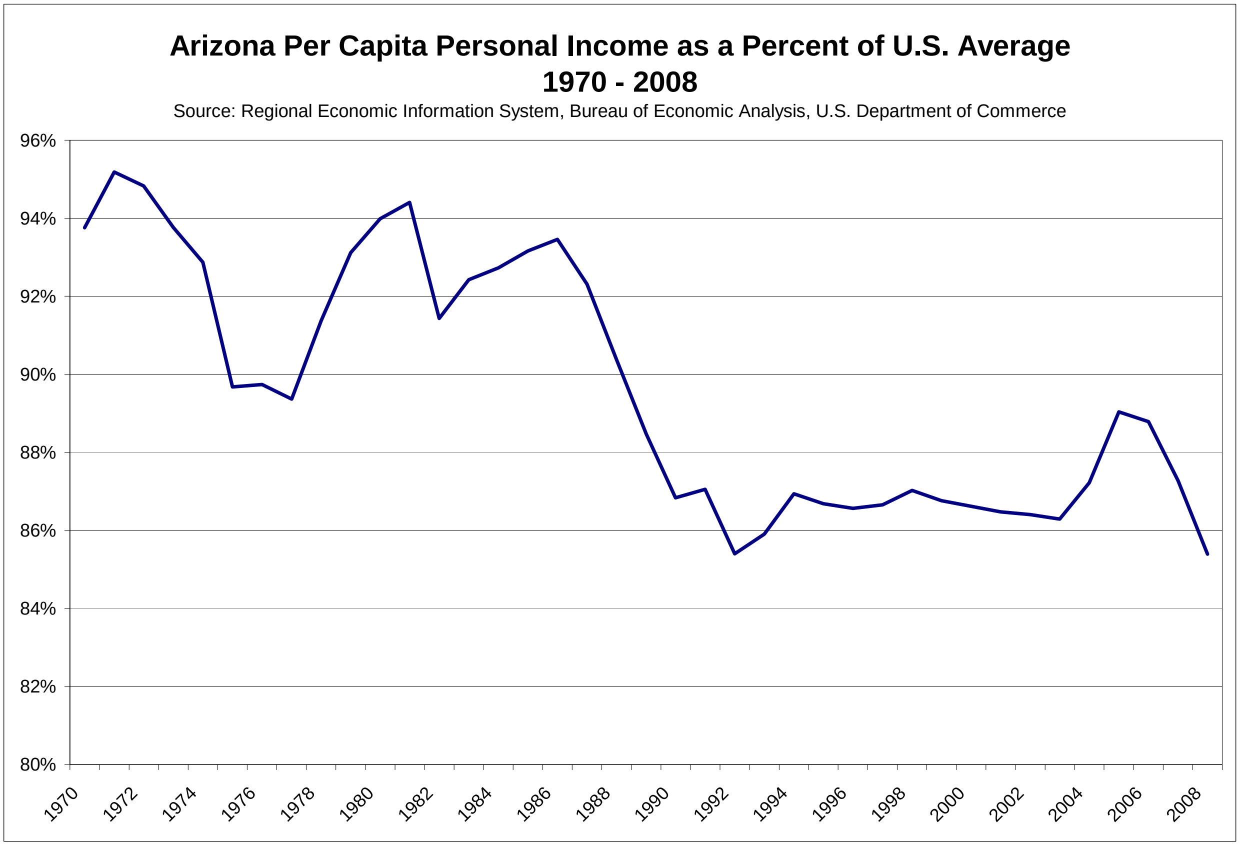
A different source, the University of Arizona, projects that professional services employment will continue to decline through 2011 (forecast as of fourth quarter 2009). All other sectors will have turned positive by then. Though the figures may differ between sources, the most important thing to take from the following table is that 2010 will be another weak year with significant employment growth not occurring until 2012.

Metro Phoenix Employment Projection
Source: University of Arizona

	2009	2010	2011	2012
Mining	-10.3%	-19.8%	8.0%	6.0%
Construction	-9.8%	-15.4%	3.6%	23.5%
Manufacturing	-9.9%	0.3%	2.6%	2.6%
Trade	-10.5%	-3.6%	2.6%	4.7%
Transportation and Utilities	-5.9%	2.4%	4.6%	5.5%
Information	2.4%	-4.0%	8.2%	1.3%
Financial Activities	-0.5%	-0.0%	2.5%	5.2%
Professional and Business Services	-2.7%	-7.1%	-2.5%	4.4%
Other Services	2.0%	2.3%	3.0%	3.6%
Education	1.2%	1.4%	2.0%	2.3%
Leisure and Hospitality	-6.2%	0.6%	4.4%	4.5%
Government	-0.9%	-1.1%	0.0%	1.8%
Health Services	2.4%	2.6%	3.2%	3.7%
Total	**-4.3%**	**-2.5%**	**1.9%**	**5.1%**

The indicator that is more difficult to impact with policy is per capita personal income. There are a number of reasons why a community's per capita personal income level is difficult to increase. First, different communities have different economic characteristics. As an example, a state like Arizona has favorable weather conditions that promote the tourism industry. This is a low paying industry. On the other hand, during and following World War II, the State's geographic location away from the coast promoted military operations. In decades after that, the State's new found intellectual and physical infrastructure facilitated electronics and aerospace manufacturing. During the movement from being tourism, mining, and agriculture based to being manufacturing based, the State's personal income levels improved greatly. ***However, there were specific actions/events that caused rapid changes in our economy in earlier decades. The State needs new economic actions now.***

A quick comparison of recent per capita personal income figures helps to qualify this need. A community's basic economic fundamentals impact the general level of per capita personal income. However, economic policies can enhance (or depress) from these general levels over time. Since the mid 1980s, the State's per capital personal income level has fallen as a percentage of the U.S. as a whole except for a period of lower level stability during the 1990s and temporary improvement during the boom in the housing market that has resulted in so many current troubles. See the following chart.



To summarize, the local economy has been shrinking at a rapid rate over the past year and a half and is currently in poor condition. However, the underlying economic fundamentals have not changed. We expect that during the next period of expansion the local economy will again outperform the nation as a whole in terms of basic growth. But, expansion will be in the same sectors that realized growth in the previous decade and a diversified economic base will not be achieved under present policy. ***The lack of economic diversity will result in continued weak performance in per capita personal income in future years unless some catalyst is found to enhance the State's position.***

2.1.2 How Do We Recover?

The State's economy will recover in time. Even with no new public policy measures, job growth eventually will be among the top five in the nation as will population growth. Those sectors that grew rapidly during the last decade (i.e. construction and those industries related to growth) will generate many jobs especially since we are currently beginning from a very low base. Unfortunately, the growth will occur in the same low value added industries that relate to growth and the area's per capita personal income statistics will continue to stagnate at best or deteriorate at worst.

However, the goal of policymakers should be to direct attention to the higher value added industries that tend to pay higher wages, export their product out of State and bring in new dollars, and generate new economic activity within the State. These are called "base", or export industries (addressed extensively in Section 2.2). The attraction and internal growth of these industries will not only result in higher income levels, but will also result in more government tax revenue and will improve basic quality of life measures. Diversifying the State's economic base will also offer a partial hedge against the ill effects of future downturns.

2.2 Explanation of What Makes an Economy Tick

To better understand just how important the State's base industries are to the local economy in generating jobs, one needs to first understand how businesses impact the economy. Base industries are those that export their products out of a region, and result in the importation of money into a region.

The issue of importing dollars into the State is a crucial economic development concept. Once a dollar makes its way into the State, it flows from person to person as demanded products and services are supplied. Eventually some money leaves the local economy when products (and some services) are provided by companies outside of the State. This is natural leakage and cannot be avoided. In order to compensate for these outgoing dollars an economy must be internally productive and export products beyond its borders and attract dollars from other areas. The State's base industries serve this purpose. Examples of base industries include the manufacturing sector, export-related business services, tourism, retirement, and federal government employment. As one can see, some base industries are high paying while others are relatively low paying. The key is to encourage higher value added/higher paying base industry development.

Base industry companies also tend to be more capital intensive, and/or utilize skilled labor (not in every case though, i.e. tourism, federal government). As local capital investment improves, and as more highly skilled workers are employed, productivity increases. This also leads to higher incomes and a higher standard of living for employees in these industries. Of course, this assumes that disincentives of capital investment are minimized and that skilled labor is available.

The State's local serving industries provide goods and services to the local population. Activities include most retail operations, construction, and local service banks, to name a few. The existence of base industries creates demand for these local serving industries. *Without base industries, there is no means of supporting local serving employees.* The ghost towns of the Old West further illustrate the importance of base industries. Once the local mine ran out, the railhead moved, or a drought caused agriculture to no longer be viable, many communities ceased to exist. This highlights the need for proper maintenance of base industries in this State through the implementation of a competitive tax code and progressive economic development programs.

2.2.1 Job Creation

Local serving employment created as a result of export activity is often referred to as multiplier effects or "indirect and induced" employment. "Indirect" jobs are those created by businesses that provide goods and services to an export-oriented business/industry. "Induced" jobs are created as a result of the spending by direct and indirect employees in the local economy on such things as food, housing, transportation, etc.

Indirect and induced impacts can be considerable but vary depending on the nature of the base industry in question. For example, generally accepted economic multipliers indicate that high tech industries such as scientific instruments generate a significant demand for indirect and induced employment due to the high wages in the industries and the accompanying "ripple" effects that follow. These high tech industries result in indirect and induced employment counts that actually far exceed employment at the manufacturing plants. On the other hand, employment in most of the service industries has a much smaller economic impact in terms of creating additional supporting jobs.

The chart on the following page displays these multiplier effects. The table lists the additional "spin off" jobs that would be created for each 100 newly created regional jobs. The table identifies that for 100 new jobs in the chemical manufacturing industry, spending by the business and its employees would create another 303 jobs throughout the region. This is a very high multiplier effect. The multiplier is high because: 1) average wages are high ($100,000+ jobs) thus allowing more local spending in the economy, and 2) the region has the ability to supply a large portion of its business inputs. When an industry pays relatively low wages and/or cannot supply its own business inputs (this tends to be the case with many rural economic regions) the resulting multipliers tend to be of lower value.

Multiplier Analysis
Addition of 100 Jobs to Industry
Arizona (Maricopa & Pinal) 2009

Ind. #	Industry	Total Output with 100 direct jobs	Addition of 100 Direct Jobs to Industry: Indirect Jobs	Induced Jobs	Indirect + Induced	Direct Annual Wages	Indirect Annual Wages	Induced Annual Wages	TOTAL WAGES	TOTAL AVERAGE ANNUAL WAGES
Agriculture										
1	Crop farming	$22,156,024	76	55	132	$45,666	$38,318	$42,519	$9,854,999	$42,491
15	Forestry & logging	$15,700,929	70	26	96	$12,179	$32,522	$42,477	$4,582,756	$23,435
19	Agriculture & forestry services	$2,749,549	1	21	22	$27,543	$58,574	$42,598	$3,704,250	$30,393
Mining										
20	Oil & gas extraction	$39,644,133	138	95	233	$43,809	$60,148	$42,366	$16,704,056	$50,180
28	Mining services	$48,182,823	118	101	219	$65,715	$60,045	$42,515	$17,927,768	$56,265
Construction										
34	Construction - commercial and health buildings	$13,558,550	29	54	83	$56,094	$57,547	$42,571	$9,585,190	$52,353
36	Construction other new nonresidential structures	$12,988,258	32	55	86	$55,927	$56,821	$42,569	$9,711,424	$52,168
37	Construction - residential buildings	$20,952,846	67	65	132	$56,057	$48,707	$42,580	$11,624,765	$50,154
40	Construction - maintenance & repair	$12,381,971	28	53	81	$56,339	$53,260	$42,572	$9,373,709	$51,853
Manufacturing										
46	Food products	$43,606,575	154	85	240	$47,792	$44,116	$42,656	$15,224,189	$44,833
70	Beverage & tobacco	$69,731,093	171	122	293	$63,103	$60,281	$42,662	$21,811,537	$55,525
95	Wood products	$17,134,145	39	43	83	$40,111	$48,666	$42,660	$7,768,279	$42,551
104	Paper manufacturing	$48,961,422	118	110	228	$77,817	$60,030	$42,597	$19,543,539	$59,612
120	Chemical manufacturing	$85,330,464	199	174	373	$105,340	$65,097	$42,524	$30,869,831	$65,305
142	Plastics & rubber production	$28,130,838	55	61	116	$49,175	$61,262	$42,644	$10,874,116	$50,406
153	Nonmetal mineral production	$30,696,441	80	83	163	$64,134	$60,665	$42,653	$14,814,501	$56,309
170	Primary metal manufacturing	$103,254,025	261	173	434	$68,831	$62,492	$42,652	$30,573,414	$57,250
181	Fabricated metal production	$24,848,494	45	64	110	$61,837	$56,639	$42,651	$11,499,038	$54,828
203	Machinery Manufacturing	$37,846,600	84	88	172	$69,197	$60,698	$42,653	$15,769,202	$57,967
235	Computer & other electronic equipment	$31,766,012	89	129	218	$111,524	$72,232	$42,689	$23,099,355	$72,608
259	Electircal equipment & appliances	$34,024,383	69	78	147	$60,662	$64,713	$42,672	$13,865,276	$56,149
276	Transportation equipment	$35,183,650	48	100	148	$106,144	$64,336	$42,681	$17,958,263	$72,440
305	Miscellaneous manufacturing	$20,623,695	47	67	114	$62,763	$57,986	$42,589	$11,858,893	$55,431
Trade & Tranportation										
319	Wholesale trade	$19,720,881	47	74	121	$75,844	$52,427	$42,647	$13,185,362	$59,766
320	Motor vehicle & parts dealers	$11,734,719	24	51	75	$57,156	$48,771	$42,620	$9,068,860	$51,773
321	Furniture & home furnishings	$11,346,700	20	46	66	$52,048	$48,760	$42,487	$8,146,068	$49,005
322	Electronics & appliances stores	$8,785,836	19	39	58	$44,009	$48,630	$42,674	$6,969,918	$44,225
323	Building materials & garden dealers	$8,960,631	17	33	51	$36,936	$48,560	$42,664	$5,949,760	$39,533
324	Food & beverage stores	$6,669,413	14	28	41	$31,211	$48,418	$42,656	$4,957,915	$35,104
326	Gasoline stations	$9,482,141	16	33	48	$36,587	$48,536	$42,538	$5,813,443	$39,165
327	Clothing & accessories stores	$5,847,151	11	19	30	$21,052	$48,234	$42,638	$3,452,053	$26,521
329	General merchandise stores	$5,691,693	12	23	35	$25,833	$48,249	$42,683	$4,134,907	$30,669
330	Miscellaneous retailers	$6,133,848	12	26	38	$29,381	$48,365	$42,510	$4,613,359	$33,483
332	Air transportation	$32,348,112	104	102	207	$87,798	$48,330	$42,662	$18,194,940	$59,303
334	Water transportation	$59,257,066	311	170	481	$59,739	$52,683	$42,542	$29,580,653	$50,929
335	Truck transportation	$14,855,391	47	58	104	$54,133	$50,299	$42,591	$10,221,133	$50,003
336	Transit & ground passengers	$7,833,787	17	29	46	$30,749	$52,204	$42,668	$5,208,567	$35,628
337	Pipeline transportation	$89,170,219	327	218	545	$119,312	$53,651	$42,597	$38,758,549	$60,100
338	Sightseeing transportation	$9,483,996	23	47	70	$52,909	$49,166	$42,627	$8,423,799	$49,547
339	Couriers & messengers	$6,824,562	9	33	41	$39,967	$50,705	$42,575	$5,825,105	$41,223
340	Warehousing & storage	$8,395,677	18	40	59	$45,703	$48,339	$42,672	$7,171,831	$45,242
Information										
341	Publishing industries	$21,810,419	77	75	152	$63,245	$49,528	$42,625	$13,353,931	$52,914
346	Motion picture & sound recording	$13,392,502	73	38	112	$19,672	$44,118	$42,631	$6,846,126	$32,311
350	Internet publishing and broadcasting	$22,718,289	49	50	99	$41,669	$52,567	$42,666	$8,859,678	$44,606
351	Telecommunications	$40,758,181	111	95	206	$69,729	$53,563	$42,653	$16,957,034	$55,459
352	Internet & data process services	$20,280,823	79	75	154	$62,006	$50,237	$42,622	$13,365,590	$52,624
Financial Activities										
354	Monetary authorities	$25,419,576	46	63	110	$63,522	$48,817	$42,668	$11,315,219	$53,976
355	Credit inmediation & related	$20,466,669	47	74	120	$76,651	$51,349	$42,673	$13,209,638	$59,917
356	Securities & other financial	$17,500,239	87	68	155	$46,074	$52,093	$42,602	$12,036,979	$47,208
357	Insurance carriers & related	$21,637,954	75	78	152	$65,035	$54,075	$42,637	$13,842,448	$54,904
359	Funds- trusts & other finanances	$35,087,348	192	105	298	$45,899	$50,082	$42,522	$18,699,521	$47,024
Services										
360	Real estate	$27,856,996	41	36	77	$26,451	$51,312	$42,404	$6,275,568	$35,472
362	Rental & leasing services	$19,233,750	74	68	142	$52,548	$52,297	$42,546	$12,016,170	$49,674
366	Lessor of nonfinance intangable assets	$116,644,842	275	165	439	$82,419	$50,838	$42,606	$29,226,881	$54,179
367	Professional services	$12,198,065	32	63	94	$69,583	$47,547	$42,528	$11,132,881	$57,265
371	Computer Services	$12,003,573	34	68	102	$75,492	$48,871	$42,572	$12,098,977	$59,939
374	Scientific & tech services	$13,320,615	45	67	112	$69,539	$48,211	$42,553	$11,974,394	$56,473
377	Miscellaneous services	$14,616,382	36	43	79	$40,785	$47,253	$42,556	$7,617,328	$42,520
381	Management of companies	$20,535,431	68	89	158	$86,584	$51,817	$42,674	$16,015,049	$62,132
382	Admin support services	$6,329,364	16	30	47	$33,736	$47,137	$42,651	$5,433,905	$37,066
390	Waste management & remediation services	$24,723,368	66	87	153	$82,359	$53,685	$42,535	$15,483,850	$61,174
391	Educational services	$6,445,675	15	30	45	$33,643	$48,783	$42,671	$5,359,140	$37,051
394	Ambulatory health care	$12,354,919	26	59	85	$66,262	$51,456	$42,602	$10,462,072	$56,662
397	Hospitals	$12,730,773	31	60	91	$66,391	$50,784	$42,680	$10,757,083	$56,415
398	Nursing & residential care	$5,493,509	8	27	36	$33,491	$47,773	$42,661	$4,907,620	$36,203
399	Social assistance	$4,427,304	12	20	32	$21,386	$46,815	$42,665	$3,539,284	$26,879
402	Performing arts & spectator sports	$5,657,718	21	27	48	$27,580	$40,560	$42,595	$4,750,515	$32,144
406	Museums & similar	$7,849,944	18	45	63	$52,087	$47,019	$42,431	$7,979,146	$48,856
407	Amusement- gambling & recreation	$6,752,107	16	25	42	$26,014	$50,675	$42,639	$4,512,575	$31,841
411	Accomodations	$9,904,602	28	35	63	$34,184	$49,054	$42,647	$6,267,186	$38,529
413	Food services & drinking places	$5,993,706	14	21	35	$20,977	$51,275	$42,656	$3,731,178	$27,563
414	Repair & maintenance	$11,133,195	25	38	64	$39,049	$52,002	$42,584	$6,853,773	$41,874
419	Personal & laundry services	$7,954,869	24	26	50	$23,741	$46,298	$42,589	$4,609,361	$30,657
423	Religious- grantmaking- & similar organizations	$6,558,642	23	32	55	$33,105	$47,610	$42,679	$5,768,031	$37,224
Government										
440	Government & non NAICs	$8,204,911	5	47	51	$61,127	$55,041	$42,707	$8,366,704	$55,260

2.2.2 Tax Revenue Generation

The economic benefits from base industry expansion go beyond basic job creation. When these types of companies are lured to the State or grow from within, additional economic activity occurs, much of which is taxable. ***A healthy economy translates into an enhanced tax revenue stream and not vice versa.*** Some perspective on the extent that types of companies generate tax revenues is included below.

A generic economic and fiscal impact model was developed for two types of companies. The first, electronic component manufacturing, is a prototypical base industry operation. Parts are manufactured locally with local labor then exported out of the State. The level of value added is high, as are wages. The model indicates that for each 1,000 jobs that are created (or retained), the State of Arizona receives $7.7 million annually in tax revenues. Alternatively, for every 1,000 jobs created or retained in hospitality (a base industry with lower average wages), annual State revenues are only $4.2 million. Estimates exclude the tax benefits associated with constructing and equipping a new facility and so are considered conservative in years 1 and 2.

These figures include all three types of employment and economic activity: direct, indirect, and induced. Modeling of this type is helpful in designing incentive programs. The State should not provide incentives in excess of what it will receive in net new taxes. In the case of attracting an electronic component manufacturer, the incentive would need to be less than $7.7 million on an annual basis. The incentive could exceed this amount if factoring in construction tax benefits.

For hotel accommodations the level of incentives would need to be much less and are possibly not even needed since the end product of this industry, the Arizona climate and attractions, are not mobile between states.

Annual Fiscal Impact from Operations
Impact of Adding 1,000 Jobs by Industry
State of Arizona Revenues
(2009 dollars)

Electronic Component Manufacturing

	Primary Revenues		Secondary Revenues from Employees					
Impact Type	Direct Sales Tax	Direct Bed Tax	Employees Sales Tax	Income Tax	HURF Vehicle License Tax	HURF Gas Tax	Unemp. Tax	**Total Annual Revenues**
Direct Revenues	N/A	N/A	$1,034,300	$2,427,400	$64,600	$92,700	$189,000	**$3,808,000**
Indirect Revenues	N/A	N/A	$648,300	$1,000,200	$54,700	$78,500	$160,000	**$1,941,700**
Induced Revenues	N/A	N/A	$699,100	$818,000	$81,200	$116,600	$237,700	**$1,952,600**
Total Revenues	**N/A**	**N/A**	**$2,381,700**	**$4,245,600**	**$200,500**	**$287,800**	**$586,700**	**$7,702,300**

Hotel Accomodations

	Annual Primary Revenues		Annual Secondary Revenues from Employees					
Impact Type	Direct Sales Tax	Direct Bed Tax	Employees Sales Tax	Income Tax	HURF Vehicle License Tax	HURF Gas Tax	Unemp. Tax	**Total Annual Revenues**
Direct Revenues	$397,600	$1,371,000	$512,900	$514,700	$64,600	$92,700	$189,000	**$3,142,500**
Indirect Revenues	N/A	N/A	$168,700	$224,900	$18,200	$26,100	$53,300	**$491,200**
Induced Revenues	N/A	N/A	$207,600	$242,800	$24,100	$34,600	$70,600	**$579,700**
Total Revenues	**$397,600**	**$1,371,000**	**$889,200**	**$982,400**	**$106,900**	**$153,400**	**$312,900**	**$4,213,400**

1/ The total may not equal the sum of the impacts due to rounding. All dollar figures are in constant dollars. Inflation has not been included in these figures. All of the above figures do not includerevenues distributed to counties, cities, and towns. All of the above figures are representative of the major revenue sources for the State of Arizona. The figures are intended only as a general guideline as to how the State could be impacted by the project. The above figures are based on the current economic structure and tax rates of the State of Arizona.

Source: Elliott D. Pollack & Company; IMPLAN; Arizona Department of Revenue; Arizona Tax Research Association

The previous table displays just State of Arizona benefits from the example new business location. Local governments will also realize similar benefits. The following tables display the net tax benefits from the same operations for both Maricopa County and for the City of Phoenix. Therefore, the crafting of an economic development plan is not just in the best interest of State policymakers, but it is also in the best interest of local politicians as well.

Annual Fiscal Impact from Operations
Impact of Adding 1,000 Jobs by Industry
Maricopa County Revenues (Ongoing Annually)
(2009 dollars)

Electronic Component Manufacturing

	Primary Revenues			Secondary Revenues from Employees			
	Direct Sales Tax	Direct Bed Tax	Property Tax	Employees Sales Tax	Residential Property Tax	State Shared Revenues	**Total Annual Revenues**
Direct	N/A	N/A	$373,300	$189,500	$375,600	$233,210	**$1,171,600**
Indirect	N/A	N/A	N/A	$121,000	$317,900	$162,840	**$601,700**
Induced	N/A	N/A	N/A	$133,900	$472,400	$209,770	**$816,100**
Total	**N/A**	**N/A**	**$373,300**	**$444,400**	**$1,165,900**	**$605,820**	**$2,589,400**

Hotel Accomodations

	Primary Revenues			Secondary Revenues from Employees			
	Direct Sales Tax	Direct Bed Tax	Property Tax	Employees Sales Tax	Residential Property Tax	State Shared Revenues	**Total Annual Revenues**
Direct	$64,900	$656,100	$514,600	$99,000	$375,600	$431,210	**$2,141,400**
Indirect	N/A	N/A	N/A	$32,100	$105,900	$48,480	**$186,500**
Induced	N/A	N/A	N/A	$39,800	$140,400	$62,310	**$242,500**
Total	**$64,900**	**$656,100**	**$514,600**	**$170,900**	**$621,900**	**$542,000**	**$2,570,400**

1/ The total may not equal the sum of the impacts due to rounding. Inflation has not been included in these figures. All of the above figures are representative of the major revenue sources for the County. The figures are intended only as a general guideline as to how the County could be impacted by the project. The above figures are based on the current economic structure and tax rates of the County.

Source: Elliott D. Pollack & Company; IMPLAN; Arizona Department of Revenue; Arizona Tax Research Association

Annual Fiscal Impact from Operations
Impact of Adding 1,000 Jobs by Industry
City of Phoenix Revenues (Ongoing Annually)
(2009 dollars)

Electronic Component Manufacturing

	Annual Primary Revenues			Annual Secondary Revenues from Employees			
	Direct Sales Tax	Direct Bed Tax	Property Tax	Employees Sales Tax	Residential Property Tax	State Shared Revenues	**Total Annual Revenues**
Direct	N/A	N/A	$247,500	$381,900	$142,200	$243,920	**$1,015,500**
Indirect	N/A	N/A	N/A	$243,800	$120,300	$130,970	**$495,100**
Induced	N/A	N/A	N/A	$269,700	$178,800	$146,030	**$594,500**
Total	**N/A**	**N/A**	**$247,500**	**$895,400**	**$441,300**	**$520,920**	**$2,105,100**

Hotel Accomodations

	Annual Primary Revenues			Annual Secondary Revenues from Employees			
	Direct Sales Tax	Direct Bed Tax	Property Tax	Employees Sales Tax	Residential Property Tax	State Shared Revenues	**Total Annual Revenues**
Direct	$185,400	$1,853,500	$341,300	$199,500	$142,200	$195,520	**$2,917,400**
Indirect	N/A	N/A	N/A	$64,700	$40,100	$35,580	**$140,400**
Induced	N/A	N/A	N/A	$80,100	$53,100	$43,370	**$176,600**
Total	**$185,400**	**$1,853,500**	**$341,300**	**$344,300**	**$235,400**	**$274,470**	**$3,234,400**

1/ The total may not equal the sum of the impacts due to rounding. Inflation has not been included in these figures. All of the above figures are representative of the major revenue sources for the City. The figures are intended only as a general guideline as to how the City could be impacted by the project. The above figures are based on the current economic structure and tax rates of the City.

Source: Elliott D. Pollack & Company; IMPLAN; Arizona Department of Revenue; Arizona Tax Research Association

This exercise leads to a number of questions. How does one specifically define a base industry operation that is worthy of targeted incentives? How should the incentives be employed? How much should the incentives be worth? The bottom line is that any government incentive policy needs to be crafted so that incentives are provided on a discretionary basis to base industry operations that otherwise would not be in Arizona and in an amount that is less than the net new taxes that the State will collect. Incentives should also only be given to base industry operations that pay well above the average wage.

A legitimate argument can also be made to set incentive values at only the direct impact amount, or possibly at the direct plus induced impact. It is recommended that induced impacts not be used in the formulation of public policy that may impact the budget.

In the previous example of manufacturing, the annual direct tax benefits total $3.8 million versus the total impact of $7.7 million (i.e. direct, indirect and induced). While multiplier models provide a total for State tax revenue collections based on the aforementioned “spin-off” activity, it may be dangerous to craft fiscal policy based on these estimates, especially when budget shortfalls exist and the collection of every dollar is vital. Since indirect impacts are more reliable than induced impact calculations (indeed, manufacturers need suppliers), the inclusion of this benefit in the calculation is a possible option for policymakers to consider. However, as long as new incentive programs are fully thoughtful of who receives the benefit and in what amount, the program could be beneficial to both the new business operation and the State of Arizona.

2.2.3 The Difficulty of Diversifying

The existence of these indirect and induced jobs actually makes it more difficult to increase the average wages in an area. As high wage manufacturing jobs are added to an area, so are the previously discussed supporting jobs that are typically lower paying. In other words, while the addition of high wage jobs raises average wages in an area, the subsequent addition of the service oriented jobs places some downward pressure on average wages.

This issue has been covered before and even appeared as a lead article in the Greater Phoenix Blue Chip Economic Indicators document in September 2007. See the excerpt below.

> *According to the Department of Economic Security, there were about 1.8 million workers in Maricopa County in 2006. The average wage of these workers was about $37,200. To provide perspective into how difficult it is to raise average wages in an area, we calculated how many additional high paying jobs must be added to the local economy to raise overall wages by $1,000.*
>
> *If government officials and economic development professionals want to induce enough manufacturing and supporting employment growth to raise average Maricopa County wages by $1,000, they would need to be directly responsible for the creation of 145,000 new jobs with average wages of $50,600 (this includes direct, indirect, and induced employment). This also includes the creation of over 68,000 direct miscellaneous manufacturing jobs.*

The fact that 1) the local economy is large, and 2) the creation of high wage employment adds partially offsetting lower to moderate wage employment, makes it very difficult to significantly raise average wages for the region as a whole.

This is one of the most critical points in this report. No public policy measure, no matter how well crafted, will result in the immediate change in a large community's economic composition. However, if the proper tools are made available, public policy can indeed begin to attract base industries to a region rather quickly and create jobs. This is especially important during a period following a recession. This will aid in our economic recovery but we will need to remain patient. Policymakers will not only need to provide these tools as soon as possible but will need to continue to be aggressive about economic development for many more years. This will allow for a gradual improvement in local personal income and also in the quality of life of Arizona residents.

2.3 What Drives Business Locations?

The previous section provides tools for identifying at what point incentives may be provided to induce business locations while not resulting in a revenue loss to the State. The following section addresses general competitiveness and broad strategies beyond the provision of financial incentives.

2.3.1 General Competitive Issues

Businesses care about profits. If a company can earn a higher profit in one area versus another the company will relocate to the more profitable area. This is also true of business retention. If a company is already located where it can maximize its returns then it will stay where it is currently located.

Thus, the first level of review must include an examination of what factors influence a company's profit potential. Primary business inputs that translate into the extent a company earns a profit include: 1) labor supply, quality, and cost, 2) access to transportation networks, 3) affordable and reliable energy access, 4) proximity to similar industries and common suppliers, 5) land and construction costs, 6) competitive tax rates, and 7) economic incentive packages.

Area Development Magazine also surveys companies annually on the most important site selection factors. While those factors vary in ranking from year to year, highway access, labor costs, and incentives were among the most important cited in the last several surveys.

Top Site Selection Factors 2009 Corporate Real Estate Executive Survey	
1	Transportation infrastructure
2	Existing workforce skills
3	State and local tax scheme
4	Utility infrastructure
5	Land/building prices & supply
6	Ease of permitting & regulatory procedures
7	Flexibility of incentives programs
8	Access to higher education resources
9	Availability of incentives
10	State economic development strategy

Source: Site Selection Magazine

While all of these items are important in a business location decision, specific factors are often necessary to actually land a desired business. For example, when the CEO of a business is considering where to locate a manufacturing plant, he or she will ask a business location analyst to identify the top 10 states for relocation based on a set of specific criteria such as being business regulation friendly, having a competitive business tax code, having access to a specific worker skill set, etc.

We do not have control over our geographical location or lack of a seaport. We do have some control over providing a competitive tax structure that gets us in the economic development game. Once this is addressed, policymakers can then move on to designing economic development incentives to actually win the desired business location decisions.

2.4 Current Tax Structure

A large number of reports have been authored recently on the State's current tax structure. Detailed reports can be found on a number of websites including Arizona State University's Center for Competitiveness and Prosperity Research. The 2009 Arizona Town Hall also focused on State tax policy. In general, the published documents display accurate basic data pertaining to state rankings for each of the primary tax categories and are a worthy read. For the most part, each report identifies a number of recommended changes to the State's tax code to partly assist with the current budget deficit and anticipated deficits in future years.

As previously noted, this issue is beyond the scope of this report. This report's primary focus is to provide recommendations to immediately facilitate new business locations that create jobs (and thus new tax revenue) with the secondary focus of encouraging additional business development from within the State.

There is one area of consistent disagreement between this report's authors and the opinions included in many published reports. ***The current economic woes of the State are not a direct***

result of the tax code. The problems are instead directly tied to an extremely harsh recession, a lack of local economic diversity, and a consistent record of poor public policy. A complete overhaul of the State's tax code is not necessary and is not practical. Instead, less than a handful of tax law changes will go a long way in improving Arizona's competitive position.

2.4.1 Theory: What Should be Taxed?

Much has been written on taxation and efficiency throughout the years. Books written in the 1800s by leading economists addressed some of the same issues that policymakers are dealing with today. However, economic theory serves only to provide an underlying perspective into how tax law changes could impact the behavior of both individuals and businesses. Conclusions formed by theorists should not be the sole criteria for evaluating tax proposals. Policymakers must also be pragmatic in developing solutions.

Basic economic theory, when combined with practical business location criteria, and in consideration of the current economic structure of the State, will allow for an intelligent analysis of how to best modify the current tax code. Fortunately, very few modifications are needed to greatly improve Arizona's competitive position.

Theory - Taxation of Income

The ultimate question with respect to the income tax is if the current tax structure is already optimal given the characteristics of this State and, if not, how can it be improved? One of the most important issues to address relates to the extent the income tax system should be progressive. Flat tax systems appear to result in a smaller excess burden, defined as the loss of welfare above the value of the tax revenue collected. In other words, from an economic development perspective, a flat tax seems to offer less opportunity for lost productivity and may result in less of a disincentive to work. The potential negative social consequences of such an action may be countered with a tax exemption for lower income families. The Tax Reform Act of 1986 followed this argument and substituted for the highly progressive income tax rates fewer tax brackets and lower rates, in addition to removing loopholes from which tax "avoidance" originated.

Increases (decreases) in the individual income tax rates result in a decrease (increase) in the effective wage rate of an employee. Scholars of labor economics suggest that a wage decrease through additional taxation could lead to two types of phenomenon: substitution effects and income effects. Substitution effects from income tax increases result in fewer hours of work because the marginal return from work declines, while income effects result in more hours of work as people try to make up for lost wages from the tax. The exact impact will depend on which effect is dominant.

It is suggested that higher taxation through higher marginal tax rates would likely result in the substitution effect being dominant, resulting in reduced hours of work. In theory, this would be the impact associated with raising the individual income tax rates in Arizona. Alternatively, the supply-side tax cuts of the 1980s targeted the marginal income tax rates and held average tax rates constant by eliminating deductions. This likely resulted in the substitution effect again being dominant, but this time resulting in an increase in hours worked.

However, state taxes represent only a fraction of an individual's overall tax burden, with the heftiest taxes being imposed by the federal government. This does not mean that states have a free pass to impose high tax rates on individuals without consequence. At some point a higher income tax burden will result in economic distortions and a disincentive to produce. Unfortunately, we do not know at what point this will occur, but only that it will occur.

What is often ignored is the fact that a progressive income tax system is most appropriate when a government entity distributes benefits consistently throughout society. However, this is not the case. Lower income individuals receive a disproportionately *high* percentage of government benefits while also paying a disproportionately *low* percentage of government costs. When government benefits are skewed to this degree it may be appropriate to implement a less progressive income tax structure. The least progressive income tax structure is a flat tax where everybody pays the same tax rate on their income and deductions do not apply. A removal of deductions is not likely to be politically feasible though.

Theory - Taxation of Products

If theory suggests that raising individual income tax rates will result in economic distortions, what does it say about the next alternative – taxes on consumption? When compared to income taxes, consumption taxes likely result in fewer economic distortions and less disincentive to save and produce.

Consumption taxes typically come in two forms: the ad valorem tax (tax on value of the good) and the unit tax (tax on the quantity of the good such as a gallon of gas). The imposition of sales taxes is also considered an effective way to indirectly charge a user fee for some government expenses such as a gas tax that is used to pay for road improvements.

Theory suggests that an efficient system can be derived by placing a higher tax rate on products with inelastic demand (consumers are not sensitive to price), and a lower tax rate on products with an elastic demand (consumers are very sensitive to price). If a tax is increased on a product with elastic demand, consumption of the product will decline and tax collections may also decline. This is not always the case with products that have an inelastic demand. While a multi-rate system may be efficient according to economic theory, a system with many different tax rates would be difficult to administer and would be in conflict with any national streamlined sales tax proposal. A single state tax rate (or as few as possible) appears to be reasonable.

The question of taxing services is also worthy of discussion. The taxing of services needs to follow the same rules that are applied to the taxing of goods. Many goods that are used in the production process are currently exempt from taxation as the end product is already subject to taxation. For example, a computer chip that is installed into a computer should not be taxed since the end product, the computer, is taxed based on the retail value (which is dependent on the value of the individual components including chips).

The taxing of services does not conflict with economic theory (other than it constitutes a tax increase and distortions will still result), as long as the service is not considered part of any production process like the above example of the computer chip. This may be a difficult criteria to define for some services. Many business to business services could be considered part of a production process and it may not be efficient to tax this activity. It may also be difficult to tax professional services that are subject to interstate competition. Conversations with tax professionals revealed that the taxation of professional services that cross state borders is difficult to enforce. Further discussions with tax professionals on this topic may be required. However, taxing local market services such as haircuts, laundry services and lawn maintenance does appear appropriate.

Sales taxes are considered regressive because people with lower incomes spend a larger percentage of their income on goods and therefore pay a larger portion of their income towards taxes. Of course, in absolute terms lower income individuals pay far fewer taxes.

When income fluctuates, fewer changes need to be made to consumption patterns in the short run because consumers have the ability to save in good times and borrow in bad times. Individuals are less likely to significantly change their propensity to consume under the short-term distress of a recession (unless the consumer loses his or her job). This adds some stability to the sales tax compared to income taxes.

Theory - Business Tax Incentives

Much has been written about how the federal government can positively influence the national economy by modifying tax rates. While state taxation represents only a fraction of what businesses pay to the federal government, state tax policy still has some impact on business location decisions. Capital and skilled labor are mobile, and the state must establish a tax structure that encourages these inputs to locate in Arizona. However, without a careful review of its incentive package, the State government may experience a "dead weight revenue loss." This is defined as the loss of government revenue with no resulting benefit to the State. In other words, the State needs to carefully apply its incentives where they will do the most good.

One problem associated with business tax incentives is that it is difficult to precisely calculate the extent that tax policy enhances or hinders business locations. ***Unfortunately, while Arizona has been proactive with tax reductions, it has not been proactive in perhaps the most important element: developing complementary economic development programs.*** These are programs that provide for job training, rebates related to the creation of higher wage jobs, etc. Economic development programs are addressed extensively in Section 3.0.

Tax reductions focused on the industries that create base industry jobs and that bring money into the State will positively impact the economy far more than tax reductions targeted at local market industries. Local market industries are here primarily because there is a population to service. There will be few to no economic gains if tax reductions only benefit the local market industries and are not focused on the State's base industries. This is because local market industries are captive. They cannot relocate out of the State. If special incentives are ultimately utilized, sunset provisions should be imposed to assure a regular evaluation of each incentive's effectiveness.

2.4.2 Arizona's Major Tax Categories

This section of the report focuses only on the state's major taxes: the sales tax, the individual income tax, and the corporate income tax (the property tax is primarily locally imposed). Many have recently argued that the State's reliance on the sales tax is directly tied to the budget deficit. This is not true. In fact, the sales tax is much more stable than either the individual income tax or the corporate income tax. The criticism of the sales tax is based on an incorrect assumption and is nothing more than an indirect promotion of a new statewide property tax.

More sophisticated techniques exist for examining statistical deviations in tax collections and can certainly be pursued in a separate technical report. However, the conclusions formed from such an exercise would be similar to what are presented in this simple review. Tax law changes are removed from the data to separate legislated changes from economy-wide influences.

All three of the state imposed taxes (sales, individual income, corporate income) are cyclical. The sales tax is the least cyclical of the three. All three tax categories provide healthy collections in times of economic growth, and all three respond negatively in times of economic slowing or decline. None are counter-cyclical.

Transaction Privilege Tax (Sales Tax)

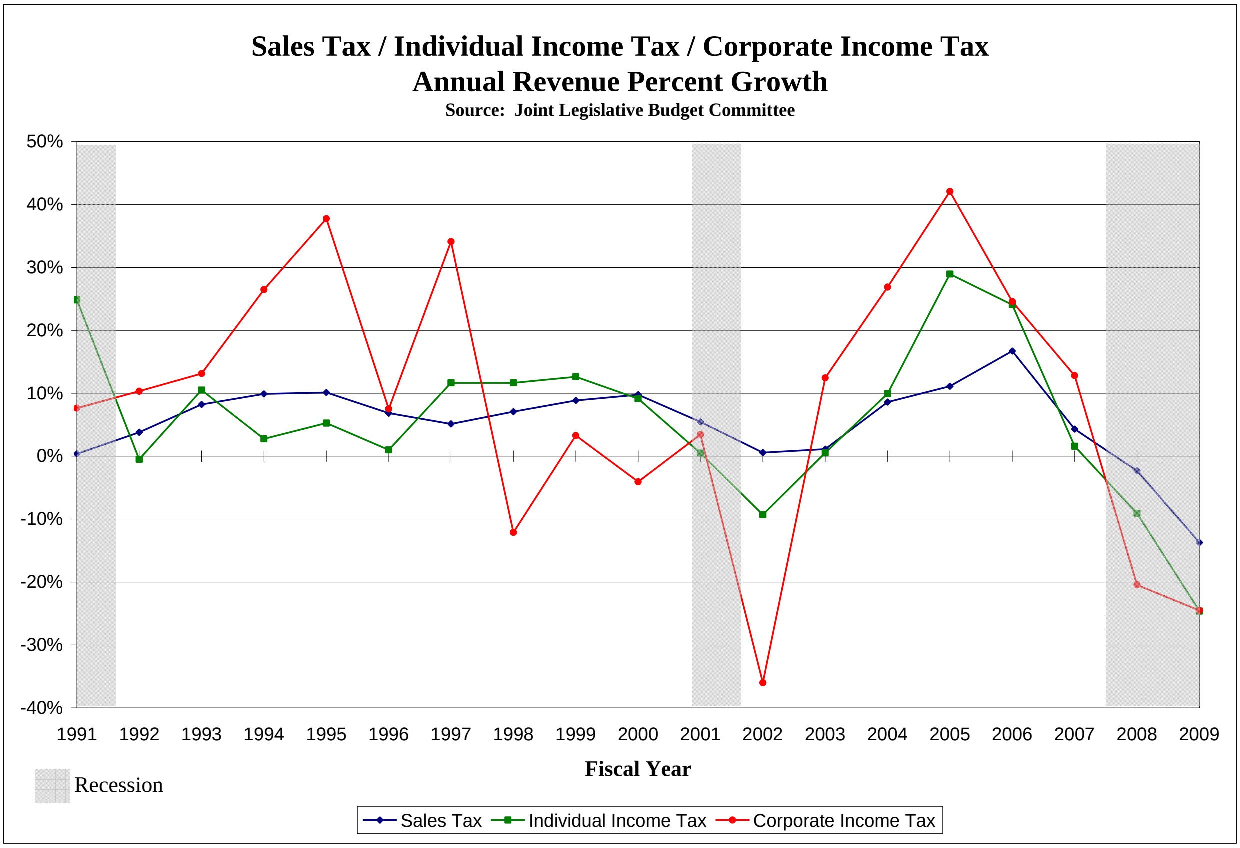
The State employs a transaction privilege tax, or a tax paid by the seller of goods rather than the buyer. In reality, a transaction privilege tax is not much different than a sales tax (except for dealing with federal government contracts) and the terms are used interchangeably.

The sales tax in Arizona consists of many different categories. According to the JLBC's *2009 Tax Handbook*, approximately 45% of the state's total sales tax revenue is from retail sales, 11% is from utilities, 17% is from contracting, 9% is from restaurants and bars, and 18% is from other categories. The sales tax rate on most categories is 5.6%.

The sales tax is also the largest revenue generator for the State government, with nearly half of all General Fund revenue coming from this one tax. A portion of the sales tax collections are shared with local governments based on a formula.

Arizona relies on the sales tax more than most states, but an above average reliance is appropriate for a state like Arizona that is very dependent on tourism industries. Furthermore, a heavy reliance on the sales tax (vs. income taxes) may actually be efficient as the sales tax is less cyclical than the income taxes, and appears to result in fewer economic distortions.

The following charts first display State sales tax collections growth compared to growth in individual income taxes and corporate income taxes. The sales tax growth rates do dip sharply in recession years, but the percentages have never significantly turned negative until the most recent recession. However, both corporate and individual income tax collections have experienced much wider swings in percentage terms. The second of the following charts displays that the sales tax fairly closely follows growth in personal income although the correlation is not perfect.


Sales Tax / Individual Income Tax / Corporate Income Tax
Annual Revenue Percent Growth
Source: Joint Legislative Budget Committee
50%
40%
30%
20%
10%
0%
-10%
-20%
-30%
-40%
1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009
Fiscal Year
Recession
Sales Tax
Individual Income Tax
Corporate Income Tax


Sales/Use Tax Growth* vs. Personal Income Growth
Source: Joint Legislative Budget Committee
Recession
19.0%
17.0%
15.0%
13.0%
11.0%
9.0%
7.0%
5.0%
3.0%
1.0%
-1.0%
-3.0%
-5.0%
-7.0%
-9.0%
-11.0%
-13.0%
-15.0%
4%
8%
10%
10%
7%
5%
7%
9%
10%
5%
1%
1%
9%
11%
17%
4%
-2%
-14%
1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008
Fiscal Year
Sales & Use Tax
Personal Income

Regarding the taxation of services, Arizona taxes 55 of 168 services (as of 2007), which is 24th highest in the nation in number taxed (out of 51 including the District of Columbia). While the ranking indicates the State is about average in terms of the number of services that are taxed, this also means that 113 services are not taxed. The following table displays the number of taxed services by industry in Arizona. Utility services and amusements are the most heavily taxed.

Taxed Services in Arizona

Services Breakdown by Industry	# Taxed	# Possible
Utility Service - Industrial and Residential	12	16
Personal Services	2	20
Business Services	7	34
Computer Services	0	8
Admissions and Amusements	9	15
Professional Services	0	9
Fabrication, Installation, and Repair Services	2	19
Other	23	47
Taxable Entries	**55**	**168**

Source: Sales Taxation of Services: 2007 Update (Federation of Tax Administrators)

The problems with the State's budget are being directed towards the degree of reliance on the sales tax and on the fact that some potentially eligible services are not being taxed. The authors of this report believe that the discussion of overreliance on sales taxes is a little misguided and is being used by some as an argument for imposing a new State property tax. The current sales tax structure is not sufficiently flawed to be having a negative impact on economic development within this State.

Individual Income Tax

The individual income tax in Arizona is designed with progressive rates. The marginal rates range from 2.59% to 4.54%. The state collected $2.6 billion in individual income taxes in fiscal year 2009. Recently, collections have declined sharply as a result of the recession.

The individual income tax is more cyclical than the sales tax and much more difficult to predict. It tends to realize outstanding growth in expansion years and very weak growth or declines during recession years. The following chart displays the historical growth rates along with growth in personal income.

Individual income tax collections deviate from the historical trend much more than sales taxes (see chart on the following page). These deviations are difficult to forecast. During the most recent expansion, personal income tax collections skyrocketed due to huge gains in employment and due to capital gains. However, tax collections have fallen as sharply as they arrived, with Fiscal Year 2009 tax collections down nearly 25% from 2008, which was also a year of negative tax growth. There is no reason to believe that the cyclical nature of this tax will change in coming years unless the tax is modified with flatter rates and less reliance on capital gains.

Because the individual income tax is so large and cyclical, it probably offers the most risk to the State in terms of forecast errors and the resulting budget problems that accompany such errors. Increasing the State's reliance on the individual income tax will not make the revenue structure more stable.

Regarding progressivity, the top 2.9% all Arizona taxpayers (in terms of federally adjusted gross income) pay nearly half of the State's income taxes, and the bottom 38.7% of all taxpayers pay 2.6% of total tax revenues (see the following table).

Tax Year 2007 Personal Income Tax Liability

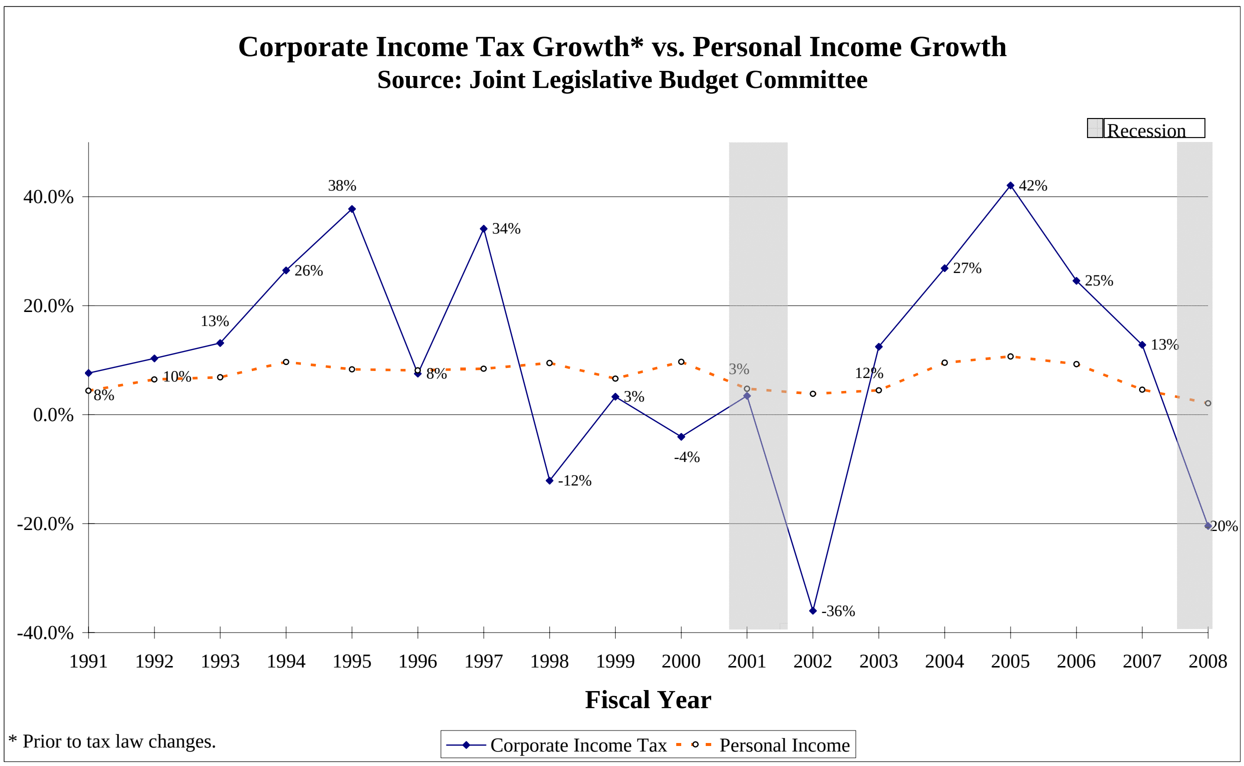
Income Level	Tax Bracket	# Filers	% Total	Tax Liability	% Total
No Income-$24,999	2.59%	931,201	38.7%	$82,886,083	2.6%
$25,000-$39,999	2.88%	437,089	18.2%	$185,904,318	5.9%
$40,000-$74,999	3.36%	537,266	22.4%	$471,000,548	15.0%
$75,000-$199,999	4.24%	427,842	17.8%	$963,618,930	30.8%
$200,000-$5,000,000+	4.54%	70,389	2.9%	$1,430,211,912	45.6%
Total		2,403,787	100%	$3,133,621,791	100%

Source: AZDOR

Corporate Income Tax

The corporate income tax is by far the most problematic of the larger State taxes in terms of being cyclical and unpredictable. The State's current corporate income tax rate is 6.968% and is applied to a company's taxable income. The corporate income tax is unpredictable, even in non-recession years. During the past decade, the corporate income tax has grown by as much as 42% in FY 2005, and declined in a single year by as much as 36% in FY 2002. Again, the most recent two consecutive fiscal years have been unprecedented in that they *both* posted percent losses (of 20% or more) creating massive declines in tax collections. No other tax comes close in terms of being unpredictable.

The tax is essentially applied to corporate profits. Since profits are the revenues that remain after accounting for a wide variety of costs, they can fluctuate wildly from year to year. Accounting procedures can also make the profits in any single year larger or smaller depending on if there is a desire to display larger returns for the benefit of investors, or smaller returns to minimize tax liability. In addition, a number of tax credits have added further uncertainty to collections. The following chart displays the historical growth rates in the tax.



Unlike the sales tax and the individual income tax that both bring billions of dollars to the state, the corporate income tax typically yields between $400 million and $800 million. While a large forecast error in the corporate income tax may not create as many problems as a small forecast error in the other taxes, even a $60 million estimation error could cause budget issues for the state. This tax is a good candidate for a rate reduction, complete elimination, or replacement with an alternative method of collecting revenue, such as a franchise tax (if an efficient and predictable one can be crafted).

2.5 Tax Law Recommendations

2.5.1 Targeted Reductions in Business Property Taxes

Recommendation Synopsis: A new property tax classification should be created to provide direct relief to targeted base sector industries. This would also eliminate the potential for "dead-weight-revenue-loss" through relief to local market industries that would arise from a general reduction in the business class assessment ratio or through a general increase in the personal property exemption value.

Absent the political support for a targeted property tax reduction, a secondary recommendation would be for broad based business property tax relief. The targeted tax reductions should come in the form of a reduction of personal property tax payments for the targeted base sector groups and/or a more general reduction in the commercial assessment ratio.

<u>*Background*</u>

The Arizona property tax system categorizes real and personal property into different "classes" by their current use. Nine different classes of property cover commercial, residential (owner occupied and rental residential), vacant or agricultural, historic, government, and other special uses. The designation of property by its use determines, most importantly, its assessment ratio.

PROPERTY TAX CLASSES

Class		
1	22%	Properties of mining, utility, and telecommunication companies, standing timber, airport fuel delivery, producing oil and gas property, pipeline property, shopping centers, golf courses, manufacturers and most other commercial property.
2	16%	Agricultural property, properties of nonprofit organizations, and vacant land.
3	10%	Residential property not used for profit.
4	10%	Leased or rented residential property and residential common areas.
5	18%	Airlines, railroad and private car company property.
6	5%	Noncommercial historic property, property located in a foreign trade, military reuse, or enterprise zone, property of a qualified environmental technology manufacturing facility.
7	22% or 1%	Property that meets the criteria for Class 1 property and also the criteria for commercial historic property.
8	10% or 1%	Property that meets the criteria for Class 4 property and also the criteria for commercial historic property.
9	1%	Improvements on federal, state, county, and municipal property.

Source: JLBC; AZ Revised Statutes

The value of property is assessed each year by either county assessors or the Arizona Department of Revenue. Various taxing entities such as school districts, municipalities, counties and others set rates to total net assessed values which creates the final property tax liability to be collected. The assessment ratio, which currently ranges from 1% to 22% of assessed value, is applied to calculate tax liability as follows:

ASSESSED VALUE * ASSESSMENT RATIO – EXEMPTIONS = NET ASSESSED VALUE

NET ASSESSED VALUE / 100 * PROPERTY TAX RATE = TAX LIABILITY

While all classes of property are treated evenly as far as assessing full cash value and holding all owners responsible to the appropriate taxing entities, the assessment *ratio* varies widely by the property's use, making equally valued property under various property tax classes have significantly different property tax liabilities. The highest assessment ratio (22%) is assigned to most commercial use property (or Class 1). This creates a much higher tax liability for commercial property owners on a "per dollar of value" basis.

Changes to the System

There have been numerous statutes enacted to alter the basic property tax system. Special zones, exemptions, limitations, depreciation schedules, and alterations to assessment ratios are among many of these changes. Some of the most notable changes are explained in more detail.

Class 6 of the property tax classes, originally set up for historic property, now contain several types of property. This class has an assessment ratio of 5%, which is quite low in comparison to most of the other classes and is likely the reason it has been used extensively for new programs. Special economic development zones have been established such as Enterprise Zones, Foreign Trade Zones, and Military Reuse Zones. Each is a specially designed program with sometimes unique qualifications. Once met, those that qualify under these zones receive significant property tax reductions, among other tax liability reductions. The following table lists some of the companies under the Foreign Trade Zone designation within Greater Phoenix.

General Purpose Zone		
Goodrich	Manufactures and services evacuation systems for commercial aircraft	Phoenix
Subzones		
Abbott Laboratories	Manufacturer of medical nutritional supplements and products	Casa Grande
American Italian Pasta Company	Manufacturer of pasta products	Tolleson
Conair	Distribution center for consumer appliances and related products	Glendale
Intel	Manufacturer of semiconductors and integrated circuits	Chandler
Microchip Technology	Manufacturer of semiconductors and integrated circuits	Chandler Tempe
PETsMART	Regional distribution center for pet products and supplies	Phoenix
ST Microelectronics	Manufacturer of semiconductors and integrated circuits	Phoenix
SUMCO Southwest Corporation	Manufacturer of silicon wafers for semiconductor producers	Phoenix

While property tax classifications have generally been designed according the use of a property, many exemptions have been established based on the type of owner of property. Most government, non-profit (educational, charitable, and religious), and cemetery property is exempt from property taxes. In addition, widows or widowers and disabled persons can qualify for property tax exemptions. In terms of personal property, household personal property and inventories for resale are exempt, as is the first $65,013 of full cash value for business and agricultural personal property.

Depreciation schedules have long been used by the Arizona Department of Revenue to determine the value of personal property. Life years are assigned to personal property and a schedule of depreciation is utilized to determine its current value based on its age. The latest accelerated depreciation schedule was enacted in 2007 and affects commercial and agricultural property for the first five years of use. Effectively, any personal property acquired after 2007 receives significant discounts on the value of the property, which ramps down over the first five years of use. By the time the additional depreciation ceases, the owner benefits through the original depreciation schedule after having five years of use. The following table has been prepared to illustrate the effect that this acceleration schedule can have for new investment.

Accelerated Depreciation Schedule
Example of Property Valued at $100,000 and 10 Year Life

Original Value	$100,000
Life of Property (Years)	10

Age (Years)	Depreciation Schedule	Value	Additional Depreciated Value	New Value for Property Tax	Effective Depreciation
1	90%	$90,000	30%	$27,000	27.0%
2	83%	$83,000	46%	$38,180	38.2%
3	77%	$77,000	62%	$47,740	47.7%
4	69%	$69,000	78%	$53,820	53.8%
5	62%	$62,000	94%	$58,280	58.3%
6	51%	$51,000	100%	$51,000	51.0%
7	39%	$39,000	100%	$39,000	39.0%
8	26%	$26,000	100%	$26,000	26.0%
9	13%	$13,000	100%	$13,000	13.0%
10	2.5%	$2,500	100%	$2,500	2.5%

Source: AZ Dept. of Revenue; Elliott D. Pollack & Co.

Lastly, the Commercial Class 1 is undergoing a gradual reduction of its assessment ratio. Beginning in 2006, the assessment ratio was to be reduced by 0.5% each year until it reached a 20% assessment ratio in 2015. It was to remain at 20% from that point forward. Beginning in 2008, that reduction was accelerated by reducing the assessment by 1% per year to reach the 20% ratio by 2011. The following table illustrates the current and expected progression of the commercial property tax assessment ratio. As it currently stands, all commercial and industrial property will realize a reduction in net assessed value by a combined 20% by 2011 from its previous high in 2005.

Class One - Commercial
Assessment Ratio Schedule

2005	2006	2007	2008	2009	2010	2011
25.0%	24.5%	24.0%	23.0%	22.0%	21.0%	20.0%

Source: JLBC

Ongoing Efforts

There have been numerous efforts to reduce the Commercial Class 1 assessment further. In the latest round of budget bills, a statute was introduced to continue the decrease of the assessment ratio down to an eventual 16% rate, which is equal to vacant and agricultural property ratios. Since that version of the budget bill was ultimately vetoed, the proposed change did not go into effect.

More specifically, the views of the Arizona Tax Research Association (ATRA) were garnered with specific attention to the business property tax. In their view, Arizona's business property tax system has been bleak for quite sometime. Though improvements have been made (as described above: competitive depreciation schedules on personal property, decreasing the assessment ratio from 25% down to 20% by 2011) which are starting to improve our rankings among states, not enough action has been taken. It is their opinion that at its core, property taxes should be based on VALUE and not use. A value based system (essentially the elimination of assessment ratio disparity) would create equality and accountability across the board. This would be a structural change to the property tax system, shifting property tax liability from previously higher assessed ratios (businesses) toward lower assessed ratios (mostly residential property owners).

In terms of specific action items in the absence of a complete overhaul of the system, ATRA recommended that the Class 1 Commercial assessment ratio be lowered to 15%. Based on their previous analyses, it was believed that there may currently be enough room between the homeowner cap of 1% to be able to allow Class 1 to be reduced to 15% and maintain current levels of revenue because property tax rates have come down significantly from their high in the mid 1990's. Thus, much like the value based system, the relief to businesses would come at the expense of all other categories (mostly residential property owners) because it would cause property tax rates to increase.

Further Considerations

The overall goal of effective economic development is to attract (or retain) base industry operations without paying out more than what would be received. The current property tax system offers a few options to accomplish effective economic development. In other words, the goal is to reduce the property tax liability of base industry companies to induce investment that would create even greater benefits (including tax benefits) to offset any foregone property tax revenue. In addition, policies that both have political support and provide the biggest return should receive prioritized attention.

Business property tax collections for the most recent three years were analyzed in depth to assist in potential policy recommendations. In the most recent tax year (2009), Class 1 Commercial comprised over 92% of the net assessed value of personal property and over 26% of real personal property. Overall, personal property makes up approximately 10% of total net assessed value for the State.

Class 1 has 11 sub-classes. Over half of those sub-classes (6) are centrally assessed, consisting of uses such as mines, gas & electric, oil & gas, water utilities, pipelines, and telecommunications. Of these uses, only mining would largely be considered a base industry for Arizona, and it is unique in that the commodity that is sold outside the state is found naturally, not created. These six sub-classes combined for over 73% of the net assessed value of personal property. Additionally, personal property comprises a large portion of these businesses' total property value. The remainder of the personal property assessed value (27%) is mostly found within the general commercial sub-category as well as manufacturing.

As observed by tax abstract reports, altering the entire personal property tax liability, even targeted at only Class 1 property, provides benefits to businesses that are not necessarily considered base industry operations. This equates to a dead weight loss of funds from these local industries because no resulting benefits would likely materialize. Thus, a more targeted approach is necessary.

The State should continue to implement modifications to the current tax code to attract *or* retain base industry operations. Bills such as the most recent Renewable Energy Headquarter or Manufacturing bill included property tax relief by allowing qualifying companies to be classified under the much desired Class 6 (5% assessment ratio) for a limited period of time.

For an example, many throughout the State recognize the benefits realized by the existence of the aerospace industry. Retention programs/statutes for base industries such as the aerospace industry should receive at least as much consideration as programs designed to attract new industries or businesses. Retention programs also appear to have political clout because the industries already exist and are both appreciated and touted as strengths of the State's economy. Losing industries that we already have would be far more devastating than losing those we haven't landed yet. There appears to be support for retention programs, even among those that oppose similar programs (targeted tax relief) designed to attract new businesses.

Recommendations

The greatest opportunity appears to be in carefully constructing a policy where a new property class is created for base industry companies for tax relief purposes. Such an adjustment appears to be both legal and politically feasible, especially if it is an across the board change where both new and existing companies realize the benefit.

In a zero sum game, any reduction or abatement of property tax liability to one group will increase property tax rates to everyone which would effectively shift the burden to non-base industry commercial, residential, agricultural and other properties. This is only true for the abatement of *existing* base industries however. Any new business attracted as a result of a more competitive business property tax rate is considered net new money.

The possibilities for a new Base Industry property tax class are open for discussion. Decisions must be made on an appropriate assessment ratio as well as whether or not the class would benefit from programs already assisting Class 1 properties such as accelerated depreciation, or whether new policies specifically given to this class should be formulated.

To the extent possible, base industry operations should be evaluated to determine their most likely property tax liabilities. For example, the manufacturing sub-class has an aggregate net assessed value of 70% real property versus 30% personal property. Any adjustment to the assessment ratio would offer the biggest impact, affecting both personal and real property. Policies such as personal property tax exemptions and accelerated depreciation affect only the personal property tax portion of the liability. Depending on the type of base industry operation, policies affecting only personal property tax liability could have varying effects.

This new recommendation is not meant to necessarily undercut all of the programs currently in place. As such, the assessment ratio should probably not be as aggressive as the Class 6 ratio given to special geographic zones, allowing economic development efforts with such programs to remain effective. However, the new class will help to alter the overall climate of operating base industries in the State.

Through a new class for base industry companies, the operating costs of such companies would be reduced to allow for additional investment. As illustrated previously, the multiplier effects of base industries were demonstrated to show how each new dollar of investment becomes much larger through its ripple effects in the economy. Additionally, the crafting of this new class will carry with it qualifications to help ensure that the State is a net beneficiary in this effort.

Implementation

Should the decision be to adopt property tax relief to base industries through a new property tax class, implementation and administration must be considered.

We have identified a potential statewide implementation strategy though the alteration of the Arizona Department of Revenue Property Use Code Manual, which is a standardized method of describing property within the State for purposes of classification and proper taxation. A four-digit numeric code is used to identify the current use of properties throughout the State. This use code is established by selecting the general type of property use from a list of choices (this comprises the first two digits). Next, the third digit identifies the use of the property by several subcategories. Finally, the fourth digit is checked against a list to determine if the property can be described more completely (such as type of ownership, story height, etc.). Personal property classifications have also been established as well as categories of exempt property, which is mainly based on ownership.

After use codes are established, property tax systems have been automated to assign groups of use codes to the appropriate larger legal class (Classes 1-9). Once property has its legal class, its assessment ratio and any other specific exemptions or adjustments are made to determine tax liability. It appears that the four-digit property use code could be used by amending it to include sub-categories or even refining fourth digit uses to classify base industry operations separately from similar uses. Once those new codes have been established, they can be programmed to filter into the new Base Industry class of property.

A clearinghouse would need to be established to recode existing properties as well as assess new base industries. It appears that the Department of Revenue may be an appropriate entity to administer such a program. After guidelines are determined to "qualify" as a base industry, the administering department would authorize base industry coding through new applications and through annual assessments. The charge should not fall on local county assessors to make the final determination of a base industry.

While attracting new base industries, the entity charged with "landing" a company or helping a company to get established should be aware of all of the economic development tools that the State offers and ensure that these companies receive all of the promised benefits. That would include assisting in the coding or recoding of property to receive property tax relief. It is recommended that the defining criterion for a base industry property tax code be limited in its initial implementation to guard against loopholes and unintended recipients of property tax relief, and that the criterion be reevaluated periodically as unique circumstances or unprecedented export related industries present themselves for qualification.

The recommended business property tax reduction has the potential of having an immediate impact on business relocation decisions and also on the retention of current businesses if combined with a proper State marketing campaign and the implementation of additional economic development programs that are recommended in this report.

2.5.2 Corporate Income Tax Rate Reduction

Synopsis: It is recommended that the corporate income tax rate be reduced to from 6.968% to 5.0%. There are multiple choices for funding such a reduction: 1) delay and/or phase the reduction until fiscal stability is achieved, 2) review and model current corporate income tax credits for effectiveness and eliminate a portion if inefficient, 3) utilize any remaining stimulus monies for implementation before fiscal stability is achieved, and 4) tie any tax rate reductions to new economic activity that will be achieved through the implementation of other policies recommended in this report. The last option will require detailed monitoring of any newly implemented programs to identify net new economic activity that would not have occurred but for the new legislation.

<u>*Background*</u>

The corporate income tax is by far the most problematic of the larger state taxes in terms of being cyclical and unpredictable. The state's current corporate income tax rate is 6.968% and is applied to a company's taxable income. California's tax rate of 8.84% is the highest among competitor states. Arizona's rate is about on par with New Mexico but is less attractive than Utah's (5.0%), Colorado's (4.63%) and Nevada's (no tax).

The tax is applied to corporate profits. Since profits are the revenues that remain after accounting for a wide variety of costs, they can fluctuate wildly from year to year. Accounting procedures can also make the profits in any single year larger or smaller depending on if there is a desire to display larger returns for the benefit of investors, or smaller returns to minimize tax liability. In addition, a number of tax credits exist that reduce the effective tax rate below the listed 6.968%. However, laws exist that prohibit the review of detailed tax records. For this reason the effective tax rate on businesses by type remains an unknown. This also means that the

State cannot rely on only a corporate tax rate reduction for business recruitment purposes. A corporate tax rate reduction needs to be combined with other economic development programs and marketing to be effective.

Unlike the sales tax and the individual income tax that both bring billions of dollars to the State, the corporate income tax typically yields less than 10% of General Fund revenues. While a large forecast error in the corporate income tax may not create as many problems as a small forecast error in the other taxes, even a $60 million estimation error could cause budget issues for the state. This tax may be a candidate for a rate reduction, complete elimination, or replacement with an alternative method of collecting revenue, such as a franchise tax (if an efficient and predictable one can be crafted).

After interviewing business location professionals from across many states, it is recommended that the corporate income tax rate simply be reduced to 5.0%. This would make the rate regionally competitive and move Arizona from middle of the pack to the bottom quartile among the 50 states. This would also yield a tax rate that is more consistent with the highest personal income tax rate of 4.54% which has a certain degree of logic. Unlike with the other recommendations contained in this report, the rate reduction down to 5.0% could come at a short term cost if not offset by the elimination of any inefficient corporate income tax credits or any net new business activity that occurs as a result of the implementation of the recommendations in this report. Therefore, the recommended rate reduction must either be phased in or delayed, or some offsetting revenue source must be identified. The first candidate for an offsetting revenue source is the potential elimination of inefficient tax credits that currently exist in statute. This review is outside the scope of this report and would need to occur before implementation of the reduction.

Despite the suggestion by many conservative tax analysts, it is not recommended that the corporate income tax be completely eliminated. While general tax competitiveness is indeed a factor in business location decisions, no known business locations around the U.S. (not just Arizona) have been made solely based on the nonexistence of a corporate income tax rate. This is because State and local taxes are only a part of a company's overall cost of doing business (about 5% to 8% typically). A low corporate income tax does signal a community's level of being business friendly and may play a role in making a top 10 list of possible relocation sites, but the rate itself does not close the deal and the rate reduction needs to be limited.

In addition, many local market businesses (i.e. retailers, local service providers, etc.) that are dependent on the resident population and cannot relocate also pay the corporate income tax. It would be inefficient to provide tax relief for this class of business beyond a modest rate reduction. While some of the aforementioned "dead-weight-revenue-loss" could occur if local market industries can also participate in the lower rate, this may be considered acceptable collateral damage as the benefits should outweigh the costs in the longer term.

The final reason to simply reduce the tax rate only moderately is the fact that the corporate apportionment formula, or the formula that allocates taxable income to Arizona, is already constructed to reduce tax liability on base industry operations. To calculate the tax liability of a multi-state firm, the firm's income is "apportioned" to Arizona through a formula that considers the amount of property, payroll, and sales that a company has in the state compared to elsewhere. Prior to 2008 there was only a double weighting of the sales element of the equation, also known as the sales factor. Currently, the sales factor is super weighted by a factor of eight. This means that a company that has mostly out of State sales activity but employs local labor receives a benefit. However, detailed records on this exact benefit are not available.

The conclusion is that the State's *effective* corporate income tax rate is not overly oppressive on those businesses that fuel the economy, but it is high enough to make the State appear less competitive in terms of business relocation or expansion decisions and could also potentially hinder some small business expansion. Only a moderate rate reduction is recommended and must be combined with enhanced marketing of the State.

3.0 Economic Development Programs

Section Synopsis: The second component of promoting a strong State and local economy is to develop targeted incentives that actually result in new business locations. Unfortunately, Arizona lags most of the country in the effectiveness of its economic development programs. On the positive side, this means that we can model the State's new programs after those across the country that have proven to be most effective and efficient.

This section of the report provides a basic primer on economic development programs and the effects on economic development policies. First, a general review of state by state rankings is provided. While a number of studies use different methodologies to form their conclusions, the same states consistently make the top 10 list in these reviews. Arizona should be one of them. Second, a discussion of why incentives matter is provided along with a description of the corporate site selection process. This provides insight into what really matters to business leaders when they look at new locations. Next, a more detailed review is provided that identifies the extent that the State is competitive when it comes to attracting new businesses. This provides insight into how we can improve. Last, a list of best practices is developed and recommendations are formed.

In general, the most effective economic development tools include programs related to job training, incentives for the creation of new (and retention of existing) high paying jobs in base industries, and the creation of deal closing funds. Other programs are also reviewed below. A list of guiding principles is also provided that will assist policymakers with designing and implementing the recommended programs.

3.1 Overview of Corporation Site Selection

The primary role of Arizona's economic development policy is to support business recruitment and retention. Firms considering relocation or expansion almost always evaluate how state economic development assistance might affect their total cost of doing business in a particular location. In order to effectively and efficiently target economic development policies, a clear understanding is needed of the corporate site selection process and what questions a CEO asks when making a location decision.

3.1.1 Business Climate Rankings

Company executives, economic development agencies, and site selection consultants keep a close eye on a state's business climate ranking. Whether to confirm a perception or satisfy curiosity, business climate rankings tend to be one of the first items of business when considering new operations. In many cases, papers on state rankings are produced by individuals or organizations with a particular agenda to promote. These are the ones that somehow list North Dakota as the best place to start a business. For this reason it is important to select those reports that are written for general research purposes and not to promote some social or economic agenda. It is also important to understand each report's methodology.

A number of business climate rankings are periodically published by Site Selection Magazine, Business Facilities, CNBC, Forbes, Chief Executive Magazine, and IBM Global Business Services, just to name a few.

State Business Climate Rankings

	2009 Business Climate Rankings	2009 Top Ten Competitive States	2009 Top States & Provinces in North America	2009 Best & Worst States for Business	2009 America's Top States for Business	2009 The Best States for Business	2009 Top 10 States for Business Climate
	Site Selection Magazine	*Site Selection Magazine*	*IBM Global Business Services*	*Chief Executive Magazine*	*CNBC*	*Forbes*	*Business Facilities*
1	North Carolina	Ohio	Ontario	Texas	Virginia	Virginia	Texas
2	Texas	North Carolina	Virginia	North Carolina	Texas	Washington	South Dakota
3	Virginia	Michigan	Ohio	Florida	Colorado	Utah	Wyoming
4	Ohio	Pennsylvania	South Carolina	Georgia	Iowa	Colorado	Utah
5	Tennessee	Kentucky	Pennsylvania	Tennessee	Utah	North Carolina	Florida
6	South Carolina	Texas	Quebec	Nevada	Minnesota	Georgia	Delaware
7	Alabama	Tennessee	North Carolina	Virginia	Kansas	North Dakota	Washington
8	Georgia	Alabama	California	Arizona	Massachusetts	Texas	Montana
9	Indiana	Indiana	Illinois	South Carolina	North Carolina	Nebraska	Oregon
10	Kentucky	South Carolina	Indiana	Colorado	Georgia	Oregon	New Hampshire
Arizona	**24**	**--**	**--**	**8**	**18**	**36**	**--**

Source: Elliott D. Pollack & Company; Site Selection Magazine; IBM Global Business Services; Chief Executive Magazine; CNBC; Forbes; Business Facilities.

The validity of the methodology used in each business climate ranking survey can certainly be argued. However, right or wrong, the typical CEO tends to rely on these rankings at face value. Arizona's ranking in these surveys should not be the primary focus of the State's economic development policy, but it is important to recognize Arizona's perception among the general business community.

Following is a brief breakdown of the methodology and where Arizona ranks in each survey.

➢ ***2009 Business Climate Rankings***

- Source = Site Selection Magazine
- Top 3 States = North Carolina, Texas, Virginia
- Arizona Ranking = 24
- Methodology

  Executive survey ranking, number of new significant businesses opened in 2008, number of new significant businesses opened between 2006 and 2008, new business openings per one million of population, and number of new significant businesses opened in 2009 through August.

➢ ***2009 Top Ten Competitive States***
- Source = Site Selection Magazine
- Top 3 States = Ohio, North Carolina, Michigan
- Arizona Ranking = n/a
- Methodology

  Total facilities per one million of population in 2008, total capital investment per one million of population in 2008, total new jobs created per one million of population in 2008, absolute number of total new facilities in 2008, % growth of new facilities from 2007 to 2008, % growth of new facilities from 2005 to 2008, ranking in Site Selection's most recent annual business climate survey, number of top 100 metro areas in Site Selection's annual ranking of top metros, number of top 100 small towns in Site Selection's annual ranking of small towns, number of 100+ job projects per one million of population in 2008.

➢ ***2009 Top States & Provinces in North America***
- Source = IBM Global Business Services
- Top 3 States/Provinces = Ontario, Virginia, Ohio
- Arizona Ranking = n/a
- Methodology

  Job creation from significant foreign investment in 2008.

➢ ***2009 Best & Worst States for Business***
- Source = Chief Executive Magazine
- Top 3 States = Texas, North Carolina, Florida
- Arizona Ranking = 8
- Methodology

  Annual survey of 543 CEOs; Issues surveyed include proximity to resources, regulation, tax policies, education, quality of living, and infrastructure; Other issues include taxation & regulation, workforce quality, and living environment

➢ ***2009 America's Top States for Business***
- Source = CNBC
- Top 3 States = Virginia, Texas, Colorado
- Arizona Ranking = 18
- Methodology

  Ranking based on 40 measures of competitiveness; Major categories include cost of doing business, workforce, quality of life, economy, transportation, technology & innovation, education, business friendliness, access to capital, and cost of living

➢ ***2009 The Best States for Business***
- Source = Forbes
- Top 3 States = Virginia, Washington, Utah
- Arizona Ranking = 36
- Methodology

  Ranking based on six categories including cost of doing business, labor supply, regulatory environment, current economic climate, growth prospects, and quality of life; Business costs that include labor, energy, and taxes are weighted the most heavily

➢ ***2009 Top 10 States for Business Climate***
- Source = Business Facilities
- Top 3 States = Texas, South Dakota, Wyoming
- Arizona Ranking = n/a
- Methodology

    Ranking includes cost of labor, business tax climate, quality of life, educated workforce, greenest state, transportation infrastructure, per capita GDP, population growth, and energy costs/efficiency

3.1.2 Key Strategic Drivers

Site Selection Magazine conducts an annual survey (similar findings as within the Area Development Magazine survey) of corporate real estate executives from a broad array of industries. This survey asks each executive to list the main site selection factors they consider when evaluating a location decision.

Top Site Selection Factors
2009 Corporate Real Estate Executive Survey

1	Transportation infrastructure
2	Existing workforce skills
3	State and local tax scheme
4	Utility infrastructure
5	Land/building prices & supply
6	Ease of permitting & regulatory procedures
7	Flexibility of incentives programs
8	Access to higher education resources
9	Availability of incentives
10	State economic development strategy

Source: Site Selection Magazine

Infrastructure, workforce, and tax climate are on the top of the list. Following these items are availability & cost of real estate and regulatory concerns. Overall, relative to all items most corporate real estate executives consider, economic incentives tend to be one of the final factors in a location decision.

The results of this Corporate Executive Survey are indeed practical and realistic in site selection today. Based on a fifteen year history of site selection engagements conducted by the CBRE Labor Analytics Group and Economic Incentives Group, the availability and cost of adequate labor, land, and facilities are usually the most important site selection factors. Incentives can become more decisive when competing markets have relatively similar labor costs and skill levels.

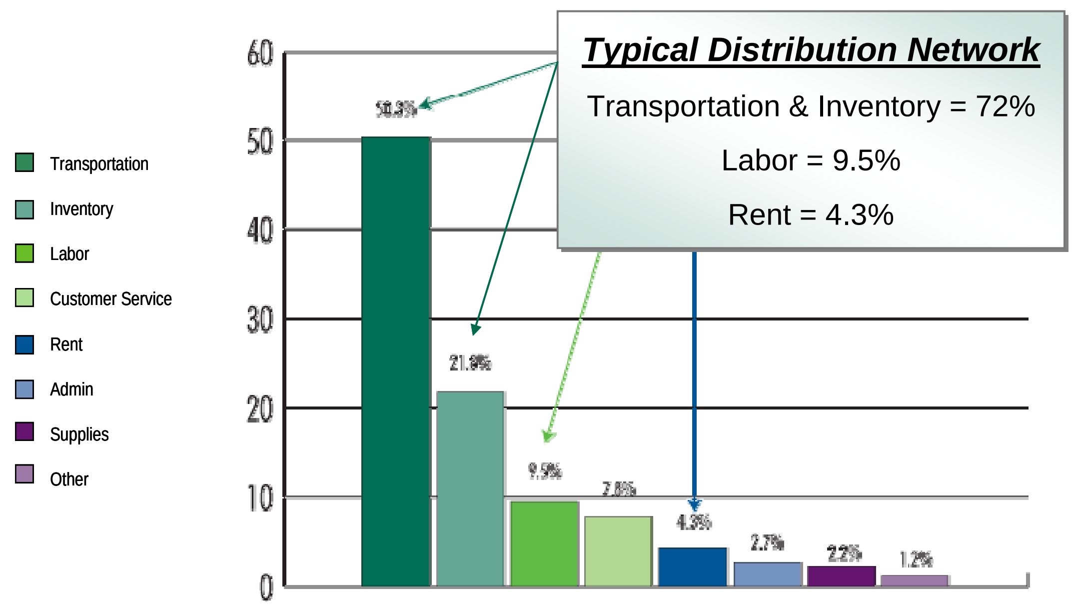
Economic development policy should be tied to the key strategic drivers of the base industries and operations a state wishes to recruit and retain. These strategic drivers can vary. There are two types of operations: capital-intensive and labor-intensive.

<u>Capital-Intensive Operations</u>

Capital-intensive operations tend to heavily invest in infrastructure, machinery, and equipment. These capital-intensive operations typically include manufacturing, distribution, life science/bio science facilities, research & development, and data centers. In general, start-up investment in machinery and equipment (part of business personal property) tends to be over $50 million for most significant capital-intensive operations around the U.S. For example, according to the CBRE Economic Incentives Group, the capital investment profile of a high-end data center can be $800 million with machinery & equipment accounting for 75% of total (or $600 million). The remaining 25% consists of real property investment (i.e. land acquisition, construction costs).

As shown on the following chart, transportation and inventory costs account for nearly 72% of the total cost of doing business for typical manufacturing and distribution operations. According to CBRE's Industrial Services division, location decisions for these operations start and stop with an evaluation of logistics (transportation & infrastructure) as well as proximity to suppliers and customers. Overall, labor costs, rent, and taxes are only a portion of the costs within the operations equation.

Operating Cost Profile for Captial-Intensive Operations



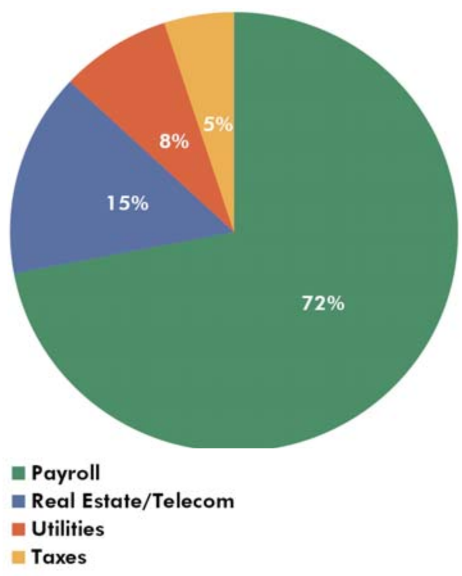
Source: CBRE Industrial Services – The Americas

From an economic development perspective, leading with a location's labor market attributes and taxes, for example, will not materially attract capital-intensive operations. Marketing and providing solutions for transportation costs, infrastructure, inventory taxes, and real estate (to an extent) is much more effective in recruiting these types of industries to Arizona. Targeting incentives to offset startup costs of these operations is critical for successful business recruitment or retention.

Labor-Intensive Operations

Labor-intensive operations tend to invest heavily in workforce and job training rather than machinery and equipment. These labor-intensive operations arise from industries such as financial services, business services, healthcare, information, insurance, and outsourcing just to name a few. Labor is at the forefront of an operation's success and is the key driver in a location decision. Since payroll costs can be upwards of 70% to 80% of total operating costs, the savings of locating in a more cost effective labor market is essential. For example, a savings of just $1 per hour for a financial analyst in Tucson compared to Denver yields annual labor savings of more than $1 million a year for a 500-job operation. Practically speaking, no amount of economic incentives or real estate cost savings could counteract the impact of labor costs in the long term.

Operating Cost Profile for Labor-Intensive Operations



Source: CBRE Labor Analytics Group

According to the CBRE Labor Analytics Group, a national site selection consulting group, a multitude of companies (from Fortune 500 to privately-held firms) realize tapping the right people for the jobs is the heart of their competitive advantage. Further expanding on the focus on labor, according to a 2009 White Paper from the CBRE Labor Analytics Group titled "When Companies Combine":

> "Understanding the future implications on operations by evaluating which markets can sustain operations when the economy returns to historic averages will

> be a crucial success factor as companies decide which markets to invest in today. By identifying new locations that align both with the location strategy set forth initially, as well as the specific skill set and logistic requirements, real estate departments can react quickly and locate the company in optimal labor markets for years to come."

From an economic development perspective, leading with a location's labor market attributes and job training & recruitment resources will be most effective in recruiting these types of industries to Arizona. Targeting incentives to offset the costs of labor, job training, and capital investment (to a lesser degree) is critical for successful business recruitment or retention.

3.2 How do Incentives Win Business?

Of course, incentives will not be the one and only factor that secures a business location in the State. The overall business strategy tends to come first with consideration of supply chain, transportation, labor, real estate, and taxes. After these strategic drivers are reasonably solved for, incentives can either level the playing field or be the deciding factor.

The net effects of meaningful incentive programs are to lower startup investment and reduce on-going operating costs. If an incentives package hits neither of these hot buttons, a business and site selection consultant will immediately write off the projected savings. At the end of the day, all pieces of a State incentives package need to be financially significant to the prospective business.

To help illustrate how incentives can win business, the CBRE Economic Incentives Group shared details of a recent confidential client who was evaluating two markets in the U.S. to combine into one facility a back-office call center and a mission critical Tier 3 data center operation. This opportunity was both a labor-intensive and capital-intensive operation. Projections called for 1,250 total jobs and total capital investment of $2.0 billion ($1.6 billion for equipment). The two markets on the short list have different real estate / facility options. One market has an existing building that could be retrofitted to fit the needs of the operation. The Governor and local community leaders were aggressively selling this option due to the economic importance of the proposed operation and relatively low cost structure of the state. The second market includes a "greenfield" site (vacant land that could accommodate new construction of the facility). After a 12-month site selection search, these two markets were identified has having relatively equal attributes including transportation, proximity to suppliers, labor availability and skill sets, and business tax climate.

First and foremost, labor costs were the primary focus since significant job creation was planned. As shown on the following table, the 1,250-job operation includes mostly Customer Service Associates and Management/Support. Average salaries for the Associate positions are $25,000 (or $12/hour) in the existing facility market compared to $20,800 (or $10/hour) in the greenfield site market. Additionally, Management/Support salaries were on average 10% lower in the greenfield site market. Over a 10-year period of time, total payroll was $44.8 million lower (on a net present value basis) in the greenfield site market compared to the market with the existing facility. Without incentives, the client would have chosen the market with the greenfield site.

Labor Cost Differential
Back office call center / data center

	Labor Cost Savings		
	Existing Facility	Greenfield Site	Existing Fac. Costs (Savings)
Number of Jobs			
Associates	1,000	1,000	
Management & Support	250	250	
Total	**1,250**	**1,250**	
Average Salaries			
Associates	$25,000	$20,800	
Management & Support	$65,000	$55,000	
Average	**$33,000**	**$27,640**	
Payroll			
Annual	$41,250,000	$34,550,000	$6,700,000
10-year Total	$412,500,000	$345,500,000	$67,000,000
Net Present Value	**$276,375,000**	**$231,485,000**	**$44,890,000**

Source: CBRE Economic Incentives Group

States and communities offered significant incentive packages to win the business. The market with the greenfield site offered $28.3 million in incentives over a 10-year period. This included free land, job creation tax credits, and a job training grant. The existing facility community offered $105.5 million in State and local incentives. This included federal grants for energy efficiency & infrastructure, use tax exemption on new equipment purchases, and a forgivable loan to help offset the cost of equipment. Additionally, the incentive package incorporated corporate income tax credits for job creation & investment, a job training grant, and real property tax abatement. Over 10 years on a net present value basis, the incentive package from the existing facility yielded savings about $64.6 million higher than the market with the greenfield site. If incentives were the driving force in this location decision, the existing facility market would be the clear winner.

In order to put the incentive savings in the proper context, a comparison to labor costs was necessary. Labor costs in the existing facility market were $67 million more expensive over ten years. By comparison, the existing facility market had an incentive package valued at more than $77 million higher than the greenfield site market. Combining these two items, total net operating costs over 10 years was $10 million lower (or $19 million lower on a net present value basis) in the market with the existing facility. All things considered, this confidential client chose the existing facility market because it had the best net economic opportunity.

Overall, the state and community with the existing facility creatively crafted an incentive package that addressed the inherent labor cost disadvantage for the jobs being created and addressed the client's sensitivities to both start-up investment and on-going operating costs. Ultimately, given the projected $2 billion investment, the state and community's contribution of

$53 million in start-up incentive savings was a significant consideration that helped win the business. Stated differently, if the incentive offers were equal between both markets, the Client would have chosen the existing facility market since more money was offered upfront rather than over a period of ten years.

Economic Incentive Savings
Back office call center / data center

	Economic Incentive Savings		
	Existing Facility	Greenfield Site	Existing Fac. Costs (Savings)
Start-up Investment			
Land cost subsidy	$0	$1,175,000	
Infrastructure grant	$1,200,000	$0	
Energy efficiency block grant	$500,000	$0	
Use tax exemption on equip.	$50,000,000	$0	
Forgivable loan for equip. purchases	$2,000,000	$0	
Total Start-up Incentives	**$53,700,000**	**$1,175,000**	**($52,525,000)**
Ongoing Operations			
Job creation tax credits	$20,625,000	$25,912,500	
Investment tax credits	$10,000,000	$0	
Job training grant	$1,250,000	$1,250,000	
Real property tax abatement	$20,000,000	$0	
Personal property tax abatement	Exempt	Exempt	
Total Ongoing Incentives	**$51,875,000**	**$27,162,500**	**($24,712,500)**
Total Incentive Savings (10-yr)	**$105,575,000**	**$28,337,500**	**($77,237,500)**
Net Present Value	**$84,460,000**	**$19,836,250**	**($64,623,750)**

Source: CBRE Economic Incentives Group

Net Economic Opportunity
Back office call center / data center

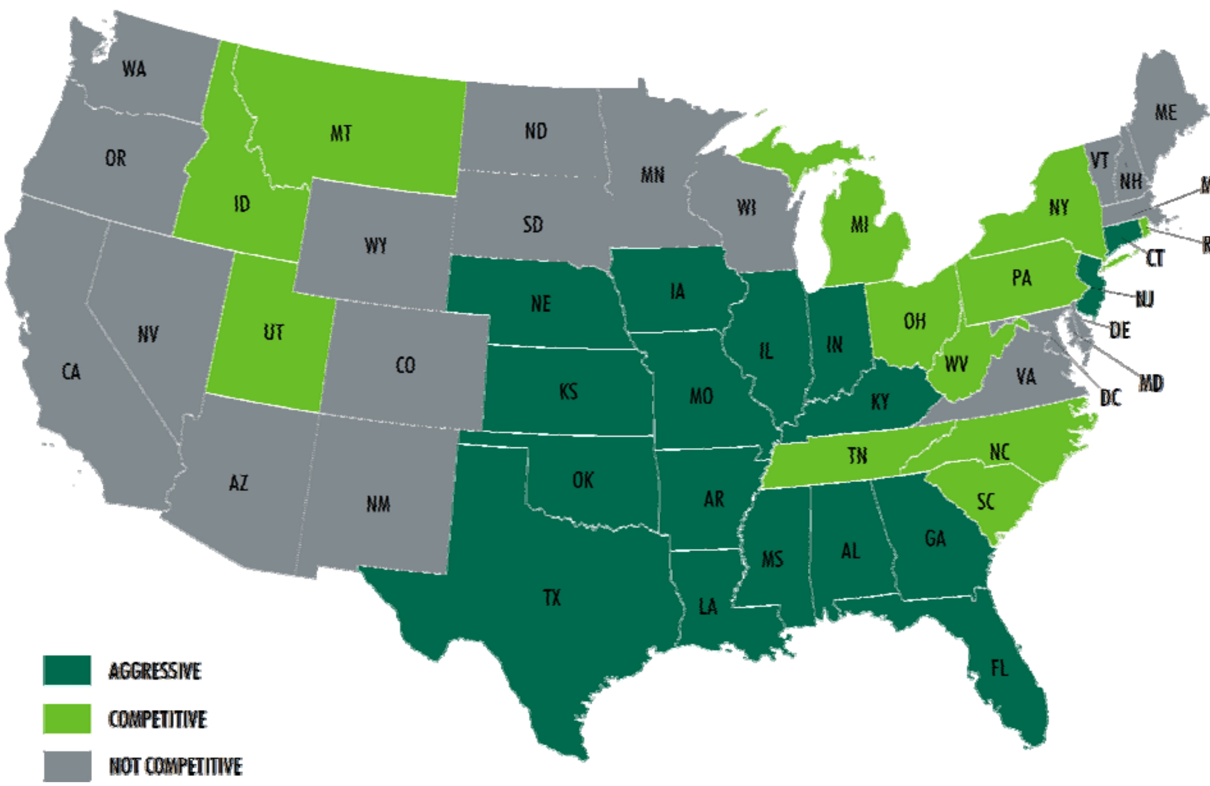
	Net Operating Costs (10-years)		
	Existing Facility	Greenfield Site	Existing Fac. Costs (Savings)
Labor Costs	$412,500,000	$345,500,000	$67,000,000
Economic Incentives Savings	($105,575,000)	($28,337,500)	($77,237,500)
Net Operating Costs	**$306,925,000**	**$317,162,500**	**($10,237,500)**
Net Present Value	**$191,915,000**	**$211,648,750**	**($19,733,750)**

Source: CBRE Economic Incentives Group

3.3 How Competitive is Arizona with Economic Incentives

All things considered (including geography, transportation infrastructure, supply chain, labor cost & availability, and other factors), economic incentives play a critical role in recruiting and retaining strong economic development prospects across the U.S. The following map illustrates each state's relative competitiveness with economic incentives. This map is produced by CBRE's Economic Incentives Group and is based on the Group's extensive experience with economic incentive negotiations across the U.S. during the past five years, each state's main economic incentive programs, and recent precedence for offering discretionary incentives. Each state is ranked as Aggressive, Competitive, or Not Competitive.

Economic Incentives Environment in 2009



Source: CBRE Economic Incentives Group

Aggressive states tend to have incentive programs that produce the most financially significant and varied incentive savings. These aggressive states range from Nebraska down to Texas, most of the Midwest (Iowa, Missouri, Illinois, Indiana, and Kentucky, and nearly the entire Southeast (Mississippi, Alabama, Georgia, Louisiana, and Florida). These states have a deep economic incentives toolbox to pull from including tax credit, job training grants, cash, and local incentives programs (free land, property tax abatements, forgivable loans).

Competitive states have some usable incentive programs but not as many as the Aggressive states (in general) and potential savings are most significant for pre-determined base industries. Competitive states range from states in the Northeast (Ohio, Michigan, Pennsylvania & New

York) to Tennessee & the Carolinas to Idaho, Montana, and Utah. In general, these states have taken the policy position they do not want to be one of the most aggressive states but need to be competitive on a case by case basis to win business recruitment.

States that are Not Competitive do not have many useful economic incentive programs and are mostly situated in the West and Northeast. These states have taken the position they do not play the incentives game or historically have not needed incentives to lure businesses. When competing for an economic development prospect also looking at Texas, Indiana, or New York (for example), the Not Competitive states do not have the resources to win the business, all things being equal. ***Arizona is currently Not Competitive.***

3.4 Arizona's Economic Incentives Toolbox vs. Other States

Arizona has approximately 20 State incentive programs as administered by the Arizona Department of Commerce (ADOC). Following is a listing of Arizona's incentive programs. Including a brief description from ADOC and the purpose of each incentive (see Section 3.2.2). The purposes of the incentives are categorized as (a) address cost disadvantages, (b) induce favorable economic activity, and (c) revitalize distressed communities.

3.4.1 Inventory of Arizona's Incentive Programs

Only 5 of Arizona's 20 incentive programs are considered useful to compete in today's world of business recruitment & retention. These programs include Enterprise Zone Program, Job Training Program, Renewable Energy Tax Incentive Program, Government Property Lease Excise Tax, and Additional Depreciation.

Enterprise Zone Program*:* This statutory tax incentive program is designed to provide tax benefits to businesses creating jobs and private investment in areas of the Arizona with relatively high poverty and unemployment rates. The Enterprise Zone Program offers two benefits. Corporate income tax credits are offered equal to $3,000 per new job created. Residency and wage thresholds exist to earn these credits. In addition, some manufacturing and commercial printing businesses are provided a real and personal property tax reduction. Only MWBE (also called minority or women owned business enterprises) and independently owned operations are eligible. General commercial development is excluded from participating.

Job Training Program: Subject to annual legislative funding, this incentive program provides reimbursement grants to offset a business's training costs for new employees and existing employees. Grants can reimburse up 75% of eligible costs for new employee training (50% for existing employees). ***In 2009, the Job Training Grant Program is suspended as funding has been depleted.***

Renewable Energy Tax Incentive Program*:* This statutory tax incentive program was enacted in 2009 to attract renewable energy headquarters and manufacturing operations to Arizona. Benefits under this program include refundable corporate income tax credits up to 10% of eligible investment and real & personal property tax reductions for operations with more than $25 million in capital investment.

Government Property Lease Excise Tax: This tax incentive program, known as GPLET, allows for property tax reductions on qualified real property investment. Property tax benefits under this program are only available when a qualified business leases land from a City. GPLET is not available to general commercial development where a City does not own land.

Additional Depreciation: This statutory incentive program allows for additional accelerated depreciation of business personal property.

A full listing of the State's incentive programs is provided on the following pages.

Inventory of Arizona's Incentive Programs

Source: Elliott D. Pollack & Company; Arizona Department of Commerce

Program	Purpose / Benefit
Grant & Loan Programs	
AZFAST Grants: Designed for entrepreneurs to develop and commercialize global technology by accessing Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) federal funding.	**Purpose** Induce favorable economic activity **Benefit** Discretionary Grant
Market Assessment Grants: Provides emerging technology entrepreneurs with a commercialization feasibility study; hence contributing to the formulation of successful marketing and licensing strategies.	**Purpose** Induce favorable economic activity **Benefit** Discretionary Grant
Commerce and Economic Development Commission (CEDC): To manage and leverage financial resources that enhance economic development within Arizona. ***2009: Program suspended***	**Purpose** Address cost disadvantages Induce favorable economic activity Revitalize distressed communities **Benefit** Discretionary Grant
ESP Program: Offers grants for road construction projects. This is a very competitive program.	**Purpose** Address cost disadvantages Induce favorable economic activity Revitalize distressed communities **Benefit** Discretionary Grant
Job Training Program: Supports the design and delivery of training plans that meet unique industry standards and challenges. ***2009: Program suspended***	**Purpose** Address cost disadvantages **Benefit** Discretionary Grant = 75% of new hire training costs and up to 50% of existing employee training costs

Continued

Private Activity Bonds:	**Purpose** Address cost disadvantages Induce favorable economic activity Revitalize distressed communities **Benefit** Below-market financing
Trade Adjustment Assistance (TAA) Program: Sponsored by the US Department of Commerce, has proven to be highly effective in addressing the challenges of import impacted manufacturing and producing firms.	**Purpose** Address cost disadvantages Induce favorable economic activity **Benefit** Discretionary grants
Tax Incentive Programs	
Additional Depreciation: Provides an additional depreciation schedule to encourage new capital investment by reducing personal property tax liability. The additional depreciation schedule is applied to the first five years of the property assessment and accelerates depreciation by five percentage points per year for five years.	**Purpose** Address cost disadvantages **Benefit** * Statutory * Accelerated depreciation over 5-year period. Year 1 to 5 depreciation factors are 30%, 46%, 62%, 78%, and 94%.
Angel Tax Credit: Expand early stage investments in targeted Arizona small businesses. The program accomplishes this goal by providing tax credits to investors who make capital investment in small businesses certified by the Arizona Department of Commerce.	**Purpose** Induce favorable economic activity **Benefit** * Statutory * Corporate income tax credit up to 35% of qualified investment
Commercial/Industrial Solar Energy Tax Credit Program: Stimulate the production and use of solar energy in commercial and industrial applications by subsidizing the initial cost of solar energy devices.	**Purpose** Induce favorable economic activity Address cost disadvantages **Benefit** * Statutory * Corporate income tax credit = 10% of cost of solar energy device not to exceed $25,000 per building

Continued

Enterprise Zone Program: Improve the economies of areas in the state with high poverty and/or unemployment rates. The program does this by enhancing opportunities for private investment in certain areas that are called enterprise zones.	**Purpose** Induce favorable economic activity Address cost disadvantages Revitalize distressed communities **Benefit** * Statutory * Corporate income tax credit = $3,000 per new job over 3 years; * Property tax reduction to 5% assessment ratio for manufacturing and commercial printing businesses. Limited to minority/women owned small businesses, independent firms.
Foreign Trade Zone: Areas treated as though legally outside the U.S. Custom's territory. Merchandise may be brought in duty-free for purposes such as storage, repacking, display, assembly or manufacturing.	**Purpose** Induce favorable economic activity **Benefit** * Federal & Statutory * Property tax reduction = 80% of real and personal property taxes
Government Property Lease Excise Tax Program (GPLET): All real property tax has been waived and replaced with an excise tax that is an established rate per square foot and based upon the type of use. Available to businesses that lease parcels from the City rather than own them outright.	**Purpose** Address cost disadvantages **Benefit** * Discretionary property tax reduction
Healthy Forest Enterprise Incentives Program: Promote forest health in Arizona. The program achieves this by proving incentives for certified businesses that are primarily engaged in harvesting, initial processing or transporting of qualifying forest products.	**Purpose** Induce favorable economic activity **Benefit** * Statutory * Use fuel tax reduction, transaction privilege tax exemption, use tax exemption on equipment, property tax reduction (real & personal), new job income tax credit
Military Reuse Zone Program: Established to lessen the impact of military base closures. Currently there are two Military Reuse Zones in Arizona.	**Purpose** Induce favorable economic activity **Benefit** * Statutory * Transaction privilege tax exemption, new job income tax credit, property tax reduction

Continued

Motion Picture Production Tax Incentives Program: Promote and stimulate the production of commercial motion pictures in Arizona.	**Purpose** Induce favorable economic activity **Benefit** * Statutory * Transaction privilege tax exemption, use tax exemption, new job income tax credit
Pollution Control Tax Credit: Stimulate the installation of pollution control equipment.	**Purpose** Induce favorable economic activity **Benefit** * Statutory * Corporate income tax credit = 10% of cost of pollution control equipment
Renewable Energy Tax Incentive Program: Encourage business investment that will produce high quality employment opportunities and enhance Arizona's position as a center for production and use of renewable energy products.	**Purpose** Induce favorable economic activity Address cost disadvantages **Benefit** * Statutory * Corporate income tax credit up to 10% of qualified investment in renewable energy headquarters or manufacturing facilities * Property tax reduction for facilities with capital investment exceeding $25 million.
Research & Development Income Tax Credit: Encourage qualified research and development done in Arizona. This includes research conducted at a state university and funded by the company.	**Purpose** Induce favorable economic activity **Benefit** * Statutory * Corporate income tax credit
In-Kind Programs	
Technology Assessment Program: Offers technology entrepreneurs access to an independent, expert review of their technology under development. Emphasis is placed on determining if the technology already exists, is a good candidate for intellectual property protection and likely to find an attractive market.	**Purpose** Induce favorable economic activity **Benefit** * Discretionary in-kind services

3.4.2 Inventory of Incentive Program in Other States

All 50 states have a number of economic incentive programs. These programs vary by type, availability, target industries, performance metrics, and methods of payment. For purposes of comparing Arizona to each state, this analysis is limited to the incentive programs available for general commercial and industrial businesses. Exclusions to this analysis are direct business financing, municipal grants & loans, local incentive programs, and other State programs not directly available to economic development prospects.

The CBRE Economic Incentives Group maintains a proprietary incentives database of more than 1,300 statutory and discretionary incentive programs across the U.S. and Canada. The table on one of the following pages summarizes the availability of incentive programs for all 50 states into seven primary categories. These categories include job tax credit, investment tax credit, job training grant, payroll rebate, cash grant / closing fund, sales/use tax exemption or rebate, and other tax exemptions.

Job Tax Credit*:*

➢ 38 of 50 states offer job tax credits;

➢ *Arizona – Limited: Enterprise Zone Program*

➢ These programs provide corporate income tax credits based on job creation and/or retention. Tax credits are issued upon employment verification on an annual basis, allowed to cover between 50% and 100% of tax liability in any given year, and permitted to be carried over to future tax years should tax liability not be sufficient to cover the earned tax credits. Some states allow tax credits to be transferred/sold to third parties. A few states allow these tax credits to be refunded.

Investment Tax Credit*:*

➢ 32 of 50 states offer investment tax credits;

➢ *Arizona – Limited: Renewable Industries ("Solar" legislation)*

➢ These programs provide corporate income tax credits based on capital investment in real and/or personal property. Tax credits are issued upon investment verification, allowed to cover between 50% and 100% of tax liability in any given year, and permitted to be carried over to future tax years should tax liability not be sufficient to cover the earned tax credits. Some states allow tax credits to be transferred/sold to third parties. A few allow tax credits to be refunded.

Job Training Grant*:*

➢ 49 of 50 states offer job training grants;

➢ *Arizona - Inactive*

➢ These programs provide grants to offset a portion of a company's training costs. Grants typically cover a defined list of eligible training costs and are typically paid out on a reimbursement basis. These costs include trainer salaries, travel costs, books, materials, training facility rent, and other items. Few states allow reimbursement of trainee wages.

Payroll Rebate*:*

➢ 9 of 50 states offer payroll rebates;

➢ *Arizona - None*

➢ Payroll rebates involve annual or quarterly cash refunds of a proportion of new annual payroll generated by an approved business. Payroll rebate benefits are expressed as either a percent of gross taxable wages or a percent of withholding taxes. Refunds are typically approved for 3 to 10 years.

Cash Grant / Closing Fund:

➢ 19 of 50 states offer cash grants or closing funds;

➢ *Arizona – Inactive/Previously limited*

➢ Cash grant funds are discretionary incentive programs that provide upfront cash to qualified businesses whose operations have a significant economic and fiscal impact on a State. These cash grants are typically paid upon receipt of full government approvals of an economic development agreement, prior to certificate of occupancy, or within two years. State deal closing funds are part of this category.

Sales/Use Tax Exemption or Rebate:

➢ 19 of 50 states offer sales/use tax exemptions or rebates;

➢ *Arizona – Limited (Film tax Credit)*

➢ Sales/use tax exemptions allow for full or partial abatements of sales or use taxes due on purchases of construction materials, equipment, and/or utility usage. Most sales/use tax exemption programs are limited to certain industries, types of operations, or performance metrics (i.e. job creation or capital investment).

Other Tax Exemptions:

➢ 19 of 50 states offer sales/use tax exemptions or rebates;

➢ *Arizona – Limited: Government Property Lease Excise Tax*

➢ Miscellaneous tax exemptions are offered by states to offset burdens of sales taxes, income taxes, use taxes, local property taxes, and fuel taxes just to name a few. These programs generally are not applicable to the typical economic development prospect. Most other tax exemption programs are limited to certain industries, types of operations, or performance metrics (i.e. job creation or capital investment).

See the table on the following page for additional detail.

Inventory of State Economic Incentive Programs

(Most widely used economic development programs)

State	Job Tax Credit	Investment Tax Credit	Job Training Grant	Payroll Rebate	Cash Grant / Closing Fund	Sales/use tax exemption or rebate	Other Tax Exemptions
Alabama	X	X	X			X	X
Alaska			X				
Arizona	**X**	**Renewable**	**Suspended**				**X**
Arkansas	X	X	X	X	X	X	
California	X		X				X
Colorado	X	X	X			X	
Connecticut	X	X	X		X		X
Delaware	X		X	X			
Florida	X	X	X		X	X	
Georgia	X	X	X		X		X
Hawaii	X	X	X				X
Idaho	X	X	X			X	
Illinois	X	X	X		X	X	
Indiana	X	X	X				X
Iowa	X	X	X		X	X	
Kansas	X	X	X	X	X	X	X
Kentucky	X	X	X				
Louisiana	X	X	X	X	X	X	
Maine		X	X			X	
Maryland	X	X	X		X		
Massachusetts		X	X				
Michigan	X	X	X				
Minnesota	X		X			X	X
Mississippi	X		X	X			
Missouri	X	X	X	X		X	X
Montana	X	X	X		X		
Nebraska	X	X	X			X	
Nevada			X			X	
New Hampshire			X				
New Jersey	X	X	X	X		X	
New Mexico	X	X	X		X		
New York	X	X	X			X	X
North Carolina	X	X	X	X	X		
North Dakota	X		X				X
Ohio	X	X	X				X
Oklahoma		X	X	X			
Oregon			X		X		X
Pennsylvania	X		X		X	X	X
Rhode Island	X	X	X				X
South Carolina	X	X	X		X		X
South Dakota			X				
Tennessee	X		X				X
Texas			X		X	X	
Utah	X	X	X		X		
Vermont	X	X	X			X	
Virginia	X		X		X		
Washington			X				X
West Virginia		X	X		X		X
Wisconsin	X		X				
Wyoming			X				

Source: CBRE Economic Incentives Group.

3.5 2009 Economic Development Announcements in the U.S.

Most state economic development agencies publicly announce major economic development successes. There were a number of significant announcements across the U.S. during 2009. A selection of these economic development projects range from auto manufacturing plants in Alabama & Louisiana to wind turbine manufacturing plants in Arkansas & Colorado to solar manufacturing facilities in Ohio & Georgia to outsources/IT support in Iowa & Indiana. While we expected a low number of economic development announces during 2009 relative to prior years, this simple example shows that companies are still expanding during a slow growth year. The case could be made that with more progressive, substantial economic incentives programs and business development efforts, Arizona could have aggressively competed for some of these projects.

Major 2009 Economic Development Announcements

State	Announcement	State	Announcement
Alabama	Mercedez-Benz to Expand Alabama Plant City = Vance Project Type = Expansion Industry/Operation = Auto assembly Jobs = n/a Investment = $290m	Kentucky	National Alliance for Advanced Transportation Batteries City = Glendale Project Type = New Industry/Operation = Advance battery manufacturing Jobs = 2,000 Investment = n/a
Arkansas	Mitsubishi Power Systems Americas City = Fort Smith Project Type = New Industry/Operation = Wind turbine manufacturing Jobs = 400 Investment = $100m	Louisiana	V-Vehicle City = Monroe Project Type = New Industry/Operation = Car manufacturing Jobs = 1,400 Investment = $248m
Colorado	Vestas Wind Systems City = Brighton Project Type = New Industry/Operation = Wind turbine manufacturing Jobs = 650 Investment = $180m	Michigan	General Electric City = Detroit Project type = New Industry/Operation = Advanced manufacturing R&D Jobs = 1,100 Investment = $100m
Connecticut	United Health Group City = Hartford Project Type = Retention Industry/Operation = Healthcare Jobs = n/a Investment = n/a	New Jersey	Arch Insurance City = Jersey City Project Type = New Industry/Operation = Insurance Jobs = 300 Investment = $n/a
Georgia	Suniva City = Atlanta Project Type = New Industry/Opreation = Solar cell manufacturing Jobs = 100 Investment = $55m	New York	Beach-Nut Nutrition Corp City = Florida NY Project Type = New, Retention Industry/Operation = Headquarters Jobs = 528 Investment = $124m
Illinois	U.S. Silica City = Ottawa Project Type = New Industry/Operation = Manufacturing Jobs = n/a Investment = n/a	Ohio	First Solar City = Toledo Project Type = Manufacturing, R&D Industry/Operation = Solar manufacturing Jobs = 134 Investment = n/a
Indiana	Alorica City = Lafayette Project Type = New Industry/Operations = Customer service Jobs = 450 Investment = $3m	South Carolina	Boeing City = North Charleston Project Type = New Industry/Operation = Aircraft manufacturing Jobs = 3,800 Investment = $750m
Iowa	IBM City = Dubuque Project Type = New Industry/Operation = IT Support Jobs = 1,300 Investment = $100m	Texas	Caterpillar City = Seguin Project Type = New Industry/Operation = Machinery manufacturing Jobs = 1,400 Investment = $169m

Source: CBRE Economic Incentives Group

3.6 Best Practices of Economic Incentive Programs

In consultation with the CBRE Economic Incentives Group, a review was conducted on all 1,300+ economic incentive programs in their database to find the most effective, flexible, targeted, and financially significant State programs across the U.S. These best practices are considered the most effective at recruiting and retaining businesses. The benefits, eligibility thresholds, and funding mechanisms should serve as the basis for any new economic incentive program in Arizona.

3.6.1 Job Training Grant Programs

Forty-nine out of 50 states (Arizona being the exception) currently have an active State job training grant program. Most job training grant programs across the U.S. are funded by general appropriations and reimburse a limited proportion of actual training costs incurred by businesses. Eligible training costs tend to include trainer salaries, books, materials & supplies, travel costs, curriculum & development, and some portion of rent for a training facility.

Iowa, Kansas, and New Mexico have the most effective State job training grant programs in the U.S. These job training grant programs have unique funding mechanisms and have evolved beyond the standard program to include reimbursement of trainee wages. The table on one of the following pages summarizes the best practices in State job training grant programs.

Iowa 260e Program

The 260e Program (also called Iowa New Job Training Program) is not funded by general appropriations. The 260e Program is funded by the issuance of industrial revenue bonds based on employee withholding taxes projected to be remitted by the business. When determining the size of the training grant, the State and local community college estimate the annual withholding taxes from the jobs and annual payroll expected to be generated by the business. Depending on the industry and average salary of the jobs, the State and community college will decide the percentage of total withholding taxes that will be diverted to cover the annual debt service of the bonds.

For the term of the bonds (5 or 10 year), the business is obligated to maintain an agreed-upon annual payroll and effectively write two checks when remitting withholding taxes. One check goes to the Department of Revenue and the second check goes to the community college for debt service. All in all, Iowa's funding mechanism is revenue-positive. Training grant proceeds rarely exceed the withholding taxes generated by the company's employees. Clawbacks are instituted to cover any shortfalls

In addition, the 260e Program covers the traditional training costs (trainer wages, consumable items, books, rent, etc) as well as trainee wages. Depending on the average wages of the new jobs to be created, up to 50% of trainee wages during training can be reimbursed. Reimbursement of trainee wages mostly outweighs all other eligible training costs.

Kansas IMPACT Program

IMPACT stands for Investments in Major Project and Comprehensive Training. Similar to Iowa, IMPACT is funded by the issuance of industrial revenue bonds based on a percentage employee withholding taxes. According to Kansas statute, no more than 95% of annual withholding taxes can be diverted to payment of debt service on IMPACT bonds. The value of a training grant is driven by the economic impact of the company on the State.

IMPACT grants have three uses of funds. Up to 50% of the IMPACT grant can be declared an upfront cash grant to offset costs of machinery, equipment, building improvements, payment of trainee wages, and other approved capital expenses. After deducting a standard 10% of gross proceeds as an administrative fee to the community college and local workforce board, the remaining grant is intended to cover traditional training costs (trainer wages, consumable items, books, rent, etc.). The upfront cash grant feature is a creative and unique feature the State of Kansas uses to thoughtfully recruit businesses to the State.

In addition to the funding mechanism, IMPACT allows for reimbursement of trainee wages. The State of Kansas has the discretion to fund up to six months of trainee wages. This discretion is dependent on the industry, average wages, and overall economic impact to the State.

New Mexico JTIP

JTIP stands for Job Training Incentive Program. JTIP is funded through general appropriations and grants are allocated on a quarterly competitive basis. The State of New Mexico bases its discretion for awarding JTIP grants on the industry, average wages, and overall economic impact to the State. Additionally, JTIP allows for reimbursement of trainee wages. Depending on the average wage levels of the projected new jobs, a JTIP grant can reimburse between 50% and 70% of trainee wages during training.

Arizona Job Training Program

Prior to being suspended in 2009, Arizona's Job Training Program provided reimbursement of eligible training costs (excluding trainee wages). Reimbursement was limited to 75% of eligible costs for new employee training and up to 50% for existing employee training. The Job Training Program was funded through general appropriations.

Other Key Features & Observations

These job training grant programs are discretionary and certain industries are eligible. The allowable industries are considered base industries such as manufacturing, processing, assembly, mining, and R&D. In fact, the enabling statutes for the Kansas and New Mexico programs limit training grants for service companies and multi-state wholesale distributors. These companies are eligible if and only if more than 51% (Kansas) and 60% (New Mexico) of revenue is generated out of state. While the statute enabling Iowa's training grant program excludes an out of state percentage, the established rules & regulations use a 60% rule of thumb for eligibility.

Clawbacks are an inherent feature in all three programs. Since the Kansas and Iowa training grants are tied to 5 to 10 year bonds, the company is liable for the full indebtedness. For example, if a company receives a training grant tied to a 10 year bond and ceases operations in year 5, the company is required to payback the remaining balance of the bonds since withholding taxes are no longer remitted. New Mexico's clawbacks are more negotiable and are indirectly based on when the State is made whole with withholding tax revenue.

All in all, these best practices in job training grant programs are designed to be revenue-positive.

Best Practices
State Job Training Grant Programs

State	Program Name	Type of Program	Eligible Industries	Eligible Uses of Funds	Clawbacks	Wage Threshold	Funding Mechanism
Iowa	**260E Program** Iowa New Jobs Training Program	* Reimbursement grant * Discretionary award	* Manufacturing * Processing * Assembly * R&D * Services in Interstate commerce;	* Customized training * On-the-job training * Skill assessment * Training equipment, materials, supplies * Training services of a community college or other institution * Testing/evaluation of employees * Travel costs of employees & trainers (airfare, hotel, per diem) * College tuition, books, fees * Fees / wages of a private / company trainer * Rent of training facilities * Up to 50% of trainee wages (depends on wages)	Yes. Company is required to fully pay down the issued bonds and related interest payments.	Yes Indirect threshold dictated by Program Rules & Regs. State and Community College have the discretion to deny an applicant with below average wages.	* Issuance of industrial revenue bond by local community college; * % of employee withholding taxes diverted to debt service on bonds; * 5 to 10 years bond term;
Kansas	**IMPACT** Investments in Major Projects and Comprehensive Training	* Reimbursement grant * Cash grant (upfront) * Discretionary award	* Manufacturing * Mutli-state wholesale distribution * Regional or national service companies (51% of revenue generated outside of KS) * Agriculture * Mining * R&D * Interstate transportation * Tourism activities targeting out-of-state tourists	* Customized training; * On-the-job training; * Trainer salaries; * Curriculum planning & development; * Travel costs (airfare, hotel, per diem) * Books, materials, supplies, manuals * Videotape development * Certain training facility costs; * Up to 50% of funds for training equipment or capital expenses; * Equipment relocation expenses; * Labor recruitment; * Up to 6 months of trainee wages;	Yes. Company must maintain operation for 2 years; Company is required to fully pay down the issued bonds and related interest payments.	Yes Indirect threshold dictated by Program Rules & Regs. State has the discretion to deny an applicant with below average wages.	* Issuance of industrial revenue bond by local community college; * Up to 95% of employee withholding taxes are diverted to debt service of bonds;
New Mexico	**JTIP** Job Training Incentive Program	* Reimbursement grant * Discretionary award * Competitive funding process	* Manufacturing * Warehouse/distribution * Export service companies (60%+ of revenue generated outside of NM)	* Classroom training at a public educational institution; * On-the-job training (OJT); * Combination of classroom and OJT; * Travel costs of trainers & employees (airfare, hotel, per diem) * 50% to 70% of trainee wages for up to 6 months (depends on wages);	Yes. Reimbursement offered on a pay-for-performance method	Yes	* General fund appropriation * Competitive funding process
Arizona	Job Training Program	* Reimbursement grant * First come, first serve	* Mostly all industries	* Course design & development * Trainer wages * Materials, supplies, consumable items * Travel costs * Equipment & machinery (some) * Rent of training facility (some) * Up to 75% of costs reimbursed for new employee training * Up to 50% of costs reimbursed for existing employee training	No	Yes	* General fund appropriation * First come, first serve

Source: Elliott D. Pollack & Company; CBRE Economic Incentives Group.

3.6.2 Payroll Rebate Programs

9 out of 50 states offer some type of payroll rebate incentive program. A payroll rebate mostly involves annual or quarterly cash refunds from a state based on a percentage of either new gross wages or new withholding taxes. This type of incentive is designed to be pay-for-performance. Incentives are directly tied to new payroll generation and job creation. Upon payroll generation and remitting withholding taxes to a state, the company is eligible for a cash refund. A state's motivation for offered a payroll rebate incentive is two-fold. First, the periodic refunds directly motivate an eligible company to create new jobs and generate new payroll. Second, the refund is delivered in the form of cash rather than tax credits or tax exemptions.

In a world where cash is king, a payroll rebate incentive program is a creative means to compete with tax credit heavy states. Indeed, a payroll rebate program is much more efficient and effective at influencing a company's location decision. Beyond the marketing benefits, a well-designed payroll rebate program can be inherently revenue-positive. Cash refunds are only paid out when payroll and withholding taxes are received. Cash refunds will not exceed incoming tax revenue.

Arkansas, Kansas, Louisiana, Missouri, and Oklahoma have the most effective payroll rebate programs in the U.S. The table on one of the following pages outlines each program's benefits, eligibility requirements, and other thresholds.

Arkansas Create Rebate

The Create Rebate program in Arkansas is a discretionary payroll rebate program that offers annual cash refunds equal to between 3.9% and 5.0% of gross wages up to seven years. The percentage of gross wages rebated is dependent on four-tier system. Each county in Arkansas is categorized based on a number of economic factors including unemployment, poverty, and historic job growth just to name a few. Tier 1 counties include the most economically vibrant communities and companies can receive the lowest rebate percentage (3.9%). Tier 4 counties are considered economically disadvantaged and companies receive the highest rebate percentage (5.0%).

Create Rebate is one of Arkansas's discretionary incentive tools to win at business recruitment. During 2009, incentive offers tend to for no more than three years. In only the most highly competitive circumstances and for projects with significant economic impacts, Arkansas will extend benefits up to the statutory max of seven years. Incentive offers are tied to base industries only. An eligible company must create and maintain a minimum annual payroll of $2 million with average wages of full time employees above the county average wage. Since rebates are paid only when a company performs, no penalty or clawback exists. If annual payroll falls below $2 million, the company is generally removed from the incentive program.

Kansas PEAK

During the 2009 legislative session, Kansas enacted its PEAK incentive program. PEAK stands for Promoting Employment Across Kansas. PEAK is a discretionary payroll rebate program that provides annual cash refunds equal to 95% of withholding taxes for 5 to 10 years. The term of the periodic cash refunds is dependent on how a company's weighted average wage stacks up against the county's average wage. PEAK is not applicable to any major business location. Currently, PEAK is statutorily limited to companies that relocate a major operation from outside the State of Kansas. The company must prove up to 10 jobs are relocated from out of state.

Incentive offers are tied to base industries only. An eligible company must create and maintain a minimum annual payroll of $2 million with average wages of full time employees equal to or above the county average wage. The standard incentive term is five years. A company can earn a bonus of a seven-year standard term if at least 100 jobs are relocated from out of state. Other bonuses include one additional year of benefits for each 10% that a company's average wage is above the county average wage. Since rebates are paid only when a company performs, no penalty or clawback exists. If annual payroll falls below $2 million, the company is generally removed from the incentive program.

Louisiana Quality Jobs Program

Louisiana's Quality Jobs Program is a discretionary payroll rebate incentive program that provides annual cash rebates equal to between 5% and 6% of gross wages for up to 10 years. The typical cash rebate is also tied to a refund of state sales sales/use taxes paid on capital expenditures. Quality Jobs offers an alternative option to the cash refund/sales tax rebate feature. A company may also choose to receive a corporate income tax credit equal to 1.5% of qualified capital expenditures.

Incentive offers are tied to base industries only. An eligible company must create at least five new jobs, pay an average wage of at least $14.50 per hour (standard threshold across Louisiana), and maintain a minimum annual payroll of $500,000 (or $250,000 for companies with less than 50 jobs). Since rebates are paid only when a company performs, no penalty or clawback exists. If annual payroll falls below $500,000, the company is generally removed from the incentive program. If a company elects the investment tax credit feature and is removed from the Quality Jobs program, the state will not allow subsequent use of the tax credit in a company's annual tax return filings.

Missouri Quality Jobs Program

Missouri's Quality Jobs Program is a discretionary payroll rebate program that provides annual benefits ranging from 3% to 5% of gross wages for up to 5 years. The state exercises the discretion to provide benefits in refundable tax credits and/or allow retention of withholding taxes. With the withholding tax retention feature, the company is first required to meet the Quality Jobs Program's eligibility requirements. Upon certification, the company is allowed to divert a portion of its remittance of employee withholding taxes to its own bank account. This retention feature is different than most payroll rebate programs that require full remittance of withholding taxes prior to receiving a cash refund.

Incentive offers are tied to base industries only. An eligible company must create the prescribed minimum number of new jobs (depends on type of business) and pay wages at or above the county average wage. The annual payroll minimum is tied to the job threshold and county average wage. The Quality Jobs Program allows for a high wage bonus and local incentive bonus. If a company's average wages are 120% to 140% of the county average wage, the allowable benefits are increased by ½% point. If a community provides incentives, the allowable benefits are increases by 1% to 3% points. For example, a company that creates 250 jobs paying 150% of the county average wage and receives local incentives can earn a maximum payroll rebate equal to 8.5% of gross wages (or 5% standard + ½% wage bonus + 3% local incentive bonus).

Since rebates and tax credits are paid only when a company performs, no penalty or clawback exists. If annual payroll falls below the prescribed minimum, the company is generally removed from the incentive program. The Missouri Legislature implemented a $80 million program tax credit cap. In no one year may there be more than $80 million in outstanding refundable tax credits under the Quality Jobs Program.

Oklahoma Quality Jobs Program

Oklahoma's Quality Jobs Program is a discretionary payroll rebate incentive program that provides quarterly cash rebates up to 5% of gross wages for up to 10 years. The rebate percentage and term of the incentive is dependent on the number of jobs and average wage compared to the county average wage as well as the economic impact of the company on the state and community.

Incentive offers are tied to base industries only. An eligible company must create at least ten new jobs, pay an average wage equal to at least the county average or the State average of $28,878 (whichever is higher) and maintain a minimum annual payroll of $2.5 million. The Quality Jobs Program provides a high wage bonus. If a company's average wage exceeds 300% of the State or county average wage, the rebate percentage is enhanced to 10% of gross wages. Since rebates are paid only when a company performs, no penalty or clawback exists. If annual payroll falls below $2.5 million, the company is generally removed from the incentive program.

Arizona Payroll Rebate Program

At this time, Arizona does not have a payroll rebate incentive program on the books.

Other Key Features & Observations

These payroll rebate programs are discretionary and certain industries are eligible. The allowable industries are considered base industries such as manufacturing, wholesale distribution, headquarters, and other base industries. The general rule of thumb is a company is eligible if and only if more than 75% (Arkansas), 51% (Kansas), 50% (Louisiana), and 75%

(Oklahoma) of revenue or sales is generated out of state. In addition, qualified small businesses are eligible for the payroll rebate programs in Oklahoma, Missouri, and Louisiana.

The payroll rebate programs are generally designed to be revenue-positive. Cash refunds should be never more than expected withholding tax revenue. Kansas is the only state in this group of best practices that directly ties benefits to a percentage of withholding taxes. The nature of the Kansas program is that benefits will never exceed withholding taxes generated by the new jobs.

The remaining states (Arkansas, Louisiana, Missouri, and Oklahoma) tie benefits to gross wages. Based on our calculations, the typical payroll rebates in these states could exceed actual withholding tax revenue. The following table compares the payroll rebate to the effective withholding tax rate (as a percent of gross wages) for a job paying $40,000 per year. For example in Louisiana, the payroll rebate is from 5% to 6% of gross wages whereas withholding taxes are estimated at only 3.4% of gross wages. It should be noted the effective withholding tax rates in this table are high estimates since they exclude downward adjustments for federal adjusted gross income (FAGI), deductions, and personal exemptions.

This disparity is similar across the board. In these cases, since the payroll rebate benefits most likely exceed withholding tax revenue, each state effectively relies on net new sales and corporate income tax revenue to cover any shortfalls to remain at least revenue-neutral.

Payroll Rebate vs. Withholding Tax Rate

State	Rebate of Gross Wages	[1] Effective Withholding Tax Rate (high estimate)
Arkansas	3.9% to 5.0%	4.9%
Louisiana	5% to 6%	3.4%
Missouri	5% to 8.5%	5.4%
Oklahoma	5%	4.9%

1 Net effective tax rate for a $40,000 salary. Excludes adjustments for federally adjusted gross income (FAGI), deductions or personal exemptions.

Source: Elliott D. Pollack & Company.

All in all, the intention of these payroll rebate programs is to be at least revenue-positive if not or neutral.

Best Practices
State Payroll Rebate Grant Programs

State	Program Name	Type	Benefits	Eligible Industries	Minimum Requirements	Wage Threshold	Clawbacks	Funding Mechanism
Arkansas	Create Rebate	Discretionary	* Cash rebate on new payroll * 3.9% to 5.0% of gross wages (depends on County Tier) * Up to 7 years * Annual basis	* Manufacturing * Computer related businesses * Motion picture production * Distribution centers * Office sector businesses * National or regional headquarters * R&D * Scientific & technical business services * Companies with at least 75% of revenue from out of state	1) Basic industry 2) Minimum new jobs => None 3) Minimum wage => County average wage 4) Minimum new payroll => $2 million 5) Health Insurance => Offered to FTEs 6) Program Bonus => None	Yes Based on County Average	No. Rebates are paid upon creation of new jobs and generation of new payroll.	Pay-for-performance program. Rebates funded out of withholding taxes.
Kansas	PEAK	Discretionary	* Cash rebate on new payroll * 95% of withholding taxes * Up to 10 years * Annual basis	* Manufacturing * Mutli-state wholesale distribution * Regional or national service companies (51% of revenue generated outside of KS) * Agriculture * Mining * R&D * Interstate transportation * Tourism activities targeting out-of-state tourists	1) Basic industry 2) Minimum new jobs => Up to 10 relocated jobs 3) Minimum wage => County average wage 4) Minimum new payroll => $2 million 5) Health Insurance => Offered to FTEs and employer must pay at least 50% of the premium cost. 6) Program Bonus => (a) 7-year term with 100 relocated jobs; (b) 1 year added for every 10% the company's average wage is above the county average wage. 7) Requires relocation of a business from one state to Kansas	Yes Based on County Average	No. Rebates are paid upon creation of new jobs and generation of new payroll.	Pay-for-performance program. Rebates funded out of withholding taxes.
Louisiana	Quality Jobs Program	Discretionary	Cash rebate on new payroll and sales/use tax rebate on capital expenditures ***OR*** investment tax credit * Cash rebate on payroll = 5% to 6% of gross wages * Sales/use tax rebate = 4% State sales tax on capital expenditures * Investment tax credit = 1.5% of qualified capital expenditures * Small business component * Up to 10 years * Annual basis	* Bioscience * Manufacturing * IT * Environmental Technology * Food Technology * Advanced Materials * Oil & Gas Field Service * Companies with at least 50% of sales out of state * Companies located in certified distressed regions in the State	1) Basic industry 2) Minimum new jobs => 5 3) Minimum wage => $14.50 per hour 4) Minimum new payroll => * Companies < 50 jobs = $250,000 * Companies > 50 jobs = $500,000 5) Health Insurance => Offered to FTEs and employers must pay premium cost equal to $1.25/hour. 6) Program Bonus => None	Yes $14.50 per hour	Yes and No. Sales tax refund must be paid back if business does not reach job metrics for 5 years. Cash rebate for payroll is only funded when jobs are created & new payroll generated.	Pay-for-performance program. Rebates funded out of withholding taxes and sales taxes received.

Continued

Missouri	Quality Jobs Program	Discretionary	* Retention of withholding taxes and/or refundable tax credits * 3% to 5% of gross wages * Up to 5 years * Above average wage bonus * Local incentives bonus * Small business component * Annual basis	* For-profit & non-profit businesses (excluding retail, public utilities, education services, religious organizations, ethanol production, biodiesel production, and public admin) * Headquarters * Admin offices	1) Basic industry 2) Minimum new jobs => * High impact business = 100 or more * Technology business = 10 or more * Small business = 20 to 40 3) Minimum wage => County average wage 4) Minimum new payroll => Indirectly tied to minimum job standard and county average wage 5) Health Insurance => Offered to FTEs and employers must pay at least 50% of premium cost 6) Program Bonus => 1/2% bonus if average wages are between 120% and 140% of County average. 1% bonus if average wages are greater than 140%. 1% to 3% bonus for local incentives.	Yes Based on County Average	No. Retention of withholding taxes only allowed upon creating jobs and generating new payroll. Tax credits are certified upon meeting minimum requirements.	Pay-for-performance (retention of withholding taxes benefit only) $80m annual program tax credit cap (set by Legislature)
Oklahoma	Quality Jobs Program	Discretionary	* Cash rebate on new payroll * Up to 5% of gross wages * Up to 10 years * Above average wage bonus * Small business component * Quarterly basis	* Manufacturing * R&D * Headquarters * Mining * Warehouse/distribution (40% of inventory shipped out of state) * Transportation (75% of sales out of state) * Flight Training Svcs * Wind Power Repair * Sports Teams * Services (75% of sales out of state)	1) Basic industry (75% of sales out of state) 2) Minimum new jobs = 10 3) Minimum wage => County average not to exceed State average of $28,878 4) Minimum new payroll = $2.5 million 5) Health Insurance => Offered to FTEs and employers must pay at least 50% of premium cost 6) Program Bonus => Rebate enhanced to 10% of gross wages if average wages exceed 300% of State or County average wage	Yes Based on County Average not to exceed State average of $28,878	No. Rebates are paid upon creation of new jobs and generation of new payroll.	Pay-for-performance program. Rebates funded out of withholding taxes.

Source: Elliott D. Pollack & Company; CBRE Economic Incentives Group.

3.6.3 Deal Closing Funds

Nineteen out of 50 states offer some type of deal closing fund or cash grant program. A deal closing fund involves upfront cash grants and/or forgivable loans only in highly competitive situations and only for projects with a substantial economic and fiscal impact to a state & community. Deal closing funds are mostly financed through periodic general fund appropriations. In a world where financial incentives are desirable and business recruitment is highly competitive for select projects, a deal closing fund is a highly effective economic incentive program that contributes cash to bring closure to a deal and win the business.

Due to the current budget deficits seen across the U.S., well-financed and active deal closing funds are few and far between. The Texas Enterprise Fund is the most plentiful, active, and highly marketed deal closing fund among the states. Arkansas, Florida, Louisiana, North Carolina, and Virginia have established deal closing funds and have been actively funding projects during 2009, according to the CBRE Economic Incentives Group. The table on one of the following pages outlines these best practices in state deal closing funds and highlights each program's benefits, eligibility requirements, and other thresholds.

Texas Enterprise Fund

The Texas Enterprise Fund (TEF) was established in 2003 to actively recruit high impact economic development prospects to the State of Texas. Between 2003 and 2009, TEF has allocated more than $383 million in grants to companies that are projected to create over 56,000 new direct jobs and $14 billion in capital investment. Currently, about $190 million remains available in the TEF.

During 2008 and 2009, Texas has continued to attract significant economic development prospects to the State despite the national recession. A selection of these prospects includes Medtronic's regional headquarters to San Antonio (1,384 jobs, $23 million investment, TEF grant of $6 million), HelioVolt's solar panel manufacturing plant to Austin (158 jobs, $63 million investment, TEF grant of $1 million), and Caterpillar's engine assembly plant to Seguin (1,714 jobs, $176 million investment, TEF grant of $8.5 million).

The Governor's funding committee evaluates TEF grant requests based on the expected return on investment to the state. This analysis looks at number of jobs, annual payroll, capital investment, financial strength of the company, industry sector outlook, local participation with incentives, and private funding match. At the end of the day, the final decision of each TEF grant request is made by the Governor, Lieutenant Governor, and Speaker.

The typical TEF grant is $6.9 million and averages $6,800 per job or 2.7% of capital investment. These per-job and per-investment metrics can vary and grants are customized to fill a funding gap for each project. Interstate competition is required, payout terms tend to be two to three years, and clawbacks are necessary component to ensure the State's return on investment. The return on investment is between 4-to-1 and 8-to-1.

Arkansas Governor's Quick Action Closing Fund

In Arkansas, the Governor's Quick Action Closing Fund is a discretionary grant program used to lure economic development prospects with significant job creation and capital investment. The Arkansas Legislature started this Fund in 2008 with $50 million. The Fund was reauthorized during the 2009 session with another $50 million.

Florida Quick Action Closing Fund

Florida's Quick Action Closing Fund (QACF) was created in 1999 as a discretionary grant incentive program to attract, retain, and provide favorable conditions for growth of certain high-impact business facilities to the state. As of the date of this report, about $13.5 million is available in the QACF. Statute requires a minimum 5-to-1 return on investment for all QACF awards.

Louisiana Economic Development Loan Program

The Economic Development Loan Program (EDLOP) is Louisiana's version of a deal closing fund. EDLOP is a discretionary incentive program that provides cash grants to high impact economic development prospects. Cash grants are structured as forgivable loans to ensure the State's return on investment. The principal and interest payments on a forgivable loan are paid in full each year a company creates and maintains a pre-determined level of jobs, payroll, and capital investment. EDLOP grants are offered at the discretion of the Governor and Secretary of Economic Development.

North Carolina Job Development Investment Grants & One NC Fund

North Carolina has two deal closing funds - Job Development Investment Grants (JDIG) and the One NC Fund. These discretionary incentive programs provide cash grants to high impact economic development prospects. One NC Fund is an upfront cash grant program that requires a 50% match from the community of county. JDIG is not an upfront cash grant program but is designed to provide annual cash grants based on the projected annual withholding taxes. Similar to a payroll rebate program, JDIG benefits can equal up to 75% of annual withholding taxes up to 12 years. The North Carolina Legislature enacted a $15 million annual limit for JDIG payments per year. Grants are offered at the discretion of the Governor and Secretary of Economic Development.

Virginia Governor's Opportunity Fund

The Governor's Opportunity Fund in Virginia was created in 1992 as a discretionary grant incentive program to attract significant employers. As of the date of this report, about $20 million is available.

Arizona Deal Closing Fund

At this time, Arizona does not have a deal closing fund on the books.

Other Key Features & Observations

These deal closing funds are discretionary and certain industries are eligible. The allowable industries are considered base industries such as manufacturing, wholesale distribution, headquarters, and other base industries that generate a majority of revenue / sales from out of state. Each of the programs requires average wages above the county average wage, local support with incentives, private funding match, and but-for situation. The but-for situation simply means there must be interstate competition and without the incentives the company would not locate in the state.

According to the CBRE Economic Incentives Group, the funding committees for each deal closing fund run an economic and fiscal impact model to best ascertain a project's return on investment. Due to scarce funding, investment of deal closing fund dollars is focused on projects that that will generate the highest return on investment to the State while strategically targeting industries of interest and regions of the state.

All in all, these deal closing funds are designed to be revenue-positive.

Best Practices
State Deal Closing Fund Programs

State	Program Name	Type	Benefits & Uses of Funds	Eligibility Criteria	Clawbacks	Funding Mechanism
Texas	Texas Enterprise Fund	Discretionary	* Cash Grant * Grants offered at the discretion of the Governor; * Grants average $6,800 per new job (range from $2,000 to $10,000); * Grants intended to offset capital investment, infrastructure, job training, and/or other approved uses. * 2 to 3 year payout term	* Basic industry * Significant return on the State's investment * Local support with incentives <u>Decision Criteria</u> * Job creation and wages * Capital investment * Financial strength of applicant * Business history * Business sector outlook & analysis * But-for requirements	Yes	Annual appropriation from General Fund * Started in 2003 with $295 million and reauthorized in 2005 with $180 million;
Arkansas	Governor's Quick Action Closing Fund	Discretionary	* Cash Grant * Grants offered at the discretion of the Governor; * Grants intended to offset capital investment, infrastructure, job training, and/or other approved uses. * 1 to 2 year payout term	* Basic industry * Significant job creation, payroll generation, and capital investment * Significant return on the State's investment * Local support with incentives * Average wages above the county average * But-for requirement	Yes	Annual appropriation from General Fund * Started in 2008 with $50 million. Reauthorized in 2009 with $50 million;
Florida	Quick Action Closing Fund	Discretionary	* Cash Grant * Grants offered at the discretion of the Governor; * Grants intended to offset capital investment, infrastructure, job training, and/or other approved uses. * 1 year payout term (typically)	* Basic industry * Significant job creation, payroll generation, and capital investment * Significant return on the State's investment * Local support with incentives * Average wages at least 25% above the county average * But-for requirement * Requires a 5-to-1 payback ratio	Yes	Annual appropriation from General Fund * 2009 funding at $13.5 million
Louisiana	Economic Development Loan Program (EDLOP)	Discretionary	* Cash Grant / Forgivable Loan * Grants offered at the discretion of the Governor and Secretary of Economic Development; * Grants intended to offset capital investment, infrastructure, job training, and/or other approved uses. * 1 to 3 year payout term (typically)	* Basic industry * Significant return on the State's investment * Local support with incentives * Average wages at least the county average * But-for requirement * Requires a business to maintain operations in the State for 150% of the term of the award	Yes	Recurring appropriation from General & Special Funds and/or GO Bonds
North Carolina	Job Development Investment Grants (JDIG) and One NC Fund	Discretionary	* Cash Grant * Grants offered at the discretion of the Governor and Secretary of Economic Development; * Grants intended to offset capital investment, infrastructure, job training, and/or other approved uses. * 1 to 12 year payout term	* Basic industry * Significant return on the State's investment * Local support with incentives * Average wages at least the county average * But-for requirement * Requires a business to maintain operations in the State for 150% of the term of the award	Yes	<u>One NC Fund</u> Biennial Appropriation <u>JDIG</u> * Pay-for-performance based on % of withholding taxes * Legislative limit of $15 million annual gross allocation
Virginia	Governor's Opportunity Fund	Discretionary	* Cash Grant * Grants offered at the discretion of the Governor; * Grants intended to offset capital investment, infrastructure, job training, and/or other approved uses. * 1 to 2 year payout term	* Basic industry * Significant job creation, payroll generation, and capital investment * Significant return on the State's investment * Local support with incentives * Average wages above the county average * But-for requirement	Yes	Annual appropriation from General Fund * Started in 1992. 2009 funding at $20 million

Source: Elliott D. Pollack & Company; CBRE Economic Incentives Group.

3.6.4 Retention Incentive Programs

Nearly all statutory and discretionary state incentive programs are designed to subsidize the creation of new jobs, new payroll, and new capital investment. These programs inherently cannot support the retention of major employers and their corresponding on-going generation of tax revenues in a state. Even the payroll rebate and deal closing fund programs previously discussed focus on net new business recruitment.

According to the CBRE Economic Incentives Group, there are five effective state incentive programs designed to target business retention. These best practices are found in Illinois, Indiana, Kentucky, Michigan, New Jersey, and Ohio. The table on one of the following pages outlines these best practices in state retention incentive programs and highlights each program's benefits, eligibility requirements, and other thresholds.

Illinois EDGE

The retention incentive program in Illinois is called EDGE – or Economic Development for a Growing Economy. The EDGE Program is a discretionary incentive program that awards corporate income tax credits equal up to 100% of withholding taxes for up to 10 years. The percentage of withholding taxes and term of the incentive is dependent on the number of jobs and average wage compared to the county average wage as well as the economic impact of the company on the state and community.

Retention incentive offers are tied to base industries only. An eligible company must retain at least 25 jobs, pay an average wage equal to at least the county average, and invest $5 million in new capital investment into the existing facility. Companies receiving EDGE tax credits will be required to maintain operations and retain a pre-determined number of jobs for a period of time. Penalties are negotiable on a case by case basis.

Indiana EDGE

The retention incentive program in Indiana is also called EDGE – or Economic Development for a Growing Economy. The EDGE Program is a discretionary incentive program that awards corporate income tax credits equal up to 100% of withholding taxes for up to 10 years. The percentage of withholding taxes and term of the incentive is dependent on the number of jobs and average wage compared to the county average wage as well as the economic impact of the company on the state and community.

Retention incentive offers are tied to manufacturing, business services, and R&D only. An eligible company must retain at least 35 jobs and pay an average wage equal to at least 105% of the county average. Minimum payroll to be maintained and any new capital investment are determined on a case by case basis. Companies receiving EDGE tax credits will be required to maintain operations and retain a pre-determined number of jobs for two years beyond the term of the EDGE award. For example, if the EDGE award provides eight years of tax credits, the company is subject to a retention period of 10 years. Penalties are negotiable on a case by case basis.

Kentucky Reinvestment Act

The retention incentive program in Kentucky is called the Kentucky Reinvestment Act (KRA). The KRA Program is a discretionary incentive program that awards corporate income tax credits up to 10 years and equal to (a) not more than 50% of approved capital costs and (b) not more than 100% of training costs to upgrade the skills of existing employees. The approved tax credit benefits are dependent on the number of jobs and average wage compared to the county average wage as well as the economic impact of the company on the state and community.

Retention incentive offers are tied to manufacturing and related manufacturing operations such as storage, warehousing, distribution, and related office facilities. An eligible company must retain at least 85% of the employment level in the previous year and incur at least $2.5 million in new capital investment. Minimum payroll to be maintained is determined on a case by case basis. Companies receiving KRA tax credits will be required to maintain operations and retain a pre-determined number of jobs for a negotiated retention period. Clawbacks are negotiable.

Michigan MEGA Retention Tax Credit Program

The retention incentive program in Michigan is called the MEGA Retention Tax Credits. MEGA is the Michigan Economic Growth Authority and has the statutory authority to promote economic development in the State of Michigan. The MEGA Retention Tax Credit Program is a discretionary incentive program that awards corporate income tax credits equal up to 100% of withholding taxes for up to 20 years. The percentage of withholding taxes and term of the incentive is dependent on the number of jobs and average wage compared to the county average wage as well as the economic impact of the company on the state and community.

Retention incentive offers are tied to manufacturing, mining, R&D, wholesale and retail trade, film & digital media, office operations, and some tourism projects. An eligible company must retain at least 50 jobs, pay an average wage at least 150% of the federal minimum wage, and make a capital investment of at least $50,000 per retained job. Companies receiving tax credits will be required to maintain operations and retain a pre-determined number of jobs for a negotiated retention period. Clawbacks are negotiable.

New Jersey Business Retention and Relocation Assistance Grant

The retention incentive program in New Jersey is called the Business Retention and Relocation Assistance Grant (BRRAG). The BRRAG Program is a discretionary incentive program that awards corporate income tax credits equal up to $1,500 per retained job. An eligible company must retain at least 50 jobs and pay an average wage at least equal to the county average wage. Minimum payroll, minimum capital investment, and allowable industries are negotiable. Companies receiving tax credits will be required to maintain operations and retain a pre-determined number of jobs for five years. Clawbacks include 100% recapture of tax credits if a company does not maintain operations for the five-year retention period.

Ohio Job Retention Tax Credit Program

The retention incentive program in Ohio is also called the Job Retention Tax Credit Program (JRTC). The JRTC Program is a discretionary incentive program that awards corporate income tax credits equal up to 75% of withholding taxes for up to 10 years. The percentage of withholding taxes and term of the incentive is dependent on the number of jobs and average wage compared to the county average wage as well as the economic impact of the company on the state and community.

Retention incentive offers are tied to manufacturing, headquarters, and other administrative offices. An eligible company must retain at least 500 jobs and make a minimum capital investment of $50 million for manufacturing facilities and $20 million for headquarters/admin operations. Minimum payroll and the overall minimum average wage are negotiable. Companies receiving JRTC tax credits will be required to maintain operations and retain a pre-determined number of jobs for negotiated number of years. Clawbacks are negotiable on a case by case basis. The Ohio Legislature implemented a $13 million annual cap for the JRTC Program.

Other Key Features & Observations

The states offering these retention incentive programs have a significant amount of discretion at offering retention incentives compared to most other state incentive programs. Each program has a but-for requirement. The primary consideration is if the company can prove the existing operation is not economic feasible without the incentives.

These retention incentive programs allow tax credits to be converted to cash (with the exception of Kentucky). Illinois, Indiana, New Jersey, and Ohio allow retention tax credits to be transferred / sold to unrelated third party investors. These investors typically exchange cash for the tax credits at a negotiated discount to the actual value of the credits. For example, an investor could agree to purchase retention tax credits for 75 cents on the dollar. For $1 million in retention tax credits, a company could receive $750,000 in upfront cash. In addition, Michigan and Indiana are the only states that issue refundable tax credits. If a company does not have sufficient state tax liability in the year the tax credit is earned, any unused retention tax credits will be refunded by the state in the form of a cash check. Kentucky does not allow tax credits to be refunded or transferred.

Based on the CBRE Economic Incentives Group's experience in negotiating retention incentive packages, these best practices have proven to be an effective and fiscally responsible way to retain existing business.

Best Practices
State Retention Incentive Programs

State	Program Name	Type	Benefits	Eligible Industries	Minimum Requirements	Wage Threshold	Clawbacks	Funding Mechanism
Illinois	**EDGE** Economic Development for a Growing Economy	Discretionary	* Tax credit * Up to 100% of withholding taxes * Up to 10 years * Transferable	* Manufacturing * Services * Companies with a significant % of revenue from out of state	1) Basic industry 2) Minimum retained jobs => 25 3) Minimum wage => Discretionary 4) Minimum new payroll => Discretionary 5) Minimum capital investment => $5m 6) Health Insurance => Discretionary 7) But-for Test => Yes 8) Retention Period => Discretionary	Discretionary	Yes Discretionary recapture if business does not maintain retained jobs for retention period	* Based on % of withholding taxes and employer paid health benefits
Indiana	**EDGE** Economic Development for a Growing Economy	Discretionary	* Tax credit * Up to 100% of withholding taxes * Up to 10 years * Transferable and refundable	* R&D * Manufacturing * Business services	1) Basic industry 2) Minimum retained jobs => 35 3) Minimum wage => 105% of County average wage in the same industry 4) Minimum new payroll => Discretionary 5) Minimum capital investment => Discretionary 6) Health Insurance => Discretionary 7) But-for Test => Yes 8) Retention Period => 2 years beyond term	Discretionary	Yes Discretionary recapture if business does not maintain retained jobs for retention period	* Based on % of withholding taxes and employer paid health benefits
Kentucky	Kentucky Reinvestment Act	Discretionary	* Tax credit * Up to 50% of approved capital costs and 100% of job skills upgrade training costs * Up to 10 years * Not transferable; Not refundable.	* Manufacturing * Related manufacturing functions including storage, warehousing, distribution, and related office facilities;	1) Basic industry 2) Minimum retained jobs => 85% of previous year's employment 3) Minimum wage => Discretionary 4) Minimum new payroll => Discretionary 5) Minimum capital investment => $2.5m 6) Health Insurance => Discretionary 7) But-for Test => Yes 8) Retention Period => Discretionary	Discretionary	Yes Discretionary recapture if business does not maintain retained jobs for retention period	Tax credit

Continued

Michigan	MEGA Retention Tax Credits	Discretionary	* Tax credit * Up to 100% of withholding taxes and employer-paid health care benefits (adjusted by personal income tax rate) * Up to 20 years * Refundable	* Manufacturing * Mining * R&D * Wholesale and trade * Film & digital media * Office operations * Certain tourism projects	1) Basic industry 2) Minimum retained jobs => 50 3) Minimum wage => At least 150% of Federal minimum wage 4) Minimum new payroll => None 5) Minimum capital investment => * $50,000 per retain job * Real & personal property investment 6) Health Insurance => Offered to FTEs 7) But-for Test => Yes 8) Retention Period = Discretionary	Yes 150% of federal minimum wage	Yes	* Based on % of withholding taxes and employer paid health benefits * No known tax credit allocation cap
New Jersey	**<u>BRRAG</u>** Business Retention and Relocation Assistance Grant	Discretionary	* Tax credit * Up to $1,500 per retained job * Transferable	Discretionary	1) Basic industry 2) Minimum retained jobs => 50 3) Minimum wage => At least County average 4) Minimum new payroll => Discretionary 5) Minimum capital investment => Discretionary 6) Health Insurance => Discretionary 7) But-for Test => Yes 8) Retention Period => 5 years	Yes Meets or exceeds County average wage	Yes 100% recapture if business does not maintain retained jobs for 5 years.	* Tax credit allocation cap is $20m annually
Ohio	**<u>JRTC</u>** Ohio Job Retention Tax Credits	Discretionary	* Tax credit * Up to 75% of withholding taxes * Up to 10 years * Transferable	* Manufacturing * Headquarters * Administrative offices	1) Basic industry 2) Minimum retained jobs => 500 3) Minimum wage => Discretionary 4) Minimum new payroll => Discretionary 5) Minimum capital investment => * Manufacturing = $50m * Headquarters/Admin = $20m 6) Health Insurance => Discretionary 7) But-for Test => Yes 8) Retention Period => 7 years or term of tax credit plus 3 years.	Discretionary	Yes Discretionary recapture if business does not maintain retained jobs for retention period	* Based on % of withholding taxes * Tax credit => $13m annual cap + unallocated tax credits from previous year

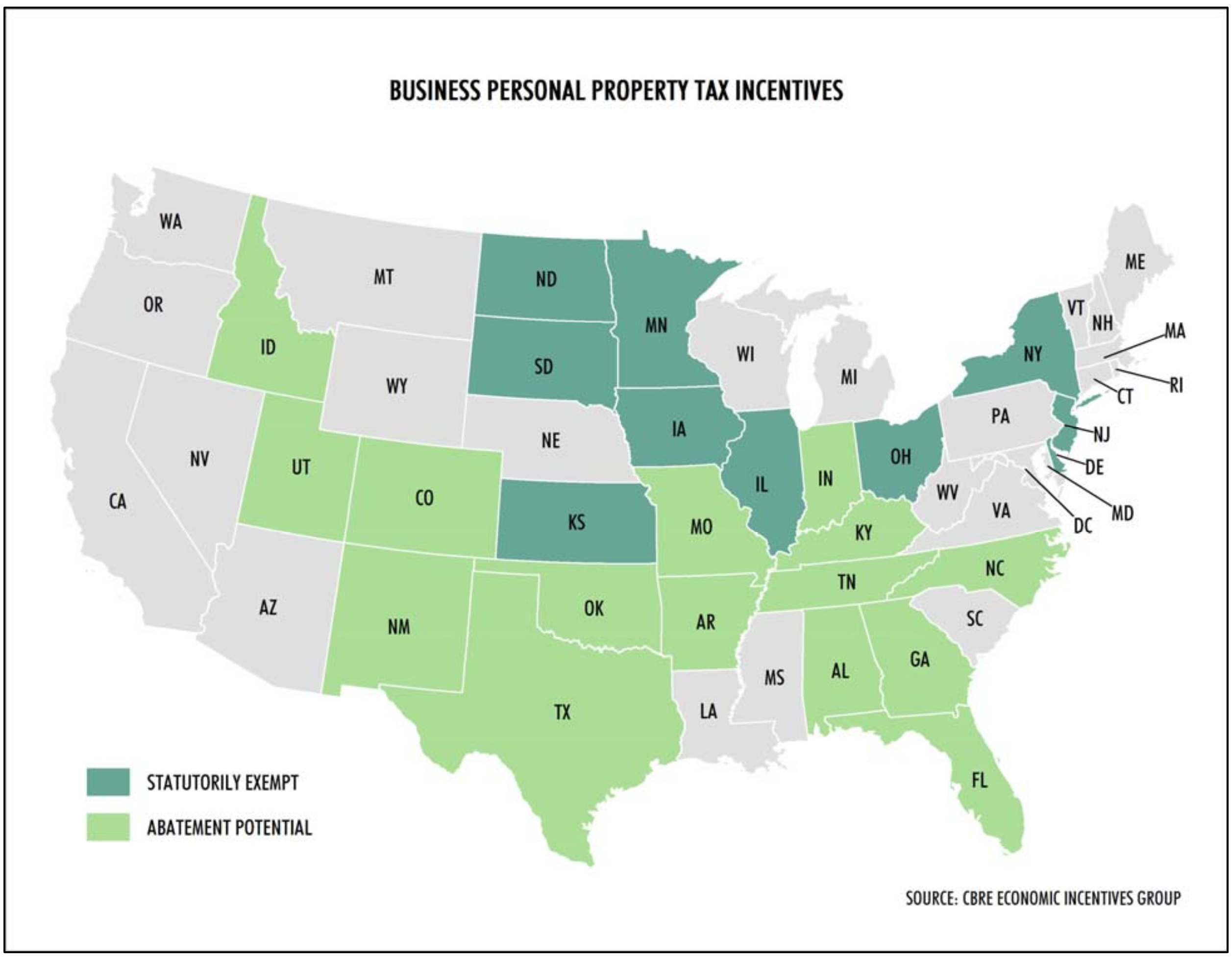
Source: Elliott D. Pollack & Company; CBRE Economic Incentives Group.

3.6.5 Business Personal Property Tax Exemption

Recognizing the need to help reduce a company's total cost of doing business, about 10 states have statutorily eliminated ad valorem taxes on business personal property for commercial and industrial uses. This means that neither a municipality, county, nor school district accrue property tax revenue from business personal property. The statutorily exempt states include Delaware, Illinois, Iowa, Kansas, Minnesota, and New Jersey. Other states include New York, North Dakota, Ohio, and South Dakota.

Additionally, there are 16 states that have granted counties and municipalities the ability to offer discretionary abatement of business personal property taxes. According to the CBRE Economic Incentives Group, abatement incentives can typically range anywhere from 20% to 100% off property taxes for up to 10 years in these states. Abatements apply to municipal and county property taxes only. School district property taxes are not allowed to be abated with very few exceptions.

The states that tend to allow for local abatement of property taxes on business personal property include Alabama, Arkansas, Colorado, Florida, Georgia, Idaho, Indiana, and Kentucky. Other states include Missouri, New Mexico, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, and Utah.



3.6.6 Tax Increment Financing

Forty-nine states and the District of Columbia have enabled the use of Tax Increment Financing for qualified economic development opportunities. *Arizona is the only state without a tax increment financing law***.**

Tax Increment Financing (TIF) allows cities to help offset a company's start-up investment by capturing increased property tax revenues generated by an economic development projects. These tax revenues are used to pay back city funds (with interest) injected at the front end of the development of new industrial or commercial facilities. TIF may be used to offset the cost of public improvements and utilities that will serve the new private development, to finance direct grants or loans to a company, or to provide the local match for federal or state economic development assistance programs. There are three general ways that cities finance TIF projects.

Bond Financing*:* Cities that wish to quickly spur development often issue municipal bonds to provide upfront financing for TIF projects. The net new tax revenue from the new development is used to pay off the bonds.

City Pay-As-You-Go*:* A city can specially designate an area or district that is already slated for new development and increasing property values. TIF allows the city to reinvest the increased property tax revenues from this specially designated area into other projects elsewhere in the same area or district. On an annual basis, the city estimates how much the area's tax revenue will increase and can fund improvements based on these estimates.

Developer Pay-As-You-Go*:* In situations where one company is leading an economic development project, a city may rely on the company to finance its own improvements. The city and company enter into a reimbursement agreement where a negotiated proportion of future net new property tax revenues generated by the project are paid directly to the company until all debts are paid off.

While bond financing is the most popular TIF method, properly implemented pay-as-you-go options are generally considered to be less risky because of the zero opportunity cost feature. Expenditures are closely tied to the amount of net new tax revenue generated by an area or district. The main taxing jurisdictions in a region (city, county, school districts) become partners in development and ensure the completion of project that would not occur but for the public participation. Once all the project costs are repaid, the TIF designation for a project is terminated and all of the taxing jurisdictions receive tax revenue from the full improvement value (original plus new investment).

Overall, TIF can be a highly effective and zero opportunity cost economic development tool for Arizona communities to spur development that otherwise would not occur. In addition to increasing property value growth, TIF projects can create new jobs and payroll, act as a catalyst for further development, and leverage other funding sources (federal/state grants, foundation contributions, private matches) to fill financing gaps.

3.7 New Incentive Programs Enacted in 2009

Despite projected state budget deficits across the U.S., 9 states including Arizona proactively passed new legislation during 2009 to enhance existing incentive programs or enact new programs. These states continue to look for ways to remain competitive in business recruitment and retention. The states that passed incentive legislation during 2009 include Arizona, Virginia, Arkansas, Colorado, New Jersey, Oklahoma, Kentucky, Kansas, and Missouri.

➢ Arizona passed the Renewable Energy Tax Incentive program to provide corporate income tax credits and property tax reductions to renewable energy manufacturing and headquarters operations.

➢ Virginia added funding to the Governor's Opportunity Fund.

➢ Arkansas added funding to the Quick Action Closing Fund.

➢ Colorado passed the Job Growth Incentive Act which allows corporate income tax credits to businesses that otherwise would not locate in Colorado.

➢ New Jersey passed the Economic Stimulus Act of 2009. A new revitalizing grant program was established to allow financing of redevelopment through net new tax revenues. In addition, the Urban Transit Hub Tax Incentive Program was enacted to provide corporate income tax credits to promote capital investment and development near mass transit centers.

➢ Oklahoma passed the 21st Century Quality Jobs Act to attract high wage jobs to the State of Oklahoma. The incentive is based on the standard Quality Jobs Program which provides a payroll rebate for qualifying jobs.

➢ Kentucky passed the Incentives for a New Kentucky Bill. This bill consolidated a number of existing incentive programs into one enhanced incentive program.

➢ Kansas passed the PEAK Act which provides payroll rebates to companies that relocate a major operation from outside the state into Kansas.

➢ Missouri enhanced its existing Quality Jobs Program to increase the annual cap of tax credits allowed under the Program. In addition, Missouri passed the Build Act which provides refundable tax credits and below-market financing to a company in lieu of the creation of new jobs and payroll.

Overall, enacting new economic incentive programs during a recession is not a new thing. There is recent precedent.

3.8 Foundation for Arizona's Economic Development Policies

For many decades, Arizona's economic development strategy loosely consisted of its quality of life, sunshine, good transportation system, skilled workforce, and pro-business governments just to name a few. Times have changed and Arizona finds itself several years behind the curve when it comes to strategic economic development across the State. Other states (mostly east of the Mississippi River) are providing a broader palette of more flexible economic incentive tools designed to have "real time" influence on business decisions. In combination with aggressive and strategically targeted business development efforts, these incentive tools have been implemented to respond to a company's primary concern of finding the best overall net economic opportunity.

The goal of economic development in Arizona is to create and retain well-paying jobs. Business recruitment and retention of high impact economic development prospects is highly competitive in the U.S. When combined with the overall business climate, Arizona's economic incentive programs must be forward-looking to effectively compete for business in the 21st Century. Following are a set of guiding principles for Arizona's economic development policy and key features for Arizona's new economic incentive programs.

3.8.1 Guiding Principles

- Economic conditions of the State are not static and require re-evaluation of economic development strategy including incentive programs;

- Incentives and economic development policy should provide long-term benefits to Arizona residents through new job creation & retention, enhancement of the overall tax base, expansion & diversification of the State's economic base, and increase in tax revenue to the State and its political subdivisions;

- Incentives and economic development policy should increase the economic competitiveness of the State and local communities in attracting and retaining industries & jobs relative to other states that have historically defined and carried out business assistance more aggressively;

- Maintaining and enhancing Arizona's economic development competitiveness is a year-in and year-out effort and should not be timed with certain periods in the business cycle.

- Focus on business recruitment and retention;

- Incentive programs need to be well-suited for projects with stable and predictable business plans;

- Allocate resources equally across attracting, retaining, and developing Arizona businesses, across different sectors of the economy, and across the various geographic regions;

- Incentive programs must be user-friendly and predictable, effective and efficient to implement, without hoops to jump through, and voluminous documentation;

3.8.2 Key Features

- *Discretionary Use:*
  Incentive programs shall be discretionary in nature. Discretionary incentive programs provide flexibility to address real time market needs, allow the ability to say "no," and tend provide a better opportunity for strategic economic development targeting than statutory incentives. Reasonable exceptions to any incentive program feature can be considered.

- *Strategic Targeting:*
  Incentive programs shall avoid the "shoot anything that flies, claim anything that falls" way of thinking. Incentive programs shall align with the State's economic development policies. Programs should be designed to strategically target and be effective at attracting those industries considered to be most desirable to Arizona.

- *New Jobs and Retention:*
  Incentive programs shall be made available to businesses creating new quality jobs in high value-added, knowledge-driven industries and retaining existing quality jobs in growing industries.

- *Geographic Distribution:*
  Incentive programs shall make best efforts to achieve uniformly regional prosperity throughout Arizona.

- *Base or Export Industries:*
  Incentive programs shall strategically target base industries that generate a majority of revenue / sales from out of state sources. These industries will have the greater economic and fiscal impact to the State and communities. Conversely, companies whose main customers or suppliers are in Arizona may find it economical to locate in the State even without incentives.

- *Wage Thresholds:*
  Incentive programs shall include reasonable wage thresholds that are market-based. Companies cannot receive incentive benefits unless the average wage of new or retained jobs is equal to or above the average wage in the county or State. This feature helps satisfy the economic development goal of increasing the standard of living of the State's residents. The absence of a wage standard will undermine Arizona's economic development goal of increasing the standard of living of the State's residents.

- *Economically Disadvantaged Areas:*
  Consideration shall be given to waive standards/thresholds and enhance benefits for economic disadvantaged regions in the State of Arizona. This potential waiver will help better achieve the objective of increasing the location of businesses in these areas.

- *Pay for Performance:*
  Incentive programs shall be *quid pro quo* – something for something. Incentive benefits shall be earned only after creating or retaining jobs, generating new or maintaining existing annual payroll, and new capital investment. Performance based incentives offer the structure to ensure incentive payments do not exceed projected tax revenues generated by a project. Additionally, these types of incentives offer better accountability and enforcement.

- *Economic & Fiscal Impact Modeling:*
  Every incentive program shall rely on economic and fiscal impact modeling to best understand the fiscal and employment benefits that could accrue to the State of Arizona and its residents. Incentive benefits should be tied to only direct company impacts. Any dynamic benefits (or ripple effects) should be considered as the potential upside return on investment to the State.

- *Zero Opportunity Cost:*
  Every incentive program shall make accountable, effective use of public dollars and have zero opportunity cost. Zero opportunity cost for incentives means the State is gaining more (jobs and tax revenue) than it is giving up (incentive benefits).

- *Return on Investment:*
  Incentive programs shall have a return on investment indicator and should be revenue positive to the State of Arizona where expected tax revenues exceed incentive benefits paid to a company.

- *Interstate Competition:*
  Discretionary incentive programs shall avoid the “robbing Peter to pay Paul” syndrome where there is competition among communities in Arizona. Incentive benefits shall be available only when there exists interstate competition with Arizona.

- *But-For Test:*
  The but-for test is central to and shall be required in all discretionary incentive programs. The but-for test is simple. If a company would have located in Arizona without discretionary incentives, it should not receive any benefits.

- *Clawbacks & Accountability:*
  All incentive programs shall have reasonable clawbacks to ensure a company’s accountability. Clawbacks include recapture provisions that protect Arizona taxpayers. If a company fails to meet its commitments (i.e. jobs, payroll, capital investment) within a reasonable amount of time, clawbacks describe how the company must repay the incentive benefits it has earned. Clawbacks should be prescribed on a pro-rate basis.

- *Rescission & Recalibration:*
  Alternative safeguards should be considered in circumstances where repayment is not feasible. A rescission occurs when participation in an incentive program is canceled in future years after a shortfall in a company’s commitments. A recalibration is when the value of an incentive benefits need to be adjusted when a shortfall occurs.

3.8.3 Implementation & Accountability

Arizona's competitive disadvantage lies in three primary areas – (1) the tactical nature of its primary economic incentive programs; (2) marketing and differentiating those programs and successes; (3) perceived lack of leadership and focus on its economic development strategy. Arizona must offer some package of economic incentive programs to compete but more aggressive programs do not necessarily make Arizona more competitive. Enacting new competitive economic incentive programs is meaningless without focused policies and aggressive business development activities. This is like having a gun with no bullets. The gun is designed to shoot a target but without ammunition it is just a useless piece of metal.

The purpose of this report is not intended to fully develop an economic development strategy for Arizona or provide a "how to" guide for effective business development. However, we would be remiss by providing policy recommendations without offering observations of how competing states are managing economic development better than Arizona.

<u>Economic Development Strategy</u>

• The mission of economic development should be more than conjecture. It should mirror the economic development goals of Legislative leadership, the Governor, and other stakeholders.

• Workforce development and infrastructure should be at the core of Arizona's economic development strategy. Arizona's future success will be defined by its ability to effectively integrate workforce development programs in the State's business development activities. Along with enhancing the skills of Arizona's workforce, no economy can thrive without safe drinking water, good schools, well-maintained roads & freeways, and other basic public goods.

• Spending on workforce development and infrastructure is an approach to reduce investment risk. Infrastructure spending is less risky because if a company relocates, the taxpayer investment in infrastructure does not leave with the company and benefits all remaining employers and workers. Workforce development spending is less risky because workers receiving job training most likely take their skills to another local employer rather than leaving the State.

• A top-class economic development strategy should:
1) Increase Arizona's economic competitiveness
2) Offer tools and assistance to enhance the competitiveness of Arizona's communities
3) Cultivate top regional economic development assets
4) Focus on business retention and expansion in industries that are strategically important
5) Develop national caliber business recruitment capabilities
6) Encourage and develop small business, innovation, and entrepreneurship
7) Develop workforce solutions that are robust and responsive

• Do not just sit back and wait for things to happen. Arizona's economic development activities should be always evolving to ensure the State's economy continues to diversify.

• Economic development policies should prioritize transparency & reporting, job quality and wage standards, health insurance guarantees, economic impact and incentive program integrity, and clawbacks.

• Clear economic development objectives should be established and achieved through new economic incentive programs.

• The Strategy should have a focus on increasing the location of businesses in economic disadvantaged areas of the State. Areas with high unemployment, blighted districts, and rural characteristics should be given a chance to compete with urban, economically advanced regions in the state. The economically disadvantaged designation should be flexible and time sensitive.

• States and communities that are more adept at helping companies eliminate or significantly reduce start-up investment and on-going operating costs tend to have the biggest successes in economic development today.

• Arizona must have the right economic incentive programs for the industries and jobs it is trying to attract and retain. These industries should provide the greatest economic and fiscal impact to the State and communities.

• Arizona does not necessarily need to have the most aggressive incentive programs around the U.S. to be highly competitive. On a relative scale, Arizona's pro-business leadership can work to create and maintain low overall costs of doing business over the long term.

• Regardless of Arizona's competitive advantages, strategically targeted and financially significant economic incentive programs are a prerequisite just to be in the ballgame.

Leadership

• Economic development in Arizona will be most efficient and effective with a top-down approach when there is a commitment to business recruitment and retention from the Legislature and Governor's Office down to the region and community levels. Today, states that do this the best include Kentucky, Kansas, Missouri, Oklahoma, Louisiana, Iowa, Pennsylvania, Ohio, and North Carolina.

• One State Agency should have the primary purpose and empowerment to manage the economic development mission of Arizona. In most states, the agency in charge of economic development is generally called Department of Commerce, Economic Development Department, Office of Economic & Community Development, Department of Development, or Economic Partnership. Economic development across the U.S. is carried out through a State Agency or through a Governor's Office. Indeed, a handful of states give economic development management powers to private, non-profit, or quasi-governmental entities. Additional study should be considered to determine the best management structure for Arizona.

• Economic development goes well beyond a pure administrative function. Successful coordination of Arizona's entire economic development toolbox will be one of the Agency's most important and challenging tasks.

• Leadership is central to an economic development strategy's success. Arizona's economic development vision requires the Agency to lead the charge.

• Arizona's success in business development will be closely tied to two factors – highly knowledgeable staff and effective coordination. However, there has been much concern in changes in executive-level leadership. Regular modifications to the Agency's structure and organization have harmed perceptions of Arizona within its borders and throughout the U.S.

• The Agency must be perceived as providing services that are integrative and effective. Arizona communities should view the Agency as a valuable resource and partner in their economic development efforts. Communities mostly want Agency leadership to set the agenda for Arizona's economic development direction.

Business Development

• Business development is a relationship business. State Agency staff needs to create and maintain well-established relationships. Traditionally, business development in Arizona has been delivered through discrete regional and local government programs designed to create a pro-business climate. *The State has been absent from the pursuit of major economic development prospects.*

• The State Agency must act as a broker. Any new business assistance program should be delivered through a variety of formal and informal partnerships among local governments, county and regional economic development associations, site location consultants, secondary and post-secondary schools, other state agencies (like the Arizona Department of Revenue), local non-profit organizations, and other stakeholders. *The State needs to be at the table and serve as a key broker for economic development.*

• The State Agency should customize its role for each region in Arizona. In the State's metropolitan areas, Agency staff should play an advisory role. Economic development agencies in metro areas tend to be comprised of highly professional personnel who have clearly formulated goals, substantial resources, and a wealth of industry specific knowledge. By comparison, the Agency may play a different role in other rural areas on Arizona particularly those with part-time local economic development staff.

Local staff tends to lack the resources or experience to implement effective business development. The State Agency can provide technical assistance and market analysis to individual businesses, assist local governments on permitting and regulatory issues for new businesses, help regional economic development organizations to identify federal grants and other outside resources, and become involved in the direct administration of business assistance in a variety of ways.

Marketing

• Marketing Arizona as a highly desired business location is a key component of a successful economic development strategy. Marketing should primarily consist of outreach and visits to industries that are in an early stage of their growth or are strategically important to the State of Arizona.

• Take advantage of the "Follow the Herd" approach to corporate site selection. Ongoing success announcements should be top priority to show the world companies are moving to Arizona and the State is open for business.

• Aggressively tell the story of Arizona. Remember the "out of sight, out of mind" mantra and develop marketing initiatives that keep Arizona top of mind throughout the U.S. and world.

On-going Oversight & Program Effectiveness

• Arizona needs to conduct periodic comprehensive evaluations of any new economic incentive programs. The evaluation will help Legislative leaders understand if the programs are working and if extensive changes are needed.

• State leaders should have on-going oversight of economic development priorities and performance. Consideration should be given to a legislative oversight function to establish economic development priorities and to assess performance of State and regional economic development entities.

• The Agency should have the available data and processes to better track the performance of Arizona's economy and the effectiveness of economic incentive programs. In addition to summarizing the successful business development pursuits, periodic reporting should include post-award compliance metrics such as jobs promised vs. jobs actually created, health care benefits participation, and small business participation, just to name a few.

• The Agency should provide biennial or triennial evaluation of all economic incentive programs. The evaluation should be focused on assessment of effectiveness as measured in the creation/retention of direct jobs, payroll, and capital investment. A cost/benefit analysis should be included to show the revenue impact of each incentive program. This periodic evaluation should be used by State leaders to ensure program accountability and to enhance or sunset economic incentive programs.

3.9 Recommendations for Economic Development Policy in Arizona

Legislative leaders should consider a number of tools and policy changes to help Arizona compete for high quality economic development prospects in the 21st Century.

The recommended economic development policy changes are a near-term focus and, if strategically designed, will have a relatively immediate impact on economic development throughout Arizona. These incentive programs should be considered during the 2010 Legislative Session.

Enhance the Job Training Program

The Job Training Program, which was suspended during the 2009 Legislative Session, should be reinstated and enhanced to be more robust and responsive to existing businesses and those companies locating to Arizona. Consideration should be given to funding through recurring general fund appropriations (standard grant program) and/or a diversion of withholding tax revenue (enhanced grant program).

Consider emulating the features and funding mechanism of job training grant programs in Iowa and Kansas. These programs fund grants through the issuance of revenue bonds. On-going debt service payments on these revenue bonds are covered by a diversion of withholding taxes from the employees of the company. Program entry should be considered for new job creation and retention of existing jobs. In addition to standard uses of grant proceeds, reimbursement of some trainee wages should be permitted.

- Impact to a Company
    - Reduces on-going cost of doing business by offsetting costs for job training, especially with provisions for reimbursement of some trainee wages;

- Impact to the State
    - Requires recurring general fund appropriations for the standard grant program. With the enhanced grant program, there is no commitment of recurring general fund appropriations because each grant is self-funded and paid for through a diversion of a proportion of withholding taxes from the employees of the company;

    - Administrative fees are deducted upfront from either recurring appropriations (standard grant program) or gross grant proceeds (enhanced grant program);

    - Zero opportunity cost and revenue positive. Given the funding mechanism in the enhanced program, grant proceeds to a company should not exceed incoming withholding tax revenue. While the standard grant program is funded through recurring appropriations, approved grants should not exceed the expected tax revenue impacts. Indeed, new tax revenue from sales, unemployment, and corporate income are untouched and serve to contribute to the State's return on investment;

Create the Arizona Quality Jobs Program

Create and design the Arizona Quality Jobs Program to provide periodic discretionary cash rebates of a percentage annual withholding tax revenue generated by qualified companies in base industries. Cash rebates should be considered for up to 10 years. Consider emulating features from payroll rebate programs in Arkansas, Kansas, Louisiana, Missouri, and/or Oklahoma.

The Program should include reasonable eligibility requirements such as job & average wage thresholds, minimum payroll & capital investment, health insurance, and potential bonuses for significant average wages. Benefits under this Program should be allowed for the creation of new jobs & payroll as well as the retention of existing jobs & payroll. Consideration should be given to over committing withholding tax revenue tied to job training grants funded through a similar mechanism.

➢ Impact to a Company
- Reduces cost of doing business by offsetting annual payroll costs;

➢ Impact to the State
- Requires no commitment of recurring general fund appropriations. Each grant is self-funded and paid for through a diversion of a proportion of withholding taxes from the employees of the company;

- Zero opportunity cost and revenue positive. Given the funding mechanism, grant proceeds to a company should not exceed incoming withholding tax revenue. Indeed, new tax revenue from sales, unemployment, and corporate income are untouched and serve to contribute to the State's return on investment;

- Allows Arizona to compete for businesses creating new quality jobs with above-average salaries and retain existing businesses in strategically important industries.

Create the Arizona Deal Closing Fund

Create and design the Arizona Deal Closing Fund to provide discretionary cash grants to high impact economic development prospects in base industries. Funding of the Deal Closing Fund can be made through a transfer of approximately $120 million under control of the Governor from Federal Stimulus proceeds. General fund appropriations can be an alternative funding source.

Consider emulating features from deal closing funds in Texas, Arkansas, Florida, Louisiana, and Virginia. The Fund should include reasonable eligibility requirements such as job & average wage thresholds, minimum payroll & capital investment, health insurance, and other significant criteria. Grants from the Fund should be available only with the existence of interstate competition, significant economic & fiscal impact, and substantial return on the State's investment. Grants should be limited to filling the financing gap of project costs or covering an overall cost differential between Arizona and a competing state.

➢ Impact to a Company
- Offsets a portion of start-up investment and/or reduces on-going costs of doing business;

➢ Impact to the State
- Requires commitment of general fund appropriations.

- Zero opportunity cost and revenue positive. Grant awards will be revenue positive over a term no longer than 10 years. The State's return on investment shall be measured based on the economic and fiscal impact of the company receiving the grant.

- Allows Arizona to more effectively compete for businesses creating new quality jobs in high value-added, knowledge-driven, growing industries.

Adequately Fund a State Economic Development Agency

Consider significant funding of a State Agency in charge of recruiting and retaining businesses to the State of Arizona. This agency can be the Arizona Department of Commerce or other desired entity to manage and implement the economic development priorities of the State. Funding should be substantial to build an organization that can effectively and efficiently implement Arizona's discretionary economic incentive programs (see Recommendation #1 through 4) and aggressively recruit businesses to Arizona.

➢ Impact to a Company
  - Potentially deliver locations with a low cost of doing business relative to other states;

➢ Impact to the State
  - Requires a commitment of general fund appropriations.

  - Should generate a return on investment to the State by recruiting high impact businesses that otherwise may not have looked at Arizona for a new location;

  - Allows Arizona to more effectively compete for high impact businesses and retain existing businesses.

Commission the Economic Development Strategy of Arizona

Commission an economic development strategy plan that establishes the economic goals of the state and provides focus of Arizona's discretionary economic incentive programs

➢ Impact to a Company
  - None.

➢ Impact to the State
  - Requires a commitment of a general fund appropriation.

  - Provides a focus of discretionary incentive programs to ensure effectiveness at recruiting and retaining high impact businesses.

Modify the Arizona Enterprise Zone Program

Consider modification of the Arizona Enterprise Zone Program to allow for the discretionary property tax reclassification beyond the statutorily permitted women/minority and independent owned manufacturing and commercial printing businesses. Additional study is needed to evaluate the effectiveness of the Program for achieving the State's economic development goals. Indeed, other modifications could be required to directly induce job creation and generate a significant return on investment to the State.

- Impact to a Company
  - Reduces on-going costs of doing business by reducing real property taxes;

- Impact to the State
  - Requires no commitment of general fund appropriations.
  - Zero opportunity cost and no tax revenue impact since the State does not impose property taxes. Possibly revenue positive to the State given the potential new tax revenue from sales, unemployment, and corporate income from high impact businesses that otherwise would not have located in Arizona.
  - Allows Arizona to more effectively compete for capital intensive operations by eliminating a significant portion of a company's tax burden.

For Later Consideration - Establish Tax Increment Financing (TIF) Legislation

Enable the use of tax increment financing (TIF) in Arizona. TIF would provide communities an additional economic incentive tool to induce infrastructure investment in blighted areas and/or to lure high impact companies that otherwise would not locate in Arizona.

- Impact to a Company
  - Reduces start-up investment in a location.

- Impact to the State
  - Requires no commitment of a general fund appropriation.
  - Zero opportunity cost and possibly revenue positive to the State assuming TIF projects are funded by local property tax revenue only. Indeed, new tax revenue from sales, unemployment, and corporate income are untouched and serve to contribute to the State's return on investment.

3.10 Summary Observations of Arizona's Competitiveness

A revisit of the three case studies illustrates how the proposed incentive programs could have helped successfully recruit high impact companies to Arizona. The new discretionary incentive programs can be designed to allow for sufficient flexibility to win these sample economic development prospects. We shared the results of this analysis with the CBRE Economic Incentives Group and asked if the proposed incentives package with the recommended programs would have been significant to lure those companies to Arizona. The answer was yes.

Appendix A

Three Approaches to Site Selection

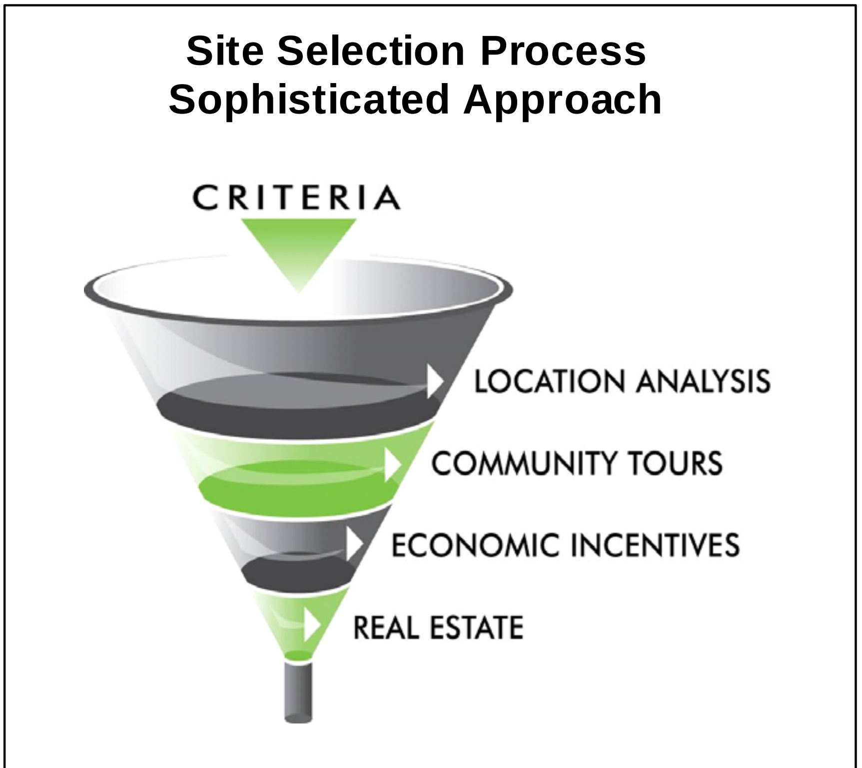
There are three approaches to corporate site selection with varying degrees of sophistication and strategy. Some companies engage in a highly sophisticated, customized, and strategic site selection process in order to find the best long-term economic opportunity for a new operation. Other companies choose a different site selection strategy called "follow the herd" in which a location decision is based solely on where its competitor is located. The third type of site selection called "sold by the sizzle" in which incentives drive a location decision.

A More Sophisticated Approach

Companies that follow the Sophisticated Approach to site selection want to thoughtfully research and evaluate the best community and State for its operations. This is true for both labor-intensive and capital-intensive operations. The following graph illustrates the filtering process of this approach.

The site selection process starts with diagnosing an operations key drivers such as logistics, infrastructure, labor availability, and labor skill sets just to name a few. A location analysis is undertaken by matching the key drivers to a community and state's demographic and economic make-up.

Upon reaching a shortlist of markets that meet an operation's key drivers, the company and/or site selection consultant will conduct community tours. The purpose of these tours is to validate the findings from the location analysis and verify the curb appeal of the community. An evaluation of economic incentives and real estate is conducted at the end of the site selection process. The endgame of the Sophisticated Approach to site selection is to find the best net economic opportunity accounting for logistics, labor, real estate, and incentives.



Source: CBRE Labor Analytics Group

From an economic development perspective, while incentives are a key component to the location decision, leading with an economic incentive package is misplaced. Discussions of incentive savings are most productive at the end of the location analysis when the company has focused on the optimal communities for its operation. This is the best point to determine the true need for incentives in successfully recruiting the company.

It should be noted that while this is the most desired site selection approach by economic development agencies, it does not happen every day.

"Follow the Herd" Approach

Companies that engage in the "Follow the Herd" Approach to site selection choose to let their competitors or other companies in the same industry do the site selection work. The reality is if a community and State are good for its competitor then that community is good enough for the company. During the last decade, this approach has been seen with bio-tech firms in San Diego, renewable energy manufacturing companies in Oregon, distribution centers in Indiana, and financial services in Charlotte.

These types of companies may tend to put some to very little weight in a location's cost advantages, or even disadvantages, just to be near similar companies. Indeed, some state economic development marketing strategies are focused on announcing any successful business recruitment or retention. More times than not, a CEO will read an announcement about a competitor and decide "if it is good for them, then it is good for us."

Based on recent experience of the CBRE Economic Incentives Group, the Follow the Heard Approach can be currently seen in Arkansas, for example. In 2008, Nordex announced a wind turbine manufacturing plant in Jonesboro, Arkansas (population of 113,084). This facility is projected to have a $100 million capital investment with 700 jobs paying $17 per hour. This announcement created a buzz about Arkansas that has led to Mitsubishi Power Systems American announcing a wind turbine manufacturing facility in Fort Smith (population of 300,000). This facility is projected to have a $100 million capital investment with 400 jobs. Business development managers with the Arkansas Economic Development Commission revealed the Nordex announcement opened the flood gates for other interested wind manufacturing companies. Arkansas is currently courting two wind turbine manufacturing prospects.

Incentives are certainly a major driver in these circumstances. From an economic development perspective, while incentives will likely be more heavily relied upon, it will be increasingly difficult to determine if incentives are needed to successfully recruit the company. Good, bad, or indifferent, an economic development policy cannot ignore prospects using this approach. Of course, given the nature of these types of prospects, economic development marketing strategies are of equal importance as economic incentive programs. See the Appendix for these official announcements.

"Sold by the Sizzle" Approach

The third approach to site selection is called "Sold by the Sizzle." In this approach, location decisions are primarily driven by the magnitude of a potential incentives package. Geographic preference, labor cost advantages, and industry clustering are of little importance in these circumstances. Some economic development agencies, both state and local, have grasped this concept to facilitate rapid economic development activity.

A recent example is Oregon and the renewable energy industry. Oregon aggressively sells its Business Energy Tax Credit (BETC) program to prospective renewable energy manufacturers. During the last several years, there has been a flood of successful recruitment activity to communities in Oregon that may not have been on the radar.

From an economic development perspective, this approach has its advantages and drawbacks. The advantage to leading with incentives is the enhanced ability to lure companies who otherwise would not look at a state. The nature of some CEOs and site selection consultants is incentive programs create interest to dive deeper into opportunities in a state. This is effectively a form of reverse site selection where incentives drive the initial interest in a state (i.e. "selling the sizzle") with real estate, labor, and logistics solved for at a later point in the location decision. The main drawback to leading with incentives is the potential criticism of misusing taxpayer dollars when it may not be necessary. Overall, leading with incentives can be a good economic development strategy to facilitate business recruitment in a state. The challenge is to ensure access to incentive programs is thoughtfully managed.

In each approach to corporate site selection, economic incentives play a critical role in a company's location decision, whether it be at the end or beginning of the selection process. This is true not only in Arizona but in every state and province across the U.S. and Canada. The economic development reality is CEOs are constantly in search of locations with the lowest total cost of doing business. While overall business strategy comes first, targeted and financially significant economic incentive programs will enhance a state's ability to successfully recruit and retain strong economic development prospects. Overall, economic incentives cannot be ignored.

Role of Incentives in Business Recruitment & Retention

The overarching goal of economic development is to increase the standard of living of a state's residents through the creation of new job opportunities paying a competitive to above-average wage at every step of the economic ladder. These opportunities can range anywhere from $9 per hour customer service jobs to $20 per hour aerospace manufacturing jobs to $60,000 per year nursing jobs. Economic incentives can play a critical role in attracting right type of jobs from the desired industries.

Economic incentives vary from state to state by type, availability, target industries, performance metrics, and methods of payment. Business recruitment in the U.S. is highly competitive. As companies become more and more mobile and indifferent to location, economic incentives can make the difference between winning or losing.

Statutory vs. Discretionary Incentives

There are two types of State economic incentives – statutory or discretionary. Statutory incentives are also called "as of right" or entitled incentives. These programs are enabled by statute, have explicit performance metrics (i.e. job creation, average wages, healthcare benefits), and the incentive benefit is fixed. If a Company meets the statutory criteria and fills in the appropriate applications, the incentive benefits are guaranteed. Statutory incentives can include corporate income tax credits for job creation, R&D tax credits, job training grants, foreign trade zone benefits, and military trade zone/re-use incentives.

Discretionary incentive programs are customized to a company's specific priorities, the incentive benefit and payment term are negotiable, and the final approval is at the discretion of a government official. Discretionary incentives are only offered on a case by case basis for strong economic development prospects that are projected to generate a significant economic and fiscal impact on the State and community. Discretionary incentives can include property tax abatements, cash grants, sales tax exemptions/refunds, donated land, forgivable loans, and free parking to name a few.

Appendix B

Purpose of Economic Incentives

Economic incentives are intended to lure businesses that will significantly expand the tax base, employ local residents, have a catalytic effect on local suppliers, are in a job-growing mode, and creates local wealth. Incentives cannot turn a bad location with inadequate workforce or infrastructure into a good location. However, incentives are the most persuasive when location factors are relatively equal between locations and can either level the playing field or be the deciding factor among a short list of locations.

Economic incentives have three functions: address cost disadvantages, revitalize distressed regional economies, and induce favorable economic activity.

Address Cost Disadvantages

There are a number of site selection factors and operating costs that cannot be controlled in the near term. These include labor costs, available workforce skill levels, real estate availability & cost, transportation infrastructure (to an extent), and geography. For example, consider an economic development prospect that needs to hire 500 financial analysts. Metro Phoenix and Metro Tampa are on the final two locations on the short list. Our focus will be on total labor cost since it accounts for 70% to 80% of these types of operations. According to latest occupational wage survey conducted by the U.S. Bureau of Labor Statistics, the median wage for a financial analyst in Metro Phoenix was $31.17 per hour. By comparison, the median wage in Metro Tampa was $28.20 per hour. This $2.97 per hour difference in wages results in total labor costs that are $3 million per year higher in Metro Phoenix (or $30 million over a 10-year time period).

Overall, strategically targeted incentives can help offset some or the entire cost disadvantage for a particular industry in Arizona when such a disadvantage is otherwise likely to result in the loss of such an investment and employment. All things being equal, the lack of incentives to offset the labor cost disadvantage for the prospect in the above example will likely mean a lost opportunity to Arizona and Metro Phoenix.

Revitalize Distressed Regional Economies

Incentive programs can be designed to encourage businesses to locate in a particular region where unemployment & poverty have been historically high and private investment has lacked other more affluent regions in a state. Offering enhanced incentive savings or even exclusive incentive opportunities to businesses investing in the revitalization areas can help support job creation and investment to these regions when they otherwise would not occur.

For example, Arizona's Enterprise Zone program is focused on providing corporate income tax credits and some property tax abatements to businesses locating in established enterprise zones across the State. Yuma County is a certified enterprise zone and any business locating in the Yuma County is entitled to these incentive benefits. Indeed, the Greater Yuma EDC actively markets these target incentive benefits to most prospects evaluating Greater Yuma for a new location – whether manufacturing, distribution, or call center operations.

Overall, the absence of incentive programs targeted for these relatively economically disadvantaged areas in Arizona could cause prospective businesses to look elsewhere. The sign of a good economic development policy is to not be one size fits all but to be flexible and customizable to the dynamics (pitfalls and all) of Arizona's regional economies.

Induce Favorable Economic Activity

Incentives can be designed to encourage the recruitment of businesses in base industries. These types of industries export outside the local economy and bring net wealth in or substitutes for imports to the local economy. Base industries produce relatively substantial ripple effects throughout the economy. These ripple effects are measured in terms of jobs, payroll, and particularly new tax revenues to the State.

For example, consider two economic development prospects are asking for incentives. One prospect is a 100-job computer manufacturing operation and the other prospect is a 100-job warehousing operation. The 100 jobs created by the computer manufacturing business will likely create an additional 218 jobs resulting in total economic activity estimated at $31.7 million annually. By comparison, the 100 jobs created by the warehousing operation will likely create only 59 additional jobs with total economic activity estimated at $8.3 million annually. The question is: *Where will $1 million in incentives have the greatest return on investment in Arizona – the computer manufacturing business or the warehousing business?*

Overall, incentive programs can be designed to provide benefits to industries that will have the greatest employment and fiscal benefits to Arizona, diversify the employment base, and especially bolster & protect certain industries that are given legislative priority.

Net New vs. Retention

Across the U.S., a majority of State incentive programs are targeted for new businesses only. Most incentive programs are designed to provide incentive benefits when a business creates new jobs or new capital investment. During the part of the business cycle when growth is abundant, the reality is most economic development agencies are focused on new opportunities that will add new jobs and tax revenue to the State. Incentive programs with sole focus on "net new" are not very usable during a recession or recovery when businesses generally shy away from new operations.

The other side of the economic development coin is the retention of existing businesses, particularly those that contribute the greatest impact to a state economy. In today's world, businesses are looking for the lowest total cost of doing business. A CEO could decide to relocate the business if less expensive opportunities exist in a location outside its current state. This potential loss of jobs will unequivocally have an economic and fiscal impact to a state. With new economic development prospects, the question is: *What is the new impact (jobs & tax* *revenue) of this new business to the state*? With retention, the question is flipped and becomes: *What is the state likely to lose (jobs & on-going tax revenue) if the business leaves the state?*

Overall, incentive programs should be designed to encourage both creation and retention of jobs. This level of flexibility will allow economic development groups in Arizona to be adaptable in every stage of the business cycle.

Appendix C

Quantifying Arizona's Competitive Disadvantage with Incentives

A comparison of the inventory of economic incentive programs from state to state reveals Arizona appears to be behind the curve when it comes to business attraction & retention. Looking beyond the number and types of incentive programs, it is necessary to better understand the order of magnitude of Arizona's competitive disadvantage.

The CBRE Economic Incentives Group provided three site selection and economic incentive assignments completed during 2008 and 2009. The Company's proposed operations in each assignment was matched to the regional economy in Arizona that could have reasonably competed for the business if it were on the short list. In these real projects, the actual incentive package secured for the Company is compared against what the incentive package would likely have been in Arizona given the State's existing incentive programs.

Confidential Regional Bank – Metro Phoenix

A confidential regional bank is currently evaluating a community in one of the states in the Rust Belt part of the U.S. for a regional operations center. This operation intends to employ 1,320 finance and accounting jobs with an average salary of $34,000. This company intends to lease approximately 185,000 square feet of existing office space and invest about $7.0 million in real and personal property. The Rust Belt state and community presented a $8.0 million incentive package. Incentives include tax credits, job training grant, sales tax exemptions, and utility incentives/rebates. In addition, a 10-year real property tax abatement and $1 million cash grant are currently on the table. By comparison, the incentive package in Metro Phoenix would likely have totaled slightly more than $3.9 million including tax credits from the Enterprise Zone. All things being equal, Arizona and Metro Phoenix would have more than a $4 million shortfall and would have lost the business. See the table on the following page for additional detail.

Overall, the foregone impact of this economic development opportunity on Arizona includes 2,067 total jobs, $80.3 million in annual wages, and $29.3 million in new tax revenues to the State over a period of ten years. During the same period, approximately $25.2 million in County and City tax revenues would have been generated.

Economic & Fiscal Impact of
Lost Economic Development Opportunity - Metro Phoenix

Company	Confidential Regional Bank
Operation Type	Regional Operations Center

Economic Impact		Fiscal Impact (10yr Total)	
Direct Jobs	1,320	State of AZ	$29.3m
Annual Wages	$44.7m	Maricopa County	$14.8m
		City of Phoenix	$10.4m
Total Jobs	2,067		
Annual Wages	$80.3m		

Source: Elliott D. Pollack & Company

Economic Development Prospect
Metro Phoenix

Current Arizona Incentives

Prospect Overview

Company	Confidential National Bank
Credit Quality	Fortune 500
Operation	Regional Operations Center
Job types	Finance, Accounting
Year Announced	In Progress

Operations Summary

Total Jobs	1,320	Project Type	Office
Average Salary	$34,000	Existing or New	Existing
Annual Payroll	$44.7m	Lease or Own	Lease
Total Capital Investment	$7.0m	Building size (sf)	185,000
		Land area (ac)	n/a

Incentive Overview

	[1] **Rust Belt State**	[2] **Metro Phoenix**	**Advantage (Shortfall)**
Tax Credits	$1,970,700	$3,960,000	
Job Training Grant	$900,000	$0	
Payroll Rebate	$0	$0	
Sales Tax Exemptions	$420,700	$0	
Cash Grant	$1,000,000	$0	
Real Property Tax Abatement	$3,137,900	$0	
Personal Property Tax Abatement	Exempt	$0	
TIF Grant	$0	$0	
Utility Incentives	$588,900	$0	
Other Local Incentives	$0	$0	
Total Incentive Package	**$8,018,200**	**$3,960,000**	**($4,058,200)**

1 Incentive package for Rust Belt State based on 2009 incentive negotiations by the CBRE Economic Incentives Group. Job tax credits = 4 year payout; Job training grant = 3 year payout; Sales tax exemptions = Upfront - prior to occupancy; Cash grant = Upfront; Property tax abatements = 10 year term.; Utility incentives = 5 year payout.

2 Metro Phoenix incentives include job tax credits of $3,000 per job under the Arizona Enterprise Zone program. Job tax credits = 3 year payout.

Source: Elliott D. Pollack & Company. CBRE Economic Incentives Group.

Medco Health Solutions – Metro Tucson

In late 2007, Medco Health Solutions announced the creation of the world's largest automated pharmacy fulfillment center in Indianapolis (see Appendix). Medco searched for a community with a substantial labor base of existing pharmacists and pharmacy techs and a university with a strong Pharmacy program. This operation is projected to employ 1,300 pharmacist and pharmacy tech jobs with an average salary of $53,000. This company planned to build a 318,000 square foot facility and invest approximately $150 million in real and personal property. The State of Indiana and Indianapolis presented a $32.0 million incentive package including tax credits, job training grant, a 10-year real and personal property tax abatement, and $5 million cash grant.

By comparison, the incentive package in Metro Tucson would likely have totaled slightly more than $4.5 million including tax credits from the Enterprise Zone and a job training grant from the Job Training Program. All things being equal, Arizona and Metro Tucson would have more than a $27 million shortfall and would have lost the business. See the table on the following page for additional detail.

Overall, the foregone impact of this economic development opportunity on Arizona includes 2,237 total jobs, $106.3 million in annual wages, and $42.9 million in new tax revenues to the State over a period of ten years. During the same period, approximately $45 million in County and City tax revenues would have been generated.

Economic & Fiscal Impact of
Lost Economic Development Opportunity - Metro Tucson

Company	Medco Health Solutions
Operation Type	Automated Pharmacy

Economic Impact		**Fiscal Impact (10yr Total)**	
Direct Jobs	1,300	State of AZ	$42.9m
Annual Wages	$69m	Pima County	$33.2m
		City of Tucson	$11.7m
Total Jobs	2,237		
Annual Wages	$106.3m		

Source: Elliott D. Pollack & Company

Economic Development Prospect
Metro Tucson
Current Arizona Incentives

Prospect Overview

Company	Medco Health Solutions
Credit Quality	Fortune 45
Operation	Automated Pharmacy
Job types	Pharmacists, Pharm Techs
Year Announced	2007

Operations Summary

Total Jobs	1,300	Project Type	Distribution
Average Salary	$53,000	Existing or New	New
Annual Payroll	$69m	Lease or Own	Own
Total Capital Investment	$150m	Building size (sf)	318,000
		Land area (ac)	25

Incentive Overview [1]

	Indianapolis, IN	Metro Tucson	Advantage (Shortfall)
Tax Credits	$16,200,000	$3,900,000	
Job Training Grant	$800,000	$650,000	
Payroll Rebate	$0	$0	
Sales Tax Exemptions	$0	$0	
Cash Grant	$0	$0	
Real Property Tax Abatement	$10,000,000	$0	
Personal Property Tax Abatement	Included above	$0	
TIF Grant	$5,000,000	$0	
Utility Incentives	$0	$0	
Other Local Incentives	$0	$0	
Total Incentive Package	**$32,000,000**	**$4,550,000**	**($27,450,000)**

1 Incentive package for Medco is based on a 2007 incentive package negotiated by the CBRE Economic Incentives Group. Job tax credits = 10 year payout; Job training grant = 2 year payout; Property tax abatements = 10 year term; TIF Grant = Upfront.

2 Metro Tucson incentives include job tax credits of $3,000 per job under the Arizona Enterprise Zone program and $500 per job from the Arizona Job Training Program. Job tax credits = 3 year payout and Job training grant = 2 year payout.

Source: Elliott D. Pollack & Company. CBRE Economic Incentives Group.

<u>*United Health Group – Prescott Valley*</u>

In 2009, United Health Group announced a customer service / claims center in Harlingen, Texas (see Appendix). United Health Group searched for a rural community where it could be a preferred employer. This operation is projected to employ 600 customer service associates with an average salary of $20.800. This company planned to lease a 55,000 square foot facility and invest approximately $5 million in real and personal property. Harlingen chose to invest in this opportunity because its residents lacked employment opportunities that are a step above retail. Harlingen presented a $4.6 million incentive package including cash grants for job creation, cash grant for building improvements, and other miscellaneous incentives tied to the building.

By comparison, the incentive package in Prescott Valley would likely have totaled almost $2.1 million including tax credits from the Enterprise Zone, local cash grant for job creation, and waiver of development and impact fees. According to the CBRE Economic Incentives Group, Prescott Valley has been working to attract a customer service center and has offered creative incentive packages similar to the figures noted above. All things being equal, Arizona and Prescott Valley would have more than a $2.6 million shortfall and would have lost the business. See the table on the following page for additional detail.

Overall, the foregone impact for this economic development opportunity includes 2,237 total jobs, $106.3 million in annual wages, and $42.9 million in new tax revenues to Arizona over a period of ten years. During the same period, approximately $45 million in County and City tax revenues would have been generated.

Economic & Fiscal Impact of
Lost Economic Development Opportunity - Prescott Valley

Company	United Health Group
Operation Type	Customer Service/Claims Center

Economic Impact		**Fiscal Impact (10yr Total)**	
Direct Jobs	600	State of AZ	$9.1m
Annual Wages	$12m	Yavapai County	$6.2m
		Prescott Valley	$1.1m
Total Jobs	769		
Annual Wages	$18.6m		

Source: Elliott D. Pollack & Company

Economic Development Prospect
Prescott Valley
Current Arizona Incentives

Prospect Overview

Company	United Health Group
Credit Quality	Fortune 21
Operation	Customer Service/Claims Center
Job types	Customer Service
Year Announced	2009

Operations Summary

Total Jobs	600	Project Type	Office
Average Salary	$20,800	Existing or New	Existing
Annual Payroll	$12m	Lease or Own	Lease
Total Capital Investment	$5m	Building size (sf)	55,000
		Land area (ac)	n/a

Incentive Overview

	[1] Harlingen, TX	[2] Prescott Valley	Advantage (Shortfall)
Tax Credits	No Corp Tax	$1,800,000	
Job Training Grant	$0	$0	
Payroll Rebate	$0	$0	
Sales Tax Exemptions	$0	$0	
Cash Grant	$4,025,000	$190,000	
Real Property Tax Abatement	$0	$0	
Personal Property Tax Abatement	$0	$0	
TIF Grant	$0	$0	
Utility Incentives	$0	$0	
Other Local Incentives	$663,700	$86,600	
Total Incentive Package	**$4,688,700**	**$2,076,600**	**($2,612,100)**

1 Incentive package for United Healthcare is based on a 2009 incentive package negotiated by the CBRE Economic Incentives Group. Cash grant = 5 year payout; Other local incentives = Upfront.

2 Prescott Valley incentives include job tax credits of $3,000 per job under the Arizona Enterprise Zone program, cash grant of $316 per job (on average); and waiver of development & impact fees. Job tax credits = 3 year payout; Cash grant = 5 year payout; Other local incentives = Upfront.

Source: Elliott D. Pollack & Company. CBRE Economic Incentives Group.

General Observations

These three case studies are intended to illustrate job creation and new tax revenues Arizona could be missing out on due to the absence of strategically targeted economic incentive programs. Arizona does not even have a shot to compete for these business opportunities.

Appendix D

How is Arizona's Competitiveness Enhanced with the Recommended Incentives?

The economic development policy recommendations include economic incentive programs that are designed to provide an immediate impact to business recruitment and retention in Arizona. Appendix C of this report discussed three case studies in which Arizona was compared to the State and community that won an actual economic development prospect. Given the proposed incentive programs, these case studies are revisited to illustrate to what extent, if any, Arizona's competitiveness has improved.

Confidential Regional Bank – Metro Phoenix

A confidential regional bank is currently evaluating a community in one of the states in the Rust Belt part of the U.S. for a regional operations center. This operation intends to employ 1,320 finance and accounting jobs with an average salary of $34,000. This company intends to lease approximately 185,000 square feet of existing office space and invest about $7.0 million in real and personal property. The Rust Belt state and community presented a $8.0 million incentive package. Incentives include tax credits, job training grant, sales tax exemptions, utility incentives/rebates, a 10-year real property tax abatement, and $1 million cash grant are currently on the table.

By comparison, the incentive package in Metro Phoenix could total about $8.2 million. Above and beyond the tax credits from the Enterprise Zone, the confidential regional bank can be eligible for a $990,000 job training grant and $3.2 million from the Arizona Quality Jobs Program.

All things being equal and with incentives being the last card to be played, Arizona and Metro Phoenix would have won the business. Arizona's incentive package was $210,000 more significant than the package offered by the Rust Belt State.

The economic and fiscal impact of this economic development opportunity on Arizona and Metro Phoenix includes 2,067 total jobs (including the 1,320 direct jobs), $80.3 million in annual wages, nearly $2.8 billion in new economic activity, and approximately $29.3 million in new tax revenues to the State over a period of ten years. During the same period, about $25.2 million in County and City tax revenues would have been generated.

Overall, the State of Arizona is projected to see a return on its investment by the fourth year of operations and would have likely generated more than $21 million in net new tax revenues (after incentives) over a 10-year period.

Potential Return on Investment to Arizona
Economic Development Prospect
Metro Phoenix

Prospect Overview	
Company	Confidential National Bank
Credit Quality	Fortune 500
Operation	Regional Operations Center
Job types	Finance, Accounting
Year Announced	In Progress

Economic Impact (10-year Total)	
Direct Jobs	1,320
Total Jobs	2,067
Direct Wages	$448,800,000
Total Wages	$803,470,000
Total Economic Activity	$2,798,640,000

Fiscal Impact to Arizona

	5 Year Total	10 Year Total
New Tax Revenue (Direct only)	$8,514,000	$17,028,000
<u>State Incentives</u>		
Tax Credits	$3,960,000	$3,960,000
Job Training Grant	$990,000	$990,000
Payroll Rebate	$1,639,110	$3,278,220
Cash Grant	$0	$0
Total State Incentives	**$6,589,110**	**$8,228,220**
Net New Tax Revenue (Direct only)	**$1,924,890**	**$8,799,780**
plus New Tax Revenue (Multiplier effects)	$6,143,500	$12,287,000
Total Net New Tax Revenue	**$8,068,390**	**$21,086,780**

Return on AZ Investment	**Up to 4 years**
New City Tax Revenue	**$10,443,000**
New County Tax Revenue	**$14,875,000**

Source: Elliott D. Pollack & Company.

Economic Development Prospect
Metro Phoenix

Enhanced Arizona Incentives

Prospect Overview

Company	Confidential National Bank
Credit Quality	Fortune 500
Operation	Regional Operations Center
Job types	Finance, Accounting
Year Announced	In Progress

Operations Summary

Total Jobs	1,320	Project Type	Office
Average Salary	$34,000	Existing or New	Existing
Annual Payroll	$44.7m	Lease or Own	Lease
Total Capital Investment	$7.0m	Building size (sf)	185,000
		Land area (ac)	n/a

Incentive Overview

	[1] Rust Belt State	[2] Metro Phoenix	Advantage (Shortfall)
Tax Credits	$1,970,700	$3,960,000	
Job Training Grant	$900,000	$990,000	
Payroll Rebate	$0	$3,278,220	
Sales Tax Exemptions	$420,700	$0	
Cash Grant	$1,000,000	$0	
Real Property Tax Abatement	$3,137,900	$0	
Personal Property Tax Abatement	Exempt	$0	
TIF Grant	$0	$0	
Utility Incentives	$0	$0	
Other Local Incentives	$588,900	$0	
Total Incentive Package	**$8,018,200**	**$8,228,220**	**$210,020**

1 Incentive package for Rust Belt State based on 2009 incentive negotiations by the CBRE Economic Incentives Group. Job tax credits = 4 year payout; Job training grant = 3 year payout; Sales tax exemptions = Upfront - prior to occupancy; Cash grant = Upfront; Property tax abatements = 10 year term.; Utility incentives = 5 year payout.

2 Job tax credits = $3,000 per job under the Arizona Enterprise Zone program (3 year payout); Job training grant = 75% of $1,000 per job training expenses incurred by Company (3 year payout); Payroll rebate = 25% of withholding taxes for 10 years;

Source: Elliott D. Pollack & Company. CBRE Economic Incentives Group.

Medco Health Solutions – Metro Tucson

In late 2007, Medco Health Solutions announced the creation of the world's largest automated pharmacy fulfillment center in Indianapolis. Medco searched for a community with a substantial labor base of existing pharmacists and pharmacy techs and a university with a strong Pharmacy program. This operation is projected to employ 1,300 pharmacist and pharmacy tech jobs with an average salary of $53,000. This company planned to build a 318,000 square foot facility and invest approximately $150 million in real and personal property. The State of Indiana and Indianapolis presented a $32.0 million incentive package including tax credits, job training grant, a 10-year real and personal property tax abatement, and $5 million cash grant.

By comparison, the incentive package in Metro Tucson could total about $32.2 million. Above and beyond the tax credits from the Enterprise Zone and initial job training grant, Medco can be eligible for additional funds for job training, $15.0 million from the Arizona Quality Jobs Program, and a $12 million cash grant from Arizona's Deal Closing Fund. In this situation, job creation, average wages, and capital investment were significant to justify the grant from the Deal Closing Fund.

All things being equal and with incentives being the last card to be played, Arizona and Metro Tucson would have won the business. Arizona's incentive package was about $208,000 more significant than the package offered by Indianapolis and the State of Indiana.

The economic and fiscal impact of this economic development opportunity on Arizona and Metro Tucson includes 2,237 total jobs (including the 1,300 direct jobs), $106.3 million in annual wages, nearly $2.3 billion in new economic activity, and about $42.9 million in new tax revenues to the State over a period of ten years. During the same period, about $45 million in County and City tax revenues would have been generated.

Overall, the State of Arizona is projected to see a return on its investment within three to seven years and would have likely generated more than $10.7 million in net new tax revenues (after incentives) over a 10-year period.

Potential Return on Investment to Arizona
Economic Development Prospect
Metro Tucson

Prospect Overview

Company	Medco Health Solutions
Credit Quality	Fortune 45
Operation	Automated Pharmacy
Job types	Pharmacists, Pharm Techs
Year Announced	2007

Economic Impact (10-year Total)

Direct Jobs	1,300
Total Jobs	2,237
Direct Wages	$689,000,000
Total Wages	$1,063,680,000
Total Economic Activity	$2,275,120,000

Fiscal Impact to Arizona

	5 Year Total	10 Year Total
New Tax Revenue (Direct only)	$15,904,700	$28,207,200
<u>State Incentives</u>		
Tax Credits	$3,900,000	$3,900,000
Job Training Grant	$1,218,750	$1,218,750
Payroll Rebate	$7,544,810	$15,089,620
Cash Grant	$12,000,000	$12,000,000
Total State Incentives	**$24,663,560**	**$32,208,370**
Net New Tax Revenue (Direct only)	**($8,758,860)**	**($4,001,170)**
plus New Tax Revenue (Multiplier effects)	$7,695,600	$14,769,100
Total Net New Tax Revenue	**($1,063,260)**	**$10,767,930**

Return on AZ Investment	**3 to 7 years**
New City Tax Revenue	**$11,745,000**
New County Tax Revenue	**$33,255,000**

Source: Elliott D. Pollack & Company.

Economic Development Prospect
Metro Tucson
Enhanced Arizona Incentives

Prospect Overview

Company	Medco Health Solutions
Credit Quality	Fortune 45
Operation	Automated Pharmacy
Job types	Pharmacists, Pharm Techs
Year Announced	2007

Operations Summary

Total Jobs	1,300	Project Type	Distribution
Average Salary	$53,000	Existing or New	New
Annual Payroll	$69m	Lease or Own	Own
Total Capital Investment	$150m	Building size (sf)	318,000
		Land area (ac)	25

Incentive Overview

	[1] Indianapolis, IN	[2] Metro Tucson	Advantage (Shortfall)
Tax Credits	$16,200,000	$3,900,000	
Job Training Grant	$800,000	$1,218,750	
Payroll Rebate	$0	$15,089,620	
Sales Tax Exemptions	$0	$0	
Cash Grant	$0	$12,000,000	
Real Property Tax Abatement	$10,000,000	$0	
Personal Property Tax Abatement	Included above	$0	
TIF Grant	$5,000,000	$0	
Utility Incentives	$0	$0	
Other Local Incentives	$0	$0	
Total Incentive Package	**$32,000,000**	**$32,208,370**	**$208,370**

1 Incentive package for Medco is based on a 2007 incentive package negotiated by the CBRE Economic Incentives Group. Job tax credits = 10 year payout; Job training grant = 2 year payout; Property tax abatements = 10 year term; TIF Grant = Upfront.

2 Job tax credits = $3,000 per job under the Arizona Enterprise Zone program (3-year payout); Job training grant = 75% of $1,250 per job training expenses incurred by Company (3 year payout); Payroll rebate = 70% of withholding taxes for 10 years; Governor's Closing Fund = discretionary cash grant to cover the funding gap (2-year payout).

Source: Elliott D. Pollack & Company. CBRE Economic Incentives Group.

United Health Group – Prescott Valley

In 2009, United Health Group announced a customer service / claims center in Harlingen, Texas. United Health Group searched for a rural community where it could be a preferred employer. This operation is projected to employ 600 customer service associates with an average salary of $20.800. This company planned to lease a 55,000 square foot facility and invest approximately $5 million in real and personal property. Harlingen chose to invest in this opportunity because its residents lacked employment opportunities that are a step above retail. Harlingen presented a $4.6 million incentive package including cash grants for job creation, cash grant for building improvements, and other miscellaneous incentives tied to the building.

By comparison, the incentive package in Prescott Valley could total about $4.9 million. Above and beyond the tax credits from the Enterprise Zone and cash grant from the Town, United Health Group can be eligible for a $360,000 job training grant, $2.0 million from the Arizona Quality Jobs Program, and a $541,000 cash grant from Arizona's Deal Closing Fund. In this situation, job creation, average wages, and capital investment were significant for Prescott Valley to justify the grant from the Deal Closing Fund. In addition, United Health Group's proposed operation would have been considered strategically important to Prescott Valley and Yavapai County.

All things being equal and with incentives being the last card to be played, Arizona and Prescott Valley would have won the business. Arizona's incentive package was about $300,000 more significant than the package offered by Harlingen.

The economic and fiscal impact of this economic development opportunity on Arizona and Prescott Valley includes 769 total jobs (including the 600 direct jobs), $18.6 million in annual wages, nearly $435 million in new economic activity over 10 years, and about $9.1 million in new tax revenues to the State over a period of ten years. During the same period, approximately $7.3 million in County and City tax revenues would have been generated.

Overall, the State of Arizona is projected to see a return on its investment within four to six years and would have likely generated more than $7.6 million in net new tax revenues (after incentives) over a 10-year period.

Potential Return on Investment to Arizona
Economic Development Prospect
Prescott Valley

Prospect Overview

Company	United Health Group
Credit Quality	Fortune 21
Operation	Customer Service/Claims Center
Job types	Customer Service
Year Announced	2009

Economic Impact (10-year Total)

Direct Jobs	600
Total Jobs	769
Direct Wages	$124,800,000
Total Wages	$186,660,000
Total Economic Activity	$435,450,000

Fiscal Impact to Arizona

	5 Year Total	10 Year Total
New Tax Revenue (Direct only)	$3,265,000	$6,530,000
<u>State Incentives</u>		
Tax Credits	$1,800,000	$0
Job Training Grant	$360,000	$0
Payroll Rebate	$1,026,072	$1,508,962
Cash Grant	$690,000	$0
Total State Incentives	**$3,876,072**	**$1,508,962**
Net New Tax Revenue (Direct only)	**($611,072)**	**$5,021,038**
plus New Tax Revenue (Multiplier effects)	$1,289,500	$2,579,000
Total Net New Tax Revenue	**$678,428**	**$7,600,038**

Return on AZ Investment	**4 to 6 years**
New City Tax Revenue	**$1,177,900**
New County Tax Revenue	**$6,271,000**

Source: Elliott D. Pollack & Company.

Economic Development Prospect
Prescott Valley
Enhanced Arizona Incentives

Prospect Overview

Company	United Health Group
Credit Quality	Fortune 21
Operation	Customer Service/Claims Center
Job types	Customer Service
Year Announced	2009

Operations Summary

Total Jobs	600	Project Type	Office
Average Salary	$20,800	Existing or New	Existing
Annual Payroll	$12m	Lease or Own	Lease
Total Capital Investment	$5m	Building size (sf)	55,000
		Land area (ac)	n/a

Incentive Overview

	[1] Harlingen, TX	[2] Prescott Valley	Advantage (Shortfall)
Tax Credits	No Corp Tax	$1,800,000	
Job Training Grant	$0	$360,000	
Payroll Rebate	$0	$2,052,144	
Sales Tax Exemptions	$0	$0	
Cash Grant	$4,025,000	$690,000	
Real Property Tax Abatement	$0	$0	
Personal Property Tax Abatement	$0	$0	
TIF Grant	$0	$0	
Utility Incentives	$0	$0	
Other Local Incentives	$663,700	$86,600	
Total Incentive Package	**$4,688,700**	**$4,988,744**	**$300,044**

1 Incentive package for United Healthcare is based on a 2009 incentive package negotiated by the CBRE Economic Incentives Group. Cash grant = 5 year payout; Other local incentives = Upfront.

2 Prescott Valley incentives include job tax credits of $3,000 per job under the Arizona Enterprise Zone program (3-year payout); Job training grant = 75% of $800 per job training expenses incurred by Company (3 year payout); Payroll rebate = 50% of withholding taxes for 10 years; Governor's Closing Fund = $500,000 discretionary cash grant to cover the funding gap and assist with rural economic development (2-year payout); Local cash grant of $316 per job (on average - 5yr payout); Other local incentives = waiver of development & impact fees (upfront payout).

Source: Elliott D. Pollack & Company. CBRE Economic Incentives Group.