# Zone Participation's Impact on the Bottom Line

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Enough success stories exist to justify exploring participation in a federal or state enterprise zone as of your company's overall location strategy.

USING A PHRASE from the late Rodney Danger-field, one might say the enterprise zone is an economic development tool that "don't get no respect." Throughout its relatively short existence, in its various forms, the zone idea has attracted scores of critics as well as legions of supporters.

Generally speaking, a federal or state zone program gives companies doing businesses in a designated geographic area special tax and non-tax incentives designed to stimulate local investment as well as employment. When private industry can flourish in these areas - many of them distressed urban and rural communities - the notion is this also can improve the lives of residents. That's the goal of every zone, no matter what name it goes by.

A history lesson is in order before moving forward: Back in the early 1980s, then President Ronald Reagan and HUD's Jack Kemp watched the fledgling success England experienced trying to revitalize abandoned industrial areas with enterprise zones. (Later they were discontinued as they didn't work as well as expected.) Wanting to duplicate that free-market experiment, political insider talk predicted Uncle Sam might implement a similar program.

"That never happened," recalls former HUD executive Jeff Finkle, who is now president/CEO of the International Economic Development Council (IEDC). Instead, state programs were instituted at the time. "Some were really good; some really not so good," he points out.

Later, after more than three I dozen state programs were up and running, the federal government created Empowerment Zones/ Enterprise Communities on President Clinton's watch. However, notes Finkle, these zones didn't address the real needs of business, but instead operated more as a "social safety net" focusing on the needs of zone residents.

It's been more than two decades since these zones popped up on the ED landscape. Some say the zones blend conservatives' fondness for business tax breaks with liberals' willingness to send more money toward impoverished cities. So how are the zones performing these days? Let's find out.

Enter the Federal Zone

Today, the federal government controls 180 Empowerment Zones (EZs), Renewal Communities (RCs), and Enterprise Communities (ECs) in just about every setting. In a nutshell:

* EZs give businesses a credit against federal taxes of up to $3,000 for each year of EZ designation for every existing employee and new hire who lives and works in the zone.

* RCs give businesses a credit against federal taxes of up to $1,500 for each year of RC designation for every existing employee and new hire who lives and works in the RC.

* ECs also give credit against federal taxes, but are more restrictive than EZs (Source: www.zonecredit.com).

Rural EZ/ECs are overseen by the U.S. Department oi AgricultureOffice of Community Development (USDA-OCD). Since Congress created the Rural Community Empowerment Program in 1993, 57 rural EZs and ECs, more than 100 Champion Communities, and five Rural Economic Area Partnerships (REAPs) have been established. According to government data, over the years they've created (or saved) almost 20,000 jobs, and have raised an aggregate of more than $10 for every dollar received.

The U.S. Department of Housing and Urban Development (HUD) administers RCs and urban EZ/ECs. All Round 1 Enterprise Communities expired last December 31, and the RCs and EZs are set to expire on December 31, 2009.

According to a representative of HUD's Office of Community Planning and Development, annual reports submitted to that agency show that since 1994, EZs have helped give financial assistance to over 3,100 businesses and technical assistance to more than 24,000 businesses. The EZs used federal funds to leverage more than $1.6 billion in loan funds, which, in turn, have been given to nearly 18,000 local businesses. Since 1994 urban EZs also have helped more than 55,000 EZ residents obtain new jobs and retain employment.

Moreover, between 1995 and 2001, state and local governments issued 36 different series of tax-exempt bonds (aggregate issue price of $315 million) to benefit businesses operating in EZs and ECs.

The Benefits of State Programs

Currently more than 35 states operate special tax-free zones under various uniquely branded names. Like the federal government's initiatives, they're not the perfect solution to fight economic misfortune. But in many areas, to some degree, they're making improvements. Most but not all such programs focus on small business development, with their greatest common achievement being job creation. The creation of research parks within a zone and shared-space incubators are among the possible tools in the mix for evolving state programs.

One early U.S. Department of Commerce study of 17 states with zones showed that more than one fourth of them "achieved a gross job gain growth higher than the national rate during comparable periods" in areas with "far worse unemployment, poverty, and economic and demographic stagnation than found elsewhere" in each state. More than 80 percent of investments were made by new/expanding firms, with zone residents holding most of the jobs gained. Local and state incentives used here typically included "tax incentives, revolving loan funds, and job credits."

A later study conducted by Robert Greenbaum and John Engberg, published in the Journal of Policy Analysis and Management (2004), echoed many of those findings. Their paper, "The Impact of State Enterprise Zones on Urban Manufacturing Establishments," analyzed urban zones in California, Florida, New Jersey, New York, Pennsylvania, and Virginia. It reviewed factors states use to choose zone locations, and the subsequent effect of those areas on business activity and employment. The bottom line: "Zones have a positive effect on the outcomes of new establishments, and a negative effect on the outcomes of previously existing establishments."

This study referenced a 1990 survey of 357 zones in 17 states (Erickson and Friedman), which found the manufacturing sector accounted for 72.6 percent of jobs created or saved by enterprise zones. Another 2002 survey (Peters and Fisher) confirmed this. Why does manufacturing thrive in these regions? They offer more stable, higher-wage jobs.

Take a look at Michigan and its Renaissance Zones (RZs). These regions aim to generate economic growth by abating state and local taxes for any business or resident inside them. Specifically they abate the single business tax, the personal income tax, and the six-mill state education tax. Operational since January 1997, these RZs will remain in effect for 15 years, or until 2012. During the last three years of the program, taxes will be gradually phased in starting at 25 percent in year 13, and adding another 25 percent in years 14 and 15. (Taxes will be 100 percent after the 15-year period.). The last round of zones created will last up until 2017. Presently there are 35 Renaissance Zones, and within them 152 geographic locations known as subzones.

Since the program's inception through March 1 of this year, RZs have generated $2.4 billion in investments, 406 projects, and 8,265 jobs according to the Michigan Economic Development Corp. (MEDC). For example, recently an old GM plant in an RZ attracted new tenants using close to one million square feet of space.

Locating in an RZ "can be a pretty sizable benefit for a business looking to relocate," stresses George Larimore of Grubb and Ellis/Paramount's office in Grand Rapids, Mich. (This city has completed 119 RZ projects over the years.) Although "a few places" exist where zones haven't worked as expected, he notes that, for the most part, these special state areas have done "phenomenally well," turning many blighted regions in western Michigan into "very good" economic development centers.

"We've seen everything from manufacturing concerns to housing developments to all kinds of mixed-use products" thrive in RZs, says Larimore. One project involved an old hot dog plant. "After it closed we got the property designated a RZ, tore down the structure, then created a major redevelopment project with three businesses." One of the three firms tripled the size of its facilities within the zone, he explains, paying for the expansion with the zone tax benefits received.

Michigan's program is a "purely free enterprise model operating in a virtually tax-free zone," adds MEDC's spokesman Jeff Kaczmarek. "As we all know, taxes are just one of the criteria a business uses in a relocation decision. The reality is that labor force, logistics, proximity to customers, etc. come into play. Some [zones] have been more successful than others; communities have to be careful as to how they designate an area." For example, boundaries shouldn't capture areas proven already to be good revenue producers. And leaders must stay on top of the program, marketing it with other ED tools.

Researcher Greenbaum agrees, saying programs not marketed well could be one reason why state incentives are underutilized - and why state programs haven't been particularly successful. Other reasons could include "confusing rules, or restrictions preventing certain firms from qualifying for benefits," he adds.

Why Some Firms Don't Pursue Zone Credits

Tom Flanagan believes if more business owners truly understood the myriad benefits of operating in a federal or state zone, there might be a sizeable increase of companies locating to them across the nation. As director of Zone Credit Consulting (ZCC) in Pasadena, Calif, he gives firms advice on how to maximize their tax zone credits.

After reviewing all key location criteria, why should any company consider locating in a zone? Simply put, it can help the bottom line. "Basically [zone residency] gives you money that goes straight into your shareholders' pockets," Flanagan explains. In a nutshell, it's all about reducing the amount of state and federal tax business owners pay. Those who want to minimize the tax they pay usually participate in these programs.

After consulting with Fortune 500 firms for years on this issue, Flanagan is now focusing on small- to mediumsized companies since "they're the ones who are the most mislead" about zones, he says. Even if they're aware of such programs, "a lot of [them] don't have the internal tax expertise to navigate through the application process," and their accountants typically have little or no experience in zone processing, says Flanagan.

Flanagan also believes that a few business owners fear that getting involved in a zone program will trigger an audit. "The reality is, for most firms this won't happen," he says. "The government understands that if a company has 50 employees and gets $50,000 in tax credits, that's not a very large amount of money in the scheme of things. The IRS and state agencies are very aware of these programs, and expect to see businesses filing for these credits."

Another typical mistake made by businesses is thinking zone programs don't apply to them. "They believe they're not eligible for anything, or that they have to be operating in a really bad area," he says. "Believe it or not, a few businesses feel this is somewhat of a scam," continues Flanagan. "Think about it. They hear they may be eligible to get back $30,000 in the form of refunds, or don't have to pay state taxes if located in a particular zone. Sometimes a red flag goes up as they wonder, 'Why hasn't my trusted accountant brought this to my attention?' But these are legitimate state and federal programs; so there really shouldn't be any hesitancy here."

Flanagan cautions businesses not to be too surprised if the state zone program in one city is administered differently a few hundred miles away. Political infighting, disorganization among community groups and leaders, general incompetence - even greed - have negatively impacted even the most noble plans. Some programs are utilized more than others because, frankly, they're marketed better. Yet, despite the disparity of "quality" in some state and federal programs, enough success stories exist to justify exploring if zone participation may be part of your company's overall location strategy.

**[Sidebar]**

"The bottom line: Zones have a positive effect on the outcomes of new establishments, and a negative effect on the outcomes of previously existing establishments."

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