Deal Closing Funds: Introduction and Discussion

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Deal Closing Funds: An Introduction

- What Are Deal Closing Funds?
  - Deal closing funds are not traditional investment funds but rather pools of capital set aside by nearly 40 states to help provide competitive incentives to create jobs from new or expanding businesses. They are a growing trend, and increasingly well financed
  - Are mostly grants for infrastructure investments and are often used in combination with other economic incentives to be even more attractive
  - Can be used for a wide variety of needs and projects, but in New Mexico, for land, buildings or infrastructure
  - Investments range from the tens of thousands into the tens of millions of dollars
- Proponents Claim Significant Benefits from Deal Closing Funds
  - Create more jobs which typically pay above average for the area
  - Attract new business across a wide range of industries including manufacturing and high tech sectors
  - Produce high returns on investment and development in the state through economic multiples
  - Provide much needed infrastructure for states to be able to compete for new business
- Critics Question Results or Process
  - Some say it is difficult to measure the direct impact
  - Some are critical of the political influence or possibility of favoritism in the process

Examples of States With Deal Closing Funds

- As many as 38 states have some form of Deal Closing Fund. Some of the most prominent:
  - Texas Enterprise Fund
    - May be the largest, but should not be the model: too bureaucratic
    - Has more than $250 million available
    - Delivered more than $500 million in incentives since the inception of the fund
  - California Competes may be the most recently created fund, dedicating
    - $30 million until June 2014
    - $150 million from June 2014 to May 2015
    - $200 million each year thereafter
  - Florida Quick Action Closing Fund
    - With $100 million budget, has delivered $150 million in cash since inception
  - Arizona Competes Fund
    - Recently initiated a $25 million fund
  - New Mexico appropriated $3 million to the Economic Development Department in the FY14 budget as part of the Local Economic Development Act

In New Mexico

•On November 8, 1994, the voters of New Mexico passed a constitutional amendment to Article IX, Section 14, enabling communities in the state to offer these discretionary incentives.

•Subsequently, the legislature passed the Local Economic Development Act (LEDA) which provided the mechanism by which municipalities and counties could pass an enabling ordinance, by the governing body, to deliver funds to qualifying entities for eligible projects.

•The legislature has amended LEDA since its inception to allow municipalities and counties the opportunity to pass a Local Option Gross Receipts Tax to provide funds that could be used for LEDA projects.

•Further amendments added eligibility for certain Arts & Cultural facilities, and retail projects in rural communities.

NM Legislative Finding and Purpose

- Legislative Finding:

  "…it is difficult for municipalities and counties in New Mexico to attract and retain businesses capable of enhancing the local and state economy without the resources necessary to compete with other states and locales; Municipalities and counties may need to be able to provide land, buildings and infrastructure as a tool for basic business growth and the introduction of basic business ventures into the state;…"

- Public Purpose:

  "…to implement the provisions of the 1994 constitutional amendment to Article 9, Section 14 of the constitution of New Mexico to allow public support of economic development to foster, promote and enhance local economic development efforts while continuing to protect against the unauthorized use of public money and other public resources…"

Examples of Deal Closing Fund Applications

- There are many success stories of the positive economic impact that accompanies an influx of new business due to incentives provided by Deal Closing Funds
  - Texas attracted Apple, via a $21 million dollar award from the Texas Enterprise Fund, to open a $304 million campus in Austin which is expected to create as many as 3,600 jobs for the city. Texas has also managed to attract companies such as Facebook and Caterpillar, as well as Toyota, which had also considered New Mexico
  - Louisiana used $14+ million to attract an IBM software development center that had considered New Mexico.
  - Florida's Quick Action Closing Fund created 552 jobs through a $4.4 million award to Depository Trust & Clearing Corp., a financial firm that was able to grow via the deal closing award.
  - Arizona attracted UnitedHealth Group to implement a 400 job project using their newly established fund.
  - New Mexico closing funds helped recruit Lowe's to Albuquerque, HP to Rio Rancho, and has used funds to help recruit PreCheck to Alamogordo, Glandia Cheese to Clovis, Fidelity, Hewlett Packard, Schott Solar & Tempur-Pedic among many other examples.

Management of Funds

- There is a range of governance structures for Deal Closing Funds, the most common being
  - At the sole discretion of the Governor (Virginia, Idaho, Tenn., many others)
  - At the sole discretion of the Legislature on a committee level (Maryland)
  - Hybrid between Executive and Legislative discretion (Texas)
  - Economic Development agencies in state government (Colorado, AZ, NC)

- Deal Closing Funds are typically financed via the state budgeting process and often draw from the General Fund.
  - NM's from General Fund and, historically, from Severance Tax Bond Funding

- Deal Closing Funds are not *investment* funds
  - Mixed funding vehicles are used
  - Goals are broader than pure financial returns, focusing on a "double bottom line" approach, looking at economic impact of the project as well as positive benefit to community.

How are public resources protected?

•Some awards are only granted based on post-performance.

•For prospective growth, the company provides some form of security to cover any mutually agreed-upon penalties or “clawbacks” for non-performance under the terms of the Project Participation Agreement (PPA).

•The language within the PPA specifies what the security requirements and clawbacks will be for the LEDA project.

•In Albuquerque, the “City’s contribution” to the project is defined as any state and city funds dedicated to the LEDA project. This ensures that any contribution made by either entity is protected under the PPA.

•The State enters into an Intergovernmental Agreement or a Memorandum of Understanding (MOU) with the municipality or county to transfer funds for an economic development project. The State is not a direct party in any of the agreements with the company.

Clawbacks and Penalties

- Currently, the City’s clawback penalty is calculated on a sliding scale and is tied to the number of jobs created and the length of time the company has been in operation.

- The goal of clawbacks is to discourage a company from overestimating or overpromising the amount of investment or number of jobs created, or from leaving the community prematurely, while allowing for potential consideration for unforeseen market conditions beyond the company’s control.

- New Mexico’s definition of qualifying expenses is still more restrictive than many other states. Land, building and infrastructure.

- It is important that a fiscal impact analysis is performed to identify any potential risks and rewards that exists for the community, allowing the local governing body to make informed decisions related to these LEDA projects.

Trends

- States and Countries more aggressively using Closing Funds to win job creation projects; also being used for job retention projects

- Awards increasingly structured for blend of start-up assistance and post-performance
  - Many employers need as much benefit as possible in year one to defer infrastructure, construction and other start up costs. Many states still provide upfront money and clawbacks for non-performance, as well as some flexibility for unforeseen events that can slow down hiring or investment

- $3,000 to $10,000 per job awards are common, with more for larger impact projects. Highest value projects such as semiconductors, automotive and aircraft manufacturing, can receive up to $20,000 to $50,000/job in certain states.

- On select major projects, awards sometimes include development of training centers and skill development for new employees. (Louisiana, Mexico, Alabama)

- Speed of approval is of great importance in a competitive process