Return on Investment for The Urban High-Crime Area Job Tax Credit Program

OFFICE OF ECONOMIC & DEMOGRAPHIC RESEARCH

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EXECUTIVE SUMMARY

Background and Purpose...

In May 2014, the Speaker of the Florida House of Representatives requested the Office of Economic and Demographic Research (EDR) and Office of Program Policy Analysis and Government Accountability (OPPAGA) to conduct an evaluation of the Urban High-Crime Area Job Tax Credit Program. The request specifically asked EDR to evaluate and determine the economic benefits as defined in s. 288.005, F.S. of the program, using the approach required under s. 288.0001, F.S.

For the purpose of this analysis, the calculation of economic benefits is the same as the state's return on investment and will include all direct, indirect and induced effects of the state's investment in the program. This measure does not address issues of overall effectiveness or societal benefit; instead, it focuses on tangible financial gains or losses to state revenues, and is ultimately conditioned by the state's tax policy.

The Return on Investment (ROI) is developed by summing state revenues generated by a program less state expenditures invested in the program, and dividing that calculation by the state's investment. It is most often used when a project is to be evaluated strictly on a monetary basis, and externalities and social costs and benefits—to the extent they exist—are excluded from the evaluation. The basic formula is:

$$\frac{\text{(Increase in State Revenue – State Investment)}}{\text{State Investment}}$$

Since EDR's Statewide Model[1] is used to develop these computations and to model the induced and indirect effects, EDR is able to simultaneously generate "State Revenue" and "State Investment" from the model so all feedback effects mirror reality. The result (a net number) is used in the final ROI calculation.

As used by EDR for this analysis, the return can be categorized as follows:

- **Greater Than One (>1.0)**…the program more than breaks even; the return to the state produces more revenues than the total cost of the incentives.
- **Equal To One (=1.0)**…the program breaks even; the return to the state in additional revenues equals the total cost of the incentives.
- **Less Than One, But Positive (+, <1)**…the program does not break even; however, the state generates enough revenues to recover a portion of its cost for the incentives.
- **Less Than Zero (-, <0)**…the program does not recover any portion of the incentive cost, and state revenues are less than they would have been in the absence of the program because taxable activity is shifted to non-taxable activity.

The numerical ROI can be interpreted as return in tax revenues for each dollar spent by the state. For example, an ROI of 2.5 would mean that $2.50 in tax revenues is received back from each dollar spent by the state.

[1] See Methodology section for more details.

Overall Results and Conclusions...

The Urban High-Crime Area Job Tax Credit Program's ROI was 0.07. That is for every dollar spent on the program, the state received back 7 cents in tax revenue. When comparing this to EDR's 2014 report entitled: "Return on Investment for Select State Economic Development Programs," the Urban High-Crime Tax Credit's ROI was lower than six out of the seven programs reviewed in that study.

The purpose of the program is to revitalize select areas within Florida, not the entire state. In practice, the tax credit is available to firms that can be classified as market or resource dependent. Market or resource dependent firms may have a localized benefit (within the designated urban zone), but no net positive economic expansion occurs for the entire state. In the study window, 40% of the firms were market or resource dependent. Their output was omitted from the study, and negatively impacted the program's ROI.

After review, EDR was not convinced that the tax credit was the determining factor for job creation due to its low value relative to the applicable wages. Therefore, EDR decided to allocate only a portion of the jobs, not all of the jobs, to the existence of the tax credit. This assumption also contributed to the low ROI.

INTRODUCTION

Pursuant to s. 212.097, F.S., certain new or expanding businesses located in certain high-crime areas are eligible to receive an urban high-crime area job tax credit for use against corporate or sales taxes. The amount of the tax credit depends upon the severity of the area's crime rate relative to the other area applicants and the number of qualifying employees. The program was created in 1997:

> "… to encourage the provision of meaningful employment opportunities that will improve the quality of life of those employed, and to encourage economic expansion of new and existing businesses in urban high-crime areas of this state."[2]

Initially, the tax credit was only available to businesses engaged in the following industries:

- Agriculture, Forestry, Fishing
- Manufacturing
- Hotel or Lodging
- Public Warehousing or Storage
- Research and Development
- Public Golf Course
- Amusement Park

However, the types of qualified businesses were expanded to include retail trade and call centers in 1999,[3] and motion picture production and allied services in 2001.[4]

Designated Urban High-Crime Areas
Tier # 1
Jacksonville, Ocala, Orlando, Palm Beach County, Tampa
Tier # 2
Miami-Dade County (Carol City, Miami & Goulds, Florida City, Homestead, Leisure)
Pompano Beach, Tallahassee, Fort Lauderdale
Tier # 3
Miami-Dade County (Hialeah, Miami & Opa Locka)
Lakeland, St. Petersburg

Since 1997, thirteen local governments have submitted applications and received approval for designated areas to qualify as eligible for tax credits from the program. Each application had to include a resolution that:

[2] Section 212.097(1), F.S.; s. 1, ch. 97-50, L.O.F. Subsection (1) was repealed by s. 15, ch. 2000-210, L.O.F.
[3] Section 86, ch. 99-251. L.O.F. expanded eligible businesses to include most retail establishments, with the exception of Eating and Drinking Places, SIC 59. Newly eligible businesses include retail related to: Building Materials/Garden Supplies; General Merchandise Stores; Food Stores; Automotive Dealers/Service Stations; Apparel and Accessory Stores; Furniture and Home Furnishings Stores; and Miscellaneous Retail.
[4] Section 2, ch. 2001-106, L.O.F.

- Finds that a high-crime area exists in such county or municipality, or in both the county and one or more municipalities, which chronically exhibits extreme and unacceptable levels of poverty, unemployment, physical deterioration, and economic disinvestment;
- Determines that the rehabilitation, conservation, or redevelopment, or a combination thereof, of such a high-crime area is necessary in the interest of the health, safety, and welfare of the residents of such county or municipality, or such county and one or more municipalities; and
- Determines that the revitalization of such a high-crime area can occur if the public sector or private sector can be induced to invest its own resources in productive enterprises that build or rebuild the economic viability of the area.

In addition, the application must include specified crime statistics for the geographic area to be used for evaluation and ranking purposes. The areas are then ranked into three tiers. Tier One areas have the highest crime rates and the largest tax credit per employee. Tier Three areas have the lowest crime rates and the smallest tax credit per employee. There is no wage or area-residency requirement for qualified employees.

The one-time credit awards range from $500 to $2,000 per qualified job and can be taken against either the Florida Corporate Income Tax or the Florida Sales and Use Tax, but not both. Awards for new businesses, by Tier, are as follows:

- In Tier One areas, $1,500 per employee, if they create at least 10 new or relocated jobs.
- In Tier Two areas, $1,000 per employee, if they create at least 20 new or relocated jobs.
- In Tier Three areas, $500 per employee, if they create at least 30 new or relocated jobs.

Awards for existing businesses, by Tier, are as follows:

- In Tier One areas, $1,500 per employee, if they create at least 5 additional jobs.
- In Tier Two areas, $1,000 per employee, if they create at least 10 additional jobs.
- In Tier Three areas, $500 per employee, if they create at least 15 additional jobs.

Both new and existing businesses are eligible for a per-job bonus award of $500 if the position is filled by a welfare transition program participant.

A total of $5 million of tax credits may be approved under the program each calendar year. From 1999 through October 2014, $54.9 million in tax credits were authorized, with $25.1 million redeemed.[5]

[5] Department of Economic Opportunity, November 14, 2014.

DATA

The analysis relied on multiple sources of data. Program data came from the Department of Economic Opportunity (DEO). The DEO data included the recipient's name, total tax credit awarded, total qualified jobs and the recipient's Standard Industrial Classification (SIC) Code. Department of Revenue provided historical Urban High-Crime Area Job credits taken against Sales and Use Tax and Corporate Income Tax. To estimate output, the analysis relied on Rims II multiplier data (RIMS II input-output multipliers show how local demand shocks affect total gross output, value added, earnings and employment in the region); North American Industry Classification System (NAICS) Code Average Florida Wage data; and 2014 Q3 Preliminary Visitor Estimates from VISIT FLORIDA.

STATEWIDE MODEL

EDR used the Statewide Model to estimate the Return on Investment for the Urban High-Crime Area Job Tax Credit Program. The Statewide Model is a dynamic computable general equilibrium (CGE) model that simulates Florida's economy and government finances. Among other things, it captures the indirect and induced economic activity resulting from the tax credit program. This is accomplished by using large amounts of data specific to the Florida economy and fiscal structure. Mathematical equations are used to account for the relationships (linkages and interactions) between the various economic agents, as well as likely responses by businesses and households to changes in the economy. The model also has the ability to estimate the impact of economic changes on state revenue collections and state expenditures in order to maintain a balanced budget by fiscal year.

When using the Statewide Model to evaluate economic programs such as the Urban High-Crime Area Job Tax Credit, the model is shocked using static analysis to develop the initial or direct effects attributable to the incentive. The main shock is through estimated output per job. Output per job is estimated through RIMS II multipliers and wage data. Since actual wages were not available, the analysis was dependent on Florida average wage data available at the NAICS-level.

The annual direct effects (shocks) took the form of:

- Removal of the incentive payments from the state budget.
- Production subsidy at the industry level.
- Increased outputs based on job and payroll estimates.

The model was then used to estimate the additional—indirect and induced—economic effects generated by the projects, as well as the supply-side responses to the new activity, where the supply-side responses are changes in investment and labor supply arising from the new activity. Indirect effects are the changes in employment, income, and output by local supplier industries that provide goods and services to support the direct economic activity. Induced effects are the changes in spending by households whose income is affected by the direct and indirect activity.

All of these effects can be measured by changes (relative to the baseline) in the following outcomes:

- State government revenues and expenditures
- Jobs
- Personal income
- Florida Gross Domestic Product
- Gross output

- Household consumption
- Investment
- Population

EDR's calculation of the Return on Investment used the model's estimate of net state revenues and expenditures. Other required measures for this report include the number of jobs created, the increase or decrease in personal income, and the impact on gross state product, all of which are included in the model results.

KEY ASSUMPTIONS

The following key assumptions are used in the Statewide Model to review the Urban High-Crime Area Job Tax Credit Program. Some of the assumptions are used to resolve ambiguities in the literature, while others conform to the protocols and procedures adopted for the Statewide Model.

1. The analysis assumes that not all jobs can be attributed to the tax credit. Instead, only a portion of jobs were attributed to the tax credit. The allocation was based on the conversion of awarded tax credits to average compensation for the business. The resulting count of employees whose compensation could be completely or substantially (over 50%) covered by the awards was the operative driver for the rest of the analysis. This method was done for each qualified project.

2. The analysis assumes that any market or resource dependent business did not expand the Florida economy, and that business was culled from the analysis. This amounted to culling about 40% of the projects in the study window.

3. The analysis assumes that the influence of any federal incentives awarded to state-funded projects is immaterial to the size and location of the project. This is also true for local incentives.

4. The analysis assumes all data provided by DEO, DOR, and other state entities related to projects and tax incentives was complete and accurate. The data was not independently audited or verified by EDR; however, data discrepancies between agencies were addressed.

5. The analysis assumes businesses received the full value of the state incentives and that related costs due to federal taxes or consultant fees are immaterial to the decision making process.

6. The analysis assumes that given the time span under review, applying discount rates would not prove material to the outcome.

7. The analysis assumes that any state expenditure made for incentives is a redirection from the general market basket of goods and services purchased by the state. Similarly, any revenue gains from increased business activities are fully spent by the state.

8. The analysis assumes the relevant geographic region is the whole state, not individual counties or regions. The Statewide Model does not recognize that any economic benefit arises from intrastate relocation. However, the model accounts and makes adjustments for the fact that industries within the state cannot supply all of the goods, services, capital, and labor needed to produce the state's output.

9. The analysis assumes that businesses treated the incentives as subsidies. The subsidies lowered the cost of production for each individual firm.

10. The analysis assumes distribution of capital purchases by each business was the same as the industry in which it operates. This assumption was made because data was not available regarding the specific capital purchases associated with each project. It is also assumed that the businesses within a program were not large enough to affect the rate of return on capital within the industries in which the businesses operated.

11. The analysis assumes that the output from non-culled projects did not displace the market for goods and services of existing Florida businesses. To do this, output associated with the businesses was assumed to be exported to the rest of the world. The "rest of the world" is defined as other states or the international market.

12. The analysis assumes that businesses are indifferent between tax credits and cash awards and will not change their behavior based on the type of incentive award given.

ANALYSIS AND FINDINGS

Market or Resource Dependent

If a business' customers or clients are primarily based in Florida or the business is dependent on Florida resources to produce its products or services, the business is considered "market or resource dependent." Any new activity induced by incentives displaces existing employment, economic activity in or revenues to the state, because the demand for such products or services is driven by the in-state market. There is no net economic expansion, as existing businesses would likely shed jobs as their market share decreases. In contrast, a business is not considered market or resource dependent if it is likely that it exports a majority of its goods and services out of the state.

The type of businesses that qualify for the tax credit can be found below. Many of these types of businesses are market or resource dependent. Examples include public golf courses and retail establishments. The retail sector includes furniture stores, supermarkets, car dealerships or clothing stores. In the study period, 40% of the recipients were determined to be clearly market or resource dependent. These businesses were culled from the analysis, excluding any benefit from the tax credit, but retaining the cost to the state.

Qualified Business Types	
SIC Code	**SIC Description**
01-09	Agriculture; Forestry; and Fishing
20 - 39	Manufacturing
52 - 57, 59	Retail: General Merchandise, Food, Auto, Apparel, Home Furnishing, etc.
70	Hotels and Other Lodging Places
422	Public Warehousing and Storage
7391	Research and Development
781	Motion Picture Production/Allied Services
7992	Public Golf Courses
7996	Amusement Parks
Call Center	Customer Service Center (serving a multistate or international market)

Certain business types presented a particular challenge. Because of their retail nature, they could have been culled from the analysis. However, retail businesses where significant portions of their product demand comes from out-of-state visitors were only partially culled (Amusement Parks, Hotels and Other Lodging Places). The analysis excluded the portion of output attributed to the businesses' demand from in-state visitors. Using VISIT FLORIDA's 2014 Q3 Preliminary Visitor Report, it is estimated that 25.6% of all visitors to these businesses are in-state. Therefore, 25.6% of the output was culled.

Results

Statewide Economic Model Impact of the Urban High-Crime Job Tax Credit Program

	2010-11	2011-12	2012-13	Total
State Payments in the Window $ (M)	0.9	1.6	1.4	**3.9**
Total Net State Revenues $ (M)	(0.0)	0.0	0.3	**0.3**
Return-on-Investment by Year	0.0	0.0	0.2	
Return-on-Investment for the 3 year period				**0.07**

		2010-11	2011-12	2012-13	Total		Average per Year
Personal Income	Nominal $ (M)	0.5	2.2	8.9	**11.6**		**3.9**
Real Disposable Personal Income	Fixed 2009 $ (M)	0.5	1.9	7.4	**9.8**		**3.3**
Real Gross Domestic Product	Fixed 2009 $ (M)	1.0	3.3	10.3	**14.6**		**4.9**
Consumption by Households and Government	Fixed 2009 $ (M)	(0.9)	(0.3)	6.2	**5.0**		**1.7**
Real Output	Fixed 2009 $ (M)	(0.0)	2.0	11.3	**13.2**		**4.4**
		2010-11	**2011-12**	**2012-13**	**Minimum**	**Maximum**	**Average per Year**
Total Employment	Jobs	8	10	51	***8***	**51**	**23**
Population	Persons	0	0	0	***0***	**0**	**0**

In the study window, 31 businesses received an Urban High-Crime tax credit. Of these businesses, 13 were culled and 7 businesses were partially-culled due to being market or resource dependent. For the remaining businesses, the awards were cumulated into salary equivalencies.

The activity associated with the remaining businesses created, on average, about $4.9 million of Real GDP and about $3.3 million of Real Disposable Personal Income every year in Florida. In addition, an annual average of 23 additional jobs was created due to the tax credit program. The analysis estimated that an additional $0.3 million of tax revenue was generated by the program. The projected Return on Investment (ROI) is 0.07. So for every dollar spent on the program, the state received 7 cents back in tax revenue.

The ROI would have been lower if the companies had redeemed all of the tax credits awarded. Only 80% of the tax credits awarded in the study window were redeemed in the same window. Even with this boost, the ROI is low. This was due to the analysis only attributing a proportion of the output to the tax credit and a high percentage of the firms being culled from the analysis.