

SUBJECT: Creating and administering defense readjustment zones

COMMITTEE: State, Federal and International Relations — favorable, with amendment

VOTE: 8 ayes — Hunter, Moreno, Chavez, Isett, Palmer, Pitts, Seaman, Wise
0 nays
1 absent — West

WITNESSES: For — James Berry, Bee Development Corporation; Robert Bomar, San Antonio Chamber of Commerce; Randy Erben, Panhandle 2000; Richard Hall, Red River Local Redevelopment Authority; Duane Lavery, Lubbock Reece Redevelopment Authority; Manuel Longoria, City of San Antonio
Against — None
On — Brenda Arnett, Scott Madole and Dan Wattles, Texas Department of Commerce

BACKGROUND : Chapter 2303 of the Government Code establishes the designation, benefits and administration of enterprise zones. These zones, defined areas with pervasive poverty, unemployment and economic distress, are authorized to receive special state and local tax and regulatory exemptions.
Selected businesses in the enterprise zones, known as enterprise projects, are eligible for sales tax refunds, franchise tax reductions, and other benefits. The Texas Department of Commerce (TDC) is responsible for handling the designation of enterprise zones and projects.

DIGEST: HB 713 would enact a new chapter 2310 in the Government Code governing the designation, benefits and administration of defense economic readjustment zones and defense readjustment projects. TDC would administer and monitor the implementation of readjustment zones and defense readjustment projects. Upon nomination by local governments, TDC would designate as defense readjustment zones areas affected by U.S. defense department facility closures or reductions or defense contract reductions.

Readjustment zones and qualified businesses and their employees or property within the zones could receive exemptions from state and local regulations and taxes and preferential treatment from state agencies.

Defense readjustment projects would be specially selected businesses that would receive certain tax refunds and franchise tax deductions under two new tax code provisions.

HB 713 would take effect immediately if finally approved by a two-thirds record vote of the membership in each house. TDC could not designate more than six defense economic readjustment zones before September 1, 2001.

Readjustment zone definitions

Defense-dependent community. An adversely affected defense-dependent community would be a municipality or county requiring assistance due to the proposed or actual establishment, realignment or closure of a defense facility, the cancellation or termination of a U.S. Department of Defense (DOD) contract or weapon system program, a publicly announced DOD reduction in spending plan that would directly affect the community, or the closure or reduction in defense facility operations caused by a merger or acquisition of a defense contractor operating the facility.

The municipality or county also would have to expect to lose at least 2,500 defense worker jobs in the metropolitan statistical area, 1,000 or more defense worker jobs in any area not located in a metropolitan statistical area, or one percent of the civilian jobs in the municipality or county.

Designation. A readjustment zone would have to be located in an adversely affected defense-dependent community with at least 50 percent of its area in a DOD facility and be nominated by an ordinance or order of the municipalities or counties in which the affected communities were located.

A readjustment zone also would have to have a continuous boundary and cover at least one square mile and not more than 10 square miles, excluding lakes, waterways or transportation arteries, or not more than 20 square miles

and contain five percent of the municipalities or counties nominating the area as a readjustment zone. After designation, boundaries could be amended following specified procedures.

An area could be designated as a readjustment zone for a maximum of seven years. No more than two readjustment zones could be designated in any one county.

TDC could remove the readjustment zone designation if the area no longer met the designation criteria or the governing body of the readjustment zone had not complied with commitments made in the ordinance or order nominating the area.

Nominations. Public hearings would be required before an order or ordinance to nominate an area as a readjustment zone could be adopted. Municipal territories could not be nominated by a county unless the municipality joined with the county in the nomination application. The order or ordinance would have to precisely describe the area under nomination and summarize the incentives for business enterprises in the area. At least one of the incentives could not be offered elsewhere except in an enterprise zone designated under Chapter 2303.

Application procedures. Written applications for readjustment zone designation submitted to TDC would have to contain specified informational items, such as a copy of the ordinance or order, statements of economic development and planning objectives and transcripts of all public hearings.

The department would have to negotiate a designation agreement with all nominating bodies within 90 days of receiving an application that satisfied designation criteria. The department could deny applications only if the area did not satisfy designation criteria.

Readjustment zone administration

The governing body of a readjustment zone would be the municipality or county or combination of municipalities or counties that applied to have the area designated. The governing body could delegate administrative duties to an administrative authority composed of an odd-numbered total of three to

15 members representing public and private entities with a stake in zone development, and private residents, if applicable.

Qualified businesses, projects

Qualified business. A qualified business would include persons who were engaged in or who had substantially committed to the active conduct of a trade or business in the readjustment zone. At least 25 percent of the new employees of a qualified business would have to be residents of the readjustment zone, economically disadvantaged individuals, or dislocated defense workers.

TDC would certify qualified businesses for the purpose of state benefits. The governing body of the readjustment zone would certify qualified businesses for the purpose of local benefits and could certify business franchises or subsidiaries.

Defense readjustment projects. At the request of the qualified business, the governing body of a readjustment zone could apply to TDC for a designation as a defense readjustment project. TDC designation of a qualified business as a defense readjustment project would be effective for five years; the department could not designate as defense readjustment projects more than two businesses in a single readjustment zone. Defense readjustment project designations could be removed for noncompliance with designation criteria.

Application provisions would require such information as economic analyses of the qualified business' plans for expansion, revitalization or other activity in the zone, and local effort to develop and revitalize a zone. The bill would set out a specific set of factors TDC would consider in evaluating local effort by public and private entities.

TDC would have to designate qualified businesses as defense readjustment projects on a competitive basis, using a weighted scale giving 50 percent of consideration to how the zone was affected by the loss of defense expenditures and employment, 25 percent to local effort to achieve development and revitalization, and 25 percent to department-determined criteria that would include level of applicant cooperation and support of

zone revitalization and the type and wage level of jobs to be created or retained.

Defense readjustment projects would be eligible for tax refunds based on the number of new or retained jobs by the qualified business and for deductions from taxable capital. TDC would have to allocate to the project the maximum number of new permanent or retained jobs eligible to be included in a computation of a tax refund. The number could not exceed 500 or equal to 110 percent of the number of jobs specified in the readjustment project designation application.

Readjustment zone and project benefits

Regulatory benefits. State agencies could exempt a qualified business, employee or property from certain of their regulations if the exemption was consistent with the protection and promotion of general health and welfare and the defense readjustment zone purposes. A local government could suspend local regulation in a readjustment zone. Exemptions from regulation would have to be adopted in the same manner the regulations were initially adopted.

Exemptions could not apply to civil rights, equal employment, equal opportunity, fair housing rights, preservation of historical sites, or public or environmental health or to regulations imposed by law. Exemptions also could not be granted if they were likely to harm the public safety.

State agencies also could provide by rule encouragements and incentives to readjustment zones to increase housing renovation or new construction and business viability and profitability. State agencies would be encouraged to contract with businesses located in readjustment zones. TDC could give preference to readjustment zones in granting economic development money or other benefits.

State agencies would have to give preference to the governing body of a readjustment zone or qualified business or employee over other eligible applicants for grants, loans or credit enhancements if the grant, loan or credit enhancement was to promote community economic development or improve, maintain or construct public facilities and at least 50 percent of it

would be spent for the direct benefit of the readjustment zone.

The comptroller would be encouraged to deposit state money in financial institutions located or doing business in readjustment zones.

Tax benefits. HB 713 would create a new provision in the Tax Code to provide tax refunds to defense readjustment projects on purchases of equipment or machinery, building materials and construction labor for use in a readjustment zone and for electricity and natural gas purchased and consumed in a readjustment zone. A defense readjustment project would have to apply to the comptroller for the refund and would qualify for a tax refund of \$2,500 for each new permanent job or retained job by the project; the total refund could not exceed \$250,000 in a state fiscal year. A project could apply for refunds in excess of the limitation in the subsequent year under certain restrictions.

HB 713 would create another new provision in the Tax Code to allow defense readjustment projects to deduct either 50 percent of their capital investment in the zone from apportioned taxable capital or five percent of capital investment in the zone from apportioned taxable earned surplus. The deductions would be limited to the depreciated value of the capital equipment or other investment used in the normal course of business in the readjustment zone. The deduction could not be used to reduce apportioned taxable capital or taxable earned surplus below a zero value.

Municipalities could refund local sales and use taxes paid by qualified businesses for the purchase, lease or rental of equipment or machinery, construction material and labor for use in a readjustment zone, or for electricity and natural gas purchased and consumed in the normal course of business in the readjustment zone. Governing bodies of readjustment zones could provide for the partial or total refund of local sales and use taxes paid by a person making a taxable purchase, lease, or rental for development of revitalization in the zone. Tax refund procedures would be subject to certain restrictions.

Readjustment zones also would be eligible for tax increment financing under Chapter 311 of the Tax Code, and tax abatements under Chapter 312 of the Tax Code. Bonds could be issued to finance readjustment zone projects

under the 1971 Act for Development of Employment, Industrial and Health Resources or the Development Corporation Act of 1979).

Other local incentives. A governing body of a municipality or county could reduce or eliminate fees or taxes, other than sales or use taxes or property taxes, on qualified businesses and their employees to promote public health, safety or welfare.

The governing body of a readjustment zone could defer compliance in the zone with subdivision and development ordinances, subject to certain limitations; give the zone priority for the receipt of community development block grants, industrial revenue bonds or job training funds; adopt a plan for police protection; reduce utility rates to qualified businesses, subject to certain restrictions; and grant several other waivers or preferences to the zone.

Readjustment zone property

Once an area was designated a readjustment zone, the state or a municipality or county that owned surplus buildings or vacant land in the zone could dispose of the property by selling it at a public auction or establishing an urban homestead program. Under such a program, the property could be sold for an amount not to exceed \$100 on the condition that the purchaser live in the residence for at least seven years and renovate or remodel it to meet agreed-to maintenance levels. When the seven-year agreement was satisfied, the governmental entity would have to assign the residence to the individual.

A subcontractor would not be required to hold a performance bond for construction or alteration projects whose contracted amounts did not exceed \$200,000 and that were performed entirely within a readjustment zone.

Liability for structural defects would be limited to 10 years after the occupancy of the building began for contractors or architects constructing or rehabilitating buildings in readjustment zones.

Commerce Department duties

TDC would have to assist both qualified businesses in obtaining the benefits of any state incentive or inducement program and governing bodies of readjustment zones in obtaining assistance from another state agency and encouraging small business development.

The department would have to provide information and appropriate assistance to people who wished to locate and engage in business in a readjustment zone, and publicize existing tax incentives. It also would have to offer technical tax abatement and alternative revenue source development assistance to units of local governments that had readjustment zones within their jurisdictions.

TDC would coordinate readjustment zone programs with other programs in state and federal agencies, such as housing, community and economic development, small business and banking, and to encourage other state agencies awarding grants, loans or services to give priority to businesses in readjustment zones.

The department would have to submit an annual report evaluating the effectiveness of the zones and describing the use of state and local incentives and suggested legislation to the governor, Legislature, and Legislative Budget Board on or before December 1.

**SUPPORTERS
SAY:**

HB 713 could help thousands of Texas workers and their families and many communities dependent upon defense contracts and facilities. The bill is directly patterned on the law establishing enterprise zones, which have proven to be effective in spurring job growth and other community benefits.

Texas is unusually dependent upon military bases and defense-related contracts because it has the largest number of base locations among all U.S. states. Comptroller and Department of Defense data show Texas has 17 operational military bases that employ about 123,350 military employees and 57,880 civilian employees and generate an estimated \$10.5 to \$17 billion in direct and indirect expenditures. Closures or reductions in the operation of these facilities leave many individuals without work, including service-oriented business not directly tied to the military, and can completely devastate once thriving communities.

The concept of enterprise zones enjoying special tax incentives has proven to be a relatively successful approach to economic development used for many years in Texas and other states to attract business to specially designated areas. A cost benefit analysis performed by the Commerce Department found that Texas enterprise zones were responsible for a total of 57,085 jobs from fiscal 1998 to fiscal 1999, with associated direct income about \$7 billion, including income associated with designated projects. Even calculating a “worst case” scenario attributing only three percent of an area’s growth to the program, the analysis found that for the Texas enterprise zone program, net income benefits exceed net costs.

The potential state loss of \$3.4 million from tax refunds and reductions is a small price to pay for giving communities the chance to rebuild after a devastating economic loss and helping responsible, hard-working individuals provide for themselves and their families.

Counties and cities would be permitted, not mandated, to grant special exemptions from local taxes, fees or other regulatory processes, and would most likely be extremely careful in offering such privileges to guard against excessive revenue losses or loss of public safety. Local control is important to Texas citizens, and local leaders have sufficient foresight and knowledge of community attributes to make wise economic development choices. Any exemption from local rules would have to be made in the same manner in which local regulations were made, giving fair opportunity for public scrutiny and comment.

Any reductions in state and local revenues would be relatively short-term because the number and duration of defense readjustment zones and projects would be limited. HB 713 would authorize the designation of only six zones and a maximum of 12 projects within the next four years. Zone designations would last only seven years and project designations only five, so the concomitant tax incentives and regulatory exemptions and preferences would be short-lived as well.

**OPPONENTS
SAY:**

Defense readjustment zones would most likely prove to be as questionably helpful as enterprise zones in revitalizing a community’s economy, cost the state about \$3.4 million in this biennium and up to \$4 million by the end of the next biennium, cost designated communities potential sales tax and fee

revenues and the loss of other public safeguards, and establish new inequities and competition between businesses and communities within the state.

Tax incentives granted for enterprise zones have not proven to be the conclusive factor in recruiting businesses or revitalizing the economy, and there is no reason to believe that they will be any more effective for defense readjustment zones. Businesses usually consider infrastructure aspects, such as location to markets, roads, airports and trained labor, before taxes when relocating, and those for whom the tax incentive is the main reason for relocating may move again once the incentive is terminated. Tax incentives also do not ensure that the relocated businesses will hire locally unemployed individuals.

Local governing bodies may not be equipped to make appropriate long-term decisions and might “give away the farm” in order to attract businesses. State and local taxes, fees and other regulations often have interdependent effects on one another, making outcome projections difficult when tinkering with one or several options of preferences and exemptions. It may be especially tempting to communities that are desperate for redevelopment to offer a broad package of tax and regulatory incentives that they later will regret.

The state should not be enacting policy that would give one Texas area or business special economic benefits over another area, or pit one community or business against another. The state should focus on solutions that would benefit the overall economy and benefits that can be accessed by a wide range of businesses or communities.

OTHER
OPPONENTS
SAY:

The structure and use of readjustment zones and projects could be improved.

State agencies should be specifically required, not simply encouraged, to offer preferences in certain areas and to coordinate with the department of commerce.

The definition of “defense worker” should be expanded to include references to employees of the U.S. Department of Energy as well as the U.S. Department of Defense. This provision is included in the engrossed

version of the companion bill, SB 226 by Madla, and would provide a recourse for any economic downturn caused by the closure or reduction of activities at the Pantex Nuclear Weapon plant outside of Amarillo.

Subcontractors should be required to hold performance bonds, or the cost of the contract subject to waiver should be smaller. HB 713 would waive performance bonds for subcontractors working on construction or other public work projects in a readjustment zone when the amount of the contract is less than \$200,000. However, \$200,000 is a lot of money to most small counties and communities and they may not be able to assume the cost of completing or improving incomplete or substandard projects initiated by a slipshod subcontractor.

NOTES:

The committee amendment would require an individual wishing to purchase surplus property under an urban homestead program agree to the conditions “in deed or contract for deed executed at the time of sale.”

The companion bill, SB 226 by Madla, passed the Senate on April 16 and was reported favorably, without amendment, by the House State, Federal and International Relations Committee on April 22. SB 266, as passed by the Senate, has been projected by the LBB to result in a net loss of revenue to the state for this biennium of \$4.1 million, an increase of \$700,000 over HB 713 due to an additional provision that would further reduce franchise tax collections.

HB 714 by D. Jones and its companion SB 227 by Madla, would establish a matching grant program for adversely affected defense-dependent communities and regional planning commissions. SB 227 passed the Senate on April 16, and both bills have been referred to the House State, Federal and International Relations Committee.