

CREDITS AND INCENTIVES

California Competes Tax Credit “And the Winner is”¹

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Dan Conger, President of the United Food and Commercial Workers Local 324 and Appointee to the California Competes Tax Credit (“CCTC”) Committee², exclaimed “*the number (\$25,000 average salary) is insufficient for full-time employees and not comparable to other grocery retail competitors, such as Safeway, Vons and Albertsons*”.

Waiting in the audience, Sara Flocks, representing the California Labor Federation (CLF), proclaimed “*CLF is opposed to this company receiving a credit as it believes that Al California’s proposed wages and benefits are significantly below average. And...there is a number of class action lawsuits filed against Al California alleging wage and labor violations.*”

With that, ultra-low-cost grocery store chain Aldi’s³ bid to earn a \$700,000 Credit in exchange for a new Moreno

Valley regional headquarters, dozens of new California stores and 182 new jobs paying \$25,000, was effectively rejected.⁴

After four rounds of CCTC awards, some policy priorities are emerging. We’ve reviewed the types of projects approved to help evaluate your potential qualification for the CCTC.

Go-Biz Evaluation Process

CCTC applications are initially submitted to Go-Biz during open application periods.⁵ Then in Phase I, applications are computer-ranked based on the lowest cost to benefit ratio (“Ratio”). Applications requesting too much credit relative to the competition are rejected without discussion. Thus, determining the appropriate level of CCTC to request is critical. Only the most competitive projects, by Go-Biz definition meaning those who ask for the lowest Ratio, move on to Phase II for a more detailed evaluation.⁶ Based on the first four rounds, the cut-off Ratio has been⁷:

FISCAL YEAR	BUSINESSES OTHER THAN SMALL	SMALL BUSINESSES
2013-14	1.84%	9.25%
2014-15 1 ST period	1.383%	34.42%
2014-15 2 ND period	1.433%	83.68%
2014-15 3 RD period	1.34%	13.89%

¹ This article is a follow-up to “*California Competes Credit, Gold Rush Redux?*” IPT Tax Report, April, 2014. See first article for background on the process and criteria for the California Competes Tax Credit.

² Mr. Conger has been replaced on the California Competes Tax Credit Committee by Madeline Janis. The California Competes Tax Committee is a 5 person committee made up of State Treasurer; Director of Finance; and the Director of the Governor’s Office of Business and Economic Development (who shall serve as chair of the committee), or their designated representatives, and one appointee each by the Speaker of the Assembly and the Senate Committee on Rules. Cal. Rev. & Taxation Code 18410.2. (a).

³ Al California, LLC is the legal entity for the Aldi grocery stores. According to Forbes, Aldi is redefining the rules of shopper engagement by eliminating services and selling primarily, if not entirely, its own privately branded knockoffs of established American foods. *ALDI Is a Growing Menace to America’s Grocery Retailers*, Forbes electronic, and April 14, 2015.

⁴ The Al California application was tabled for a second meeting which later cancelled and the application withdrawn. *Minutes of the California Competes Tax Credit Program Committee Meeting*, June 19th, 2014. <http://www.business.ca.gov/Programs/CaliforniaCompetesTaxCredit.aspx>

⁵ In Fiscal year 2014-2015, the application periods were September 29, 2014, through October 27, 2014 (\$45 million available); January 5, 2015, through February 2, 2015 (\$75 million available); March 09, 2015, through April 6, 2015 (\$31.1 million available plus any unallocated amounts from the previous application periods). The amount of credit available will increase from \$151M to \$200M and it is expected that similar timelines will be announced for Fiscal Year 2015-2016.

⁶ The CCTC requested amount is the numerator over the “Total Package Proposal” which is based on the “aggregate compensation package” plus the “aggregate investment package”.

⁷ Frequently Asked Questions #6

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Most awards have been 1.2%- 3% of the total five year new wages and new investment. This illustrates the need for a project to involve material job and investment growth over five years to make any sense for CCTC. Even a \$30M total package proposal would only garner a \$360,000 credit using 1.2% CCTC request. For California, the competitiveness of the program results in relatively low incentive cost for job and investment creation when compared to other state incentive programs.

Applicants considering locating new jobs (or relocating existing jobs) outside of California, advance automatically to Phase II⁸. In total, Go-Biz will include proposed projects requesting 200% of the total CCTC funding for that period.⁹ With double the applicants relative to credits available, making it to Phase II is way too early to celebrate your CCTC award.

While the initial evaluation is strictly based on the state's return-on-investment, during the second phase the state will review the economics of the proposed project along with a host of policy concerns. Some factors relate to the company itself (union support, wage levels, recent controversial news, benefit policies, diversity, etc.) and others are more indicative of the economic environment, such as poverty and unemployment levels at the business location, strategic importance of the industry to the state, region, or locality and opportunity for future growth and expansion.¹⁰

You should know before spending time and money on the CCTC application, that it has been a low probability of success proposition for most applicants. There have been significantly more requests for CCTC than the funding available.

The high level of credits requested in comparison to the amount granted reflects the significantly greater potential of economic activity than funding available. It may also reflect some lack of clarity about what the CCTC program is targeting for participation. The CCTC has one foot in the now defunct Enterprise Zone credit application world that applies to everyone planning new jobs and investment and another foot in the world of competitive site selection to attract new jobs and investment.

The stated purpose of the CCTC is to attract and retain jobs in California, thus competitive site selection applicants that would choose another state for the proposed project, or relocate and/or terminate all or a portion of its employees in California absent the CCTC, advance to Phase II regardless of the Ratio.¹¹ However, the percentage of projects in the at-risk category during the first CCTC round was only 13.8% of the awardees (4 out of 29).¹²

Thus, most of the CCTC winners involved in round one represented organic growth without a competitive out-of-state location. As noted, Phase I CCTC applications that move forward to Phase II do not have to involve a site selection decision, but rather may simply involve requesting the lowest CCTC Ratio.

Applicants who have been most successful during the second phase have developed projects that align with legislative and/or policy priorities. For example, the statute indicates that Go-Biz will give priority to a taxpayer that has a project or business that is located or proposed to be located in an area of high unemployment or poverty. This is the only CCTC criteria that the statute specifically identifies should be given priority.¹³

	# Approved Companies	# of Companies Requesting CCTC	Percentage of Applicants Approved	Amount Available	Amount of CCTC Requested	Percentage of Award Credits Requested
#1, 6/19/14	29	396	7.323%	\$30M	\$559M	5.367%
#2, 1/15/15	56	286	19.580%	\$45M	\$329M	13.678%
#3, 4/16/15	93	253	36.759%	\$75M	\$289M	25.952%
#4, 6/18/15	63	267	23.596%	\$31.1M + unallocated	\$320M	9.720%

⁸ Regulations Section 8030(g)(1)

⁹ Regulations Section 8030(g)(1) and California Competes Tax Application Workshop, PowerPoint, page 11. <http://www.business.ca.gov/Portals/0/CA%20Competes/Docs/CCTC%20February%202015%20Outreach%20Presentation%20-%20FOR%20WEB%20AND%20GENERAL%20USE%20-.pdf>

¹⁰ California Competes Tax Credit, *Notice of Proposed Rulemaking*, September 12, 2014 page 28

¹¹ California Competes Tax Credit, *Notice of Proposed Rulemaking*, September 12, 2014 page 2

¹² Supra FN 1

¹³ Rev. and Taxation Code Section 23689(c)(1)

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Thus, an organic growth application might be approved if the job creation is planned in an economically challenged location in the state. In the first CCTC round, 25% of the applicants were located in an area where the level of poverty and unemployment were greater than the statewide average.¹⁴ According to the statute and regulations, in Phase II, all projects are evaluated based on:

- Extent of unemployment or poverty in area;
- Whether incentives are available to the applicant in other states and the incentives available to the applicant in this state, including the utilization of such incentives in this state;
- Economic impact in the state;
- Strategic importance of the applicant's project or business in the state, region or locality;
- Number of existing employees expected to be retained in California related to the project;
- Opportunity for future growth and expansion in the state;
- The salary, benefits and fringe benefits provided by the applicant to its employees; and
- Any other information requested in the application; including, the consultant's fee.¹⁵

Go-Biz screens all the Phase II applications and determines which applications best fit with these evaluation criteria. If approved by Go-Biz, the applicant negotiates a CCTC contract that documents the amount of the award, timing of the credit and company commitments.¹⁶ Once the CCTC contract is negotiated and approved by Go-Biz, the agreement must also be approved by the California Competes Tax Credit Committee ("Committee").

California Competes Committee

Applications that advance to the overseeing body, the Committee, are presented in a public forum for final approval. The Governor's Go-Biz Office has been quite effective at screening applications given the overwhelming volume of submissions, as evidenced by the high rate of approval once applications reach the Committee. That said, there have been instances where concerns surface about specific applications in this public forum. It is important to consider the policy priorities of current Board

¹⁴ California Competes Tax Credit, *Notice of Proposed Rulemaking*, September 12th, 2014 page 5

¹⁵ Regulations 8030(g)(2)

¹⁶ Supra, FN 1

members and how an application may be viewed in that context. For example, the Aldi project had the potential to displace union jobs with lower wage non-union jobs.¹⁷ To understand the perspective of the Committee members, it is helpful to know who is on the five-person Committee.¹⁸ The current members of the Committee include:

1. Michael Rossi, Senior Advisor to the Governor of California--Director of the Governor's Office of Business and Economic Development (who shall serve as Chair of the Committee) or Designated Representative.

Mr. Rossi comes from a business background having served as an advisor and senior member of the operations team at Cerberus Capital Management, L.P. and as Chairman and Chief Executive Officer of Aozora Bank, taking it public in November 2006.¹⁹

2. John Chiang-State Treasurer

Mr. Chiang is a Democrat and was elected State Treasurer January 5, 2015. He previously served as California State Controller from 2007 to 2015 and on the California Board of Equalization from 1997 to 2007.²⁰ Mr. Chiang has not attended CCTC meetings, instead selecting Alan Gordon, who is the Deputy Treasurer for Legislative Affairs and Infrastructure Financing to go in his place.²¹

3. Michael Cohen- Director of Finance

Mr. Cohen's background is in Government Finance. He was appointed as Director of the California Department of Finance by Governor Jerry Brown in September 2013. He serves as

¹⁷ Supra FN 4

¹⁸ Cal. Rev. & Taxation Code 18410.2. (a).

¹⁹ Governor Brown announces Appointment 8/7/2011 <http://gov.ca.gov/news.php?id=17173>

²⁰ See California Treasurers web-site <http://www.treasurer.ca.gov/>

²¹ "Alan Gordon, 59, will serve as Deputy Treasurer for Legislation and Infrastructure Financing. He previously served as Deputy State Controller for Environmental Policy. Gordon has spent a significant portion of his career in the State Capitol in the roles of Principal Consultant to the Senate Committee on Delta Conveyance and Conservation, counsel to the Senate Environmental Quality and Insurance committees, and a senior staffer to two senators. He also served as Deputy Director of the Department of Toxic Substances. Gordon has a B.A. in history, an M.A. in political science (Emory University), and graduated from Golden Gate University's Law School." <http://www.treasurer.ca.gov/news/releases/2015/20150108.asp>

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the Governor's Chief Fiscal Policy Advisor.²² Mr. Cohen has not attended CCTC meetings, instead selecting Eraina Ortega to attend on his behalf. Ms. Ortega is the Chief Deputy Director, Policy at the Department of Finance.²³

4. Denise Zapata- Speaker of the Assembly Appointee

Ms. Zapata is the Zapata Private Wealth Group CEO/Founder and Member of NetWorth Financial Group.²⁴ She has also served as a Board Member of the Riverside Latino Network.²⁵

5. Madeline Janis- Senate Committee on Rules Appointee.

Ms. Janis has a background advocating for unions and led the campaign to pass L.A.'s ground breaking living wage ordinance. She was a Board member for Goods Jobs First, which supports organized labor and actively scrutinizes state incentives.²⁶

²² "From 1997 to 2010, Mr. Cohen worked at the Legislative Analyst's Office (LAO). While there, he served as a local government finance analyst, Director of State Administration, and Deputy Legislative Analyst." California Department of Finance Website. http://www.dof.ca.gov/about_finance/staff/michael_cohen/

²³ "Ms. Ortega represents the Department of Finance on more than 100 boards and commissions. From 2008 to 2013, Ms. Ortega worked at the California State Association of Counties (CSAC) as a senior legislative representative in the area of labor and employee relations. Prior to joining CSAC, she served for six years as a legislative advocate for the Judicial Council of California in a number of areas, including the state budget, court facilities and employee relations. Previously, she was a fiscal and policy analyst for the Legislative Analyst's Office (LAO). Ms. Ortega earned a Master's Degree in Public Policy from the John F. Kennedy School of Government at Harvard University and a Bachelor's Degree in Political Science from the University of California, Irvine." http://www.dof.ca.gov/about_finance/staff/eraina_ortega/

²⁴ Zapata Private Wealth Group <http://www.zapatawealth.com/>

²⁵ <http://www.riversidelatinonetwork.org/CONTACTUS.html>

²⁶ "For the past 15 years, LAANE has been in the forefront of the nation's most dynamic progressive movement. LAANE spearheaded the defeat of Wal-Mart's ballot initiative in Inglewood, led Los Angeles' groundbreaking living wage campaign and pioneered a new approach to economic development that has become a national model for community empowerment." See <http://www.laane.org/person/madeline-janis/> and <http://www.laane.org/> and <http://www.goodjobsfirst.org/>

Based on comments during the first four public hearings, some Committee members' priorities have emerged a few of which include: union support and/or lack of support can be vitally important; projects in less economically vibrant parts of the state are desired; inclusion of minimum wage jobs will not be well received; and use of sub-contractors and/or exporting jobs overseas will not be well received.²⁷

Analysis of Approved California Competes Applicants

As noted above, credit demand far outstrips funding availability. This suggest that there are too many applicants asking for too much credit and/or too many applicants that do not meet the qualitative and/or quantitative criteria Go-Biz and the Committee view as priorities for the state. For example, it would not make sense to file an application for low wage jobs that potentially displace union jobs.

Based on the first four CCTC rounds, we've summarized the winners by industry and by geography to help evaluate whether your business fits the industry and location focus favored by Go-Biz.

Industries Approved

And the winner is..... Manufacturing!²⁸

Over half the CCTC awards were to companies engaged in some form of manufacturing along with expansion of supporting facilities (e.g., distribution, headquarters, etc.). As an example, the largest \$15M award went to Tesla which agreed to expand manufacturing, R&D and other operations throughout California. Similarly, Northrop won \$10M for manufacturing and other supporting expansion at several locations across California.

Not surprisingly the other clear winners were companies with large growth potential in the information services/

²⁷ June 19, 2014; January 15, 2015; April 15, 2015 California Competes Tax Credit Program Committee Meetings.

²⁸ Go-Biz does not publish applicants' NAICS to identify the specific business activity of the winning applicants. We utilized the Go-Biz CCTC recipient list and business description to categorize each applicant into industry categories. These descriptions are based on the primary activity of the applicant versus what the applicant may have proposed to do in California. There is some subjectivity to the process. For example, Macy's.com and QVC are classified as information services internet because the primary legal entity is engaged in ecommerce and the California project involves ecommerce based growth commitments. Arguably, the Macy's.com CCTC could be classified as retailer versus information services/internet. See California Competes Tax Credit Awardee List. <http://www.business.ca.gov/Programs/CaliforniaCompetesTaxCredit.aspx>

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internet sector. For example, Riot Games won a \$3M award based on spectacular growth commitments of over 800 jobs earning nearly an average of \$100,000 per year from Los Angeles. Or Rockbot, garnering \$3.5M for over 200 jobs earning \$80,000 providing on-line music subscriptions from Oakland offices. The higher award for Rockbot could reflect the commitment to Oakland which would grow employment in a more economically distressed area than L.A.²⁹

The losing applicants are not published, but it's evident from the results that retailers, restaurants, healthcare services and real estate have not fared as well. Retailers will need more than a good growth story to enjoy CCTC. Petco agreed to an \$84M national support facility and around 250 new jobs earning \$82,000 for a \$2.6M CCTC.³⁰ Skechers agreed to invest \$110M in support facilities and create 200 jobs earning an average of \$55,000 for a \$1.250M CCTC.³¹ Healthcare providers have not significantly participated either. East Bay Ophthalmology's \$400,000 credit for 28 new jobs earning \$33,000 along with \$4.5M new investment has been the largest healthcare provider to date.

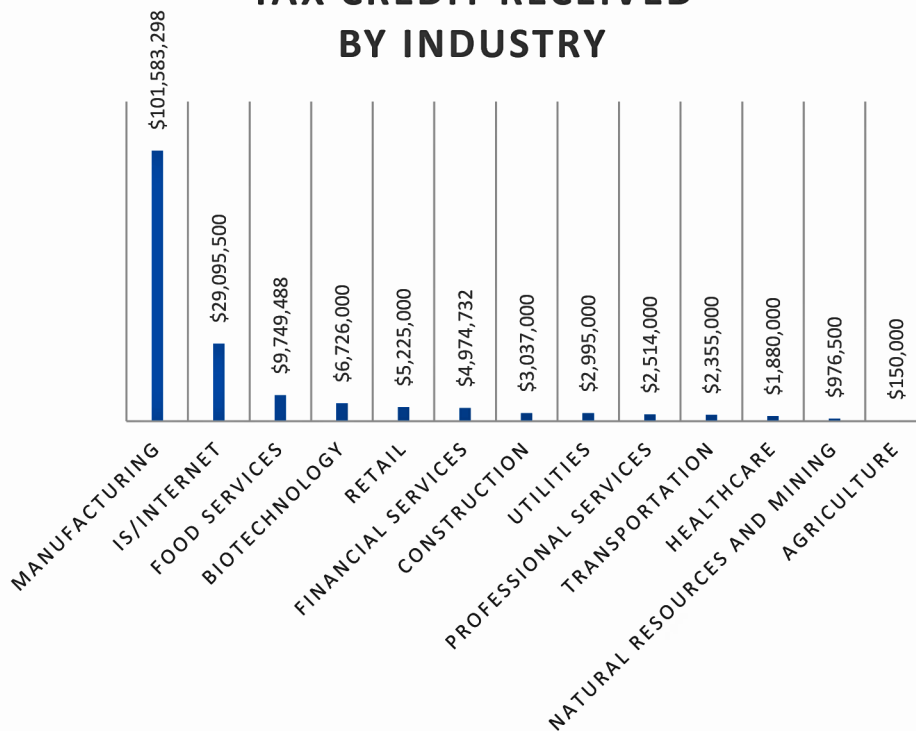
Locations Approved

And the winner is...Los Angeles!³²

As noted, the only evaluation criteria specifically mentioned in the statute is the level of unemployment and poverty in the area. This location based criteria, however, must be balanced against the state's interest in competing for projects that align with the state's other evaluation criteria: high wages, project economic impact and potential high growth industry. Not surprisingly, some of the most exciting and economically beneficial projects

³² Id Reviewing the first four rounds, we've summarized the number of approved applications and the dollar value of the approved applications by County. In some cases, the applicant's project involved multiple locations; for this summary a single city was selected based on the applicant's headquarters. If the applicant's headquarters was out of state, we identified the primary California location of the applicant for the summary.

TAX CREDIT RECEIVED BY INDUSTRY



²⁹ Id
³⁰ Id
³¹ Id

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are coming from more economically vibrant parts of the state such as Santa Clara (i.e., Silicon Valley) and Los Angeles.³³ This past history of awards may not reflect the future as the CCTC Committee has expressed a desire to award CCTC to less economically developed areas of the state.³⁴

Special thanks to Ashley Counts, Think, LLP who mined all prior CCTC winning applications to create a database by industry, location and other data used by the firm and in this analysis.

³³ Id Nearly half the \$35M Santa Clara CCTC award went to Tesla with operations at many locations in the state.

³⁴ June 19, 2014; January 15, 2015; April 15, 2015 California Competes Tax Credit Program Committee Meetings.

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