

Best Practices: Accelerating Your Recovery with Negotiated Incentives

BY MICHAEL PRESS

Although state and local government budgets are under tremendous pressure related to the recent recession, they continue to offer lucrative economic development incentive packages to bolster their floundering economies. The year 2010 has seen an avalanche of state-level economic development program changes, the vast majority of which loosen eligibility requirements and increase potential benefits. The process for accessing these incentives, however, has remained virtually unchanged. This article will present the “best practices” I have observed with end-user companies with which I have worked during

the past 14 years. You will be taken through the entire real estate project life cycle – from identifying incentives opportunities to complying with incentives agreements – which will provide insights into best practices for maximizing incentives value in each stage of the process.

Every significant capital project or relocation of a major business activity can be broken into its life cycle stages (see Figure 1). Each cycle stage can be associated with a set of best practices, and their implementation will ensure that maximum value is realized by the company.

Project Identification

The project identification phase is all

about avoiding missed opportunities. Studies have shown that a majority of the value from state and local incentives is forfeited by companies that proceed with projects without realizing their eligibility for incentives – until it is too late to capture them.

The best source of internal information regarding business incentives is employment and capital expenditure plans. Once these plans are obtained and digested, a list of potential negotiable business incentives can be assembled.

Incentives Team

This stage is about assembling the full team necessary to deliver the incentives. Usually companies will involve:



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- ↘ Real Estate
- ↘ Government Affairs
- ↘ Tax
- ↘ HR
- ↘ Finance
- ↘ Legal
- ↘ Public Affairs
- ↘ Business Units (if it is a conglomerate)

In addition, many companies will engage an outside consultant to

facilitate the coordination among the disparate departments; be a cohesive force that keeps the group on task and maximizing incentives as the primary goal; provide a best practice work plan based on specific experience in similar projects and locations; provide technical support with economic and fiscal impact studies, benchmarking data, comparative tax analyses, etc.

Strategy Development

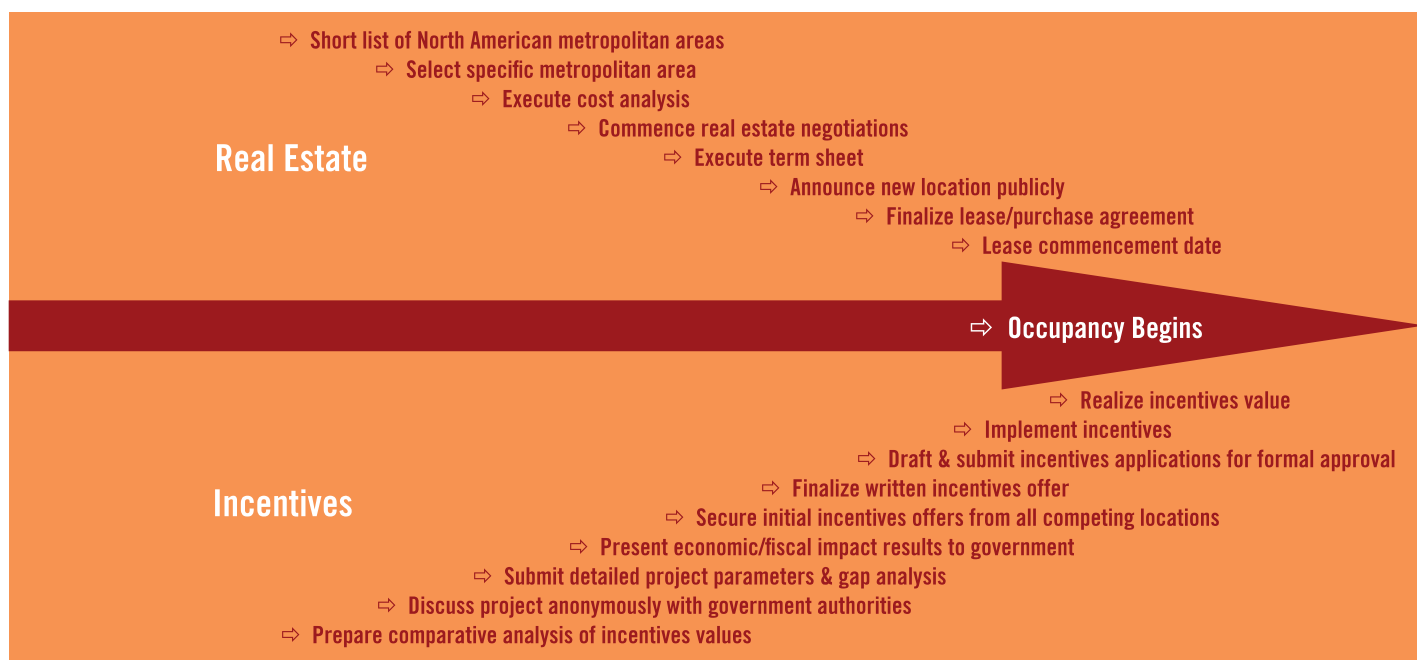
Best practice strategies are all about timing and leverage.

Timeframe. Government authorities will not be eager to incentivize decisions that have already been announced publicly. In fact, in many cases they are statutorily precluded from doing so. Figure 2 demonstrates the point that the best practice is to integrate the process

Figure 1: Project Life Cycle Stages



Figure 2: Integrating With The Real Estate Timeline



for securing maximum incentives with the investment timeline (in this case for real estate expansion).

Build Leverage. The best way to build leverage is to offer real location alternatives that are outside the target jurisdiction. In the Boeing Headquarters relocation case, three serious options (Dallas, Denver and Chicago) were under review simultaneously. All three cities were notified of the final selection simultaneously, and all three had the same amount of time to develop and enhance their incentives packages. The three-way competition was managed down to the very end in a uniquely dramatic way. Boeing’s chairman filed

three separate flight plans to announce the winning city, and only when his plane landed in Chicago where the Mayor greeted his arrival, was the company’s selection known. We had confirmed written offers from all three cities in hand at that moment.

It is also critical that you support the case for significant incentives with credible evidence that it is in the government’s best interests – economically and fiscally – to bring the project in by offering the incentives package you are seeking. A “best practice” for this stage is a full-blown economic and fiscal impact study prepared by a qualified third party using

widely accepted analytic techniques.

It is also during the strategy development phase when we need to address the following:

- Who, when and how do I approach the government authorities?
- Will the chosen strategy involve activities deemed “Lobbying” under state laws or regulations?
- What information will be required that could be made public?

Negotiation

This is the stage in the process most people identify as “getting the deal.” During this stage, we tackle the issues:

➤ **What do we want?** What will constitute a “win” for our side? Incentives can take the form of tax credits and abatements, tax rulings, cash grants, cost offsets, project approvals and good public relations. It is important during this stage to understand the company’s priorities among them. We have seen several of these traded off against one another. For instance, some companies refuse to allow their school taxes to be abated unless the state is going to be reimbursing the school district.

In determining what we want from government, we must first determine how each of the potential items benefits the company. We also need to know the details around the disclosure requirements that each will bring, as well as the size of the administrative burden that could be attached to them.

Finally, for companies with significant federal tax burdens, the best practice in determining the potential value of incentives includes a review of how each state or local incentive would affect Federal tax liability. For instance, can the value of the incentive be excluded from taxable income through the application of Section 118 of the Internal Revenue Code?

➤ **Protecting incentives from federal tax.** Economic development contracts – the kind companies sign to document the discretionary incentives they secure – may offer an opportunity to defer Federal tax on the incentives they contain. The best practice on this issue will be the tax function reviewing the risk/reward of taking a Section 118 position on each benefit included in the contract. If this is done prior to the execution of the contract, there may be opportunities to amend the language to be more supportive of the Section 118 position.

➤ **What does government need to get out of it?** Negotiation experts all agree that the more you know about your counterpart, the more your side will benefit. My 15 years of experience in tax and economic development agencies has given me a deep appreciation of the “public benefits” side of the incentives deal equation. It has also sensitized me to government’s priorities, preferences and motivations.

The best practice here would be to provide the politicians with what they want.

➤ **Political credit for jobs, economic development and tax base development.** Be generous in sharing the media attention around the project’s announcement.

➤ **Strong analytic justification that the amount of the incentives granted is not excessive compared to the public benefits to be derived.** This usually takes the form of a study by a highly-respected financial analyst/econometrician projecting the direct and indirect job creation/retention, as well as the fiscal impacts of the proposed project on the state and the locality offering the incentives package. If a trusted voice is heard to say something like, “The cost of the project is less than 10 percent of the five-year positive impact it will have on the State Treasury,” it makes it much easier for the politicians to vote in its favor.

➤ **Help with the local media.** We have often found that the difference between “public money well spent” and “corporate welfare” is the company taking the initiative to explain to the local press what the project is and how it will benefit the community in many ways.

➤ **No embarrassing surprises.** For instance, the company can never be heard to say that the incentives were not one of the deciding factors in the investment decision. Also, if there are planned layoffs elsewhere within the state, this needs to be fully disclosed before the final deal is struck.

➤ **Your promises kept.** Finally, if there is a problem in meeting job or investment commitments after the deal, it is critical that government agencies be informed as soon as possible so that a work-out and/or a media plan can be developed. If the media discovers the problem before the politicians, there is great risk of embarrassment for them.

Preserve And Comply

At the conclusion of the negotiation, a summary of the benefits secured should be circulated to the internal team. It should detail the expected annual value of the individual incentives, as well as the commitment levels required and potential drawbacks.

The company also needs a rigorous administrative process, most often involving the tax department, that is amended each time a new discretionary incentive is secured and each time a previously secured incentive expires.

As the economy continues to thaw over the coming months, many more projects will be undertaken that could qualify for negotiated incentives offered by state and local governments. Companies should begin now to revise their approach to securing and realizing negotiated incentives.

About the Author



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Future of Economic Incentives - Grubb & Ellis
<http://www2.corenet-global.org/dotCMS/kcoAsset?assetInode=7038020>

Deal or No Deal - Why Incentives Have Become More Transparent and How Their Role Has Increased in the Site Selection Process
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