



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

EVALUATION REPORT

JOBZ Program

FEBRUARY 2008

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OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

February 2008

Members of the Legislative Audit Commission:

Since January 2004, the JOBZ program has attempted to stimulate economic development in Greater Minnesota by allowing local governments to provide reductions in state and local taxes to businesses willing to locate or expand in designated zones. In its first three years of operation, local governments signed more than 300 subsidy agreements with businesses, and the program has provided businesses with more than \$45 million in tax breaks.

We found that JOBZ has been used appropriately in some cases and helped create jobs. But we also found significant problems with the program's design and implementation, resulting in some cases of ineffective and inappropriate use of tax subsidies. We make recommendations that would focus the program and improve its administration.

This report was researched and written by John Yunker (project manager) and David Kirchner. Bryan Dahl also provided valuable research assistance. The Department of Employment and Economic Development, the Department of Revenue, and various local governments cooperated fully with our evaluation.

Sincerely,

James Nobles
Legislative Auditor

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Summary

While JOBZ has been a useful economic development tool in some cases, it has not been adequately focused or administered.

Major Findings:

- The JOBZ program has some value as an economic development tool. It has helped attract some out-of-state businesses to Greater Minnesota and kept some Minnesota businesses from leaving the state (p. 97).
- However, the program has not been focused on those goals and has been used to provide tax breaks to some businesses that would have expanded in Greater Minnesota without JOBZ (p. 93).
- In addition, the program has subsidized some businesses that compete with existing Minnesota businesses for the same Minnesota customers (p. 93).
- The program is unfocused because it lacks a budget constraint and meaningful policies for local governments to follow in deciding which businesses may participate in the program (pp. 97-101).
- The JOBZ program also has not been targeted to those parts of Greater Minnesota that are economically distressed and most in need of assistance (pp. 42-46).
- There are significant problems with program administration, particularly business subsidy agreements, which too frequently lack adequate job and wage requirements (pp. 51-58).
- The process used by the Department of Employment and Economic Development (DEED)

to check business compliance with job and wage requirements is slow and may not identify some businesses that are not meeting their JOBZ obligations (pp. 62-70).

- Some businesses removed from the JOBZ program have not had to repay any property tax breaks and have continued to receive those subsidies for a time following their removal from the program (pp. 63-64).

Recommendations:

- The Legislature should require DEED to review and approve all business subsidy agreements before they can become effective. DEED should also be required to implement meaningful criteria for determining whether a business should receive JOBZ assistance (pp. 59-60, 98, and 101).
- The Legislature should either limit the number of businesses allowed to enter the JOBZ program each year or limit the estimated cost of future subsidies for new entrants each year (pp. 98-99).
- DEED should revamp the reporting forms used to monitor compliance and measure the overall effectiveness of the program (pp. 71-72).
- DEED should streamline its compliance process to more rapidly identify and remove from the program businesses that do not meet their obligations (p. 70).

Report Summary

The JOBZ (Job Opportunity Building Zones) program attempts to spur economic growth in Greater Minnesota by providing state and local tax breaks to selected businesses. To qualify for the program, a business must locate in one of the designated zones throughout Greater Minnesota and sign a business subsidy agreement with its local jurisdiction.

After the program's introduction in 2004, it quickly became one of Minnesota's most utilized economic development programs. More than 150 local communities and 350 businesses have participated in the program.

The JOBZ program has not been targeted to economically distressed areas within Greater Minnesota.

Typically, enterprise zone programs have been used across the nation to provide tax breaks to businesses locating in economically distressed parts of a state or city. Similarly, state law required the Department of Employment and Economic Development (DEED) to use various need and success criteria in establishing ten JOBZ zones across the state.

But these criteria became unimportant because DEED worked with local governments to ensure that there were only ten applications. Each of these applications included dozens of cities and townships and hundreds of noncontiguous subzones.

As a result, there has been no targeting of JOBZ incentives to areas with greater distress except to limit the program to Greater Minnesota. DEED has established over 1,150 separate subzones on a total of about 29,300 acres in more than 350 cities and townships. DEED has also frequently moved the subzones to accommodate the location preferences of interested businesses.

The JOBZ program provides a useful economic development tool, but it has been used at times to provide unnecessary subsidies.

JOBZ has some value as an economic development tool. It has been successful in attracting some businesses to Minnesota from other states and in keeping some business expansions from leaving the state. However, the program has not maintained a focus on these goals.

Surveys of JOBZ businesses indicate that about 19 percent of the participants would have expanded to the same extent in Greater Minnesota without JOBZ assistance. In addition, another 50 percent would have expanded to some extent without tax breaks.

Furthermore, local governments have approved JOBZ subsidies for businesses that compete with other Greater Minnesota companies for the same Minnesota customers. The increase in employment at subsidized businesses could be offset by job cuts at their competitors.

Finally, the program sometimes provides subsidies to businesses that do not need the full array of JOBZ subsidies in order to expand. The program lacks any procedures to

The JOBZ program has not provided much help to certain economically distressed areas in Greater Minnesota.

Local governments make decisions about business participation with little state input and no significant budget constraints.

determine whether less generous subsidies than those offered by JOBZ would be sufficient to induce a business to expand in Greater Minnesota.

The program's effectiveness is reduced by the lack of a statewide perspective in the approval of JOBZ deals and the absence of any budgetary constraints.

Local governments, not state agencies, determine what job growth and capital investment obligations companies must meet to participate in the program. The JOBZ law sets some minimum requirements but only for companies that relocate part or all of their operations into a zone from another Minnesota location.

Local officials evaluate potential JOBZ companies primarily on their likely effect on the local economy and not on the broader impact on Greater Minnesota. Furthermore, local officials do not consider the full cost of providing JOBZ subsidies, since most of the tax breaks are funded by state government. Some cities find it hard to turn down requests from local businesses for JOBZ assistance and sometimes feel obligated to offer it in order to compete with other Minnesota communities.

The number of businesses in the program is limited only by the amount of land that can be designated as JOBZ locations. The JOBZ legislation authorizes DEED to designate up to 50,000 acres statewide as JOBZ sites. This has not proved to be a meaningful limit on program participation. Essentially, any business that meets the minimal statutory requirements

may participate if approved by a local government.

As a result, JOBZ is not focused on those businesses likely to contribute to substantial economic growth in Greater Minnesota. In addition, nearly half of the businesses participating in JOBZ are obligated to hire 5 or fewer new full-time equivalent employees.

The estimates published by the Department of Employment and Economic Development overstate the impact of the JOBZ program.

In statistics posted on its web site, DEED has credited the JOBZ program with the creation of 5,459 new full-time jobs as of the end of 2006. However, our review of unemployment insurance records suggests that the increase in employment at JOBZ businesses is at least 20 percent lower. The difference is due to the lack of adequate reporting forms and a tendency of businesses to overstate their employment.

Additionally, DEED's figures assume that none of the businesses in the JOBZ program would have created any new jobs in Greater Minnesota without the tax breaks provided by the program. However, as indicated above, surveys of JOBZ businesses indicate that a substantial number of them would have expanded to some extent even without JOBZ. In addition, economic studies of enterprise zone and tax incentive programs elsewhere in the country also suggest that DEED's estimates of economic impact are inflated.

**The
administration
of JOBZ needs
significant
improvement.****There are significant problems
with the business subsidy
agreements signed by local
governments.**

To enter the JOBZ program, companies must sign business subsidy agreements with local governments in which they agree to meet employment and capital investment targets as a condition of receiving the subsidy. Nearly all of these agreements have contained ambiguous language, requiring businesses to create or retain full-time employees without providing a clear definition of “full-time” or “employee.”

Many agreements have been poorly worded and are dotted with grammatical inconsistencies that obscure the obligations of the participating companies. A few agreements set no deadlines for companies to meet their hiring commitments. Over 60 agreements do not require businesses to maintain the jobs they promise to create for as long as they are receiving tax breaks.

**DEED’s process for reviewing
JOBZ compliance is slow,
inefficient, and may fail to identify
some businesses that are not
meeting their obligations.**

Businesses and local governments that have entered JOBZ agreements must file reports with DEED every spring. However, DEED’s review of these reports has been slow. It took until February 2007 for the agency to determine that some businesses had not met their obligations during 2005. At the writing of this report, DEED had not completed reviewing and following up on reports filed for calendar year 2006.

DEED’s slowness in monitoring compliance has enabled a few businesses to receive property tax exemptions beyond the date that they became noncompliant with their business subsidy agreements. A speedier compliance process and a change in state law would address this problem.

In addition, the compliance process may fail to identify some businesses that are noncompliant. The process used by DEED to collect information on employment and wages is based on a flawed form. In addition, DEED does not require business officials to certify the accuracy of the information provided in annual progress reports. Although the information frequently conflicts with data that JOBZ businesses have submitted in their unemployment insurance filings, DEED staff have not used the unemployment insurance data to assist in monitoring compliance.

Introduction

The JOBZ program attempts to promote economic growth by providing tax breaks to certain businesses in Greater Minnesota.

In 2003, the Legislature enacted the Job Opportunity Building Zones (JOBZ) program. The program attempts to promote economic development in Greater Minnesota by providing state and local tax breaks to qualified businesses that expand, start up, or relocate within a tax exemption zone.¹ The tax breaks can be quite significant and are scheduled to last through the end of 2015. They include reductions to or exemptions from property, sales, corporate franchise, and individual income taxes. A refundable jobs credit is also available.

Supporters of the program believe that JOBZ has been very helpful in creating jobs in Greater Minnesota. They also feel that the program has attracted development that would have gone to neighboring states. Supporters say that some counties in Greater Minnesota have suffered significant declines in population and diminishing economic prospects over the last several decades. For them, JOBZ has provided the tools to attract development, create jobs, and retain population in those areas.

Critics, on the other hand, argue that programs providing tax incentives for locating in designated zones often result in significantly less job growth than claimed by supporters. Tax subsidy programs may result in new development, but they also provide tax breaks to development that would have occurred without those incentives. The overall cost per job created can be very large if little additional development was induced by the program.

Some critics of JOBZ have also pointed out that Minnesota's program is not targeted to the areas in Greater Minnesota with the most economic distress. JOBZ is available and has been used by cities with growing populations and generally prosperous economies.

As a result of these conflicting claims and arguments, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate the JOBZ program. Legislators were interested in the economic impact of JOBZ and the extent to which the program has been targeted to more economically distressed communities and areas in Greater Minnesota. In addition, legislators were interested in whether there has been adequate follow-up to ensure that participating businesses not meeting their job and wage requirements are removed from the program. This report specifically addresses the following issues:

¹ Greater Minnesota includes all of the state except the Twin Cities metropolitan area. The metropolitan area includes the counties of Anoka; Carver; Dakota, excluding the city of Northfield; Hennepin, excluding the cities of Hanover and Rockford; Ramsey; Scott, excluding the city of New Prague; and Washington. See *Minnesota Statutes* 2007, 469.312, subd. 3, and 473.121, subd. 2.

- **To what extent is the JOBZ program benefiting more economically distressed areas?**
- **What is the economic impact of the JOBZ program in Greater Minnesota? How could the program be changed to increase its net economic benefits to Greater Minnesota?**
- **How well has the JOBZ program been implemented? Is there effective oversight and accountability?**

To conduct this evaluation, we reviewed economic studies of enterprise zones and economic development and examined available analyses of Minnesota's JOBZ program. We also interviewed staff at the Department of Employment and Economic Development (DEED) and the Department of Revenue (DOR), as well as local government officials responsible for economic development. We examined in detail many of the documents collected by DEED on participating JOBZ businesses and, to the extent possible, reviewed their wage and employment records as filed with DEED for unemployment insurance purposes. Finally, we reviewed tax data filed with DOR.

Chapter 1 of this report provides background information on the JOBZ program. Chapter 2 examines the extent to which the program is targeted to economically distressed communities. In Chapter 3, we review the administration and operation of the program. In particular, we focus on the written agreements between participating businesses and local governments. We also examine the process used to review compliance of participating businesses with the job and wage requirements in these agreements and to remove noncompliant businesses from the program. Finally, in Chapter 4, we consider the economic impact of JOBZ in light of existing studies of tax incentives and the evidence we gathered on JOBZ. We also consider ways to improve the net economic impact of the program.

Background

SUMMARY

In 2004, the Job Opportunity Building Zone (JOBZ) program began providing significant state and local tax breaks to selected businesses in an effort to stimulate the economy of Greater Minnesota and revitalize economically distressed rural areas. Local governments largely decide which businesses may participate in the program and how much employment growth or capital investment is expected of participating businesses. The state has played a very limited role in determining business participation and establishing employment requirements for JOBZ businesses even though state government pays for much of the program's cost.

For nearly two decades, Minnesota has had enterprise zone programs in five cities on the state's western border. The border city enterprise zone program has provided certain tax breaks to companies locating in these zones. The purpose of these tax breaks was to dissuade businesses from relocating to the neighboring states of North Dakota and South Dakota and encourage development in Minnesota's border communities. Lower taxes and other business costs had caused businesses with both Minnesota and non-Minnesota customers to move across the border to the Dakotas. Tax breaks were used in an attempt to level the playing field in the competition for business development.

More recently, advocates for other Greater Minnesota communities argued that the need for significant tax breaks to retain and attract business activity was more widespread. Some counties in Greater Minnesota had experienced substantial job losses or declining populations. Without tax breaks or other assistance, it was believed that these areas were unlikely to recover from those losses.

In 2001, some legislators introduced bills to address their concerns about the economic future of certain areas in Greater Minnesota. These bills, modeled in part after programs in Michigan and Pennsylvania, would have established up to ten tax-free zones in Greater Minnesota. Each zone could have been no larger than 5,000 acres and could have contained no more than six noncontiguous subzones. Each subzone would have been required to cover at least 20 acres of property. The zones would have been chosen based on their economic distress and the likelihood of program success.

Under these 2001 bills, residents of the tax-free zones would have been exempt from property and income taxes. Businesses already in the zones and certain

businesses that subsequently relocated to the zones would have been eligible for reductions in property, income, and sales taxes.¹

Although these bills did not pass in either 2001 or 2002, legislators introduced very similar legislation again in 2003. The 2003 Legislature enacted a significantly modified version of the original proposal and named it the Job Opportunity Building Zones (JOBZ) program.² Under the JOBZ program, businesses located in designated zones would be eligible for tax breaks, but not residents of those zones. Amendments to the original proposal also made it possible for the zones to be spread more widely across Greater Minnesota and to consist of smaller individual portions of land than originally envisioned.³

This chapter provides more information on the program adopted in 2003 and implemented starting in 2004. In particular, we address the following questions:

- **How can a business qualify for the JOBZ program?**
- **What tax reductions does the program provide?**
- **What requirements must a participating business meet in order to continue receiving tax reductions? How do government agencies monitor compliance with these requirements?**
- **What government agencies are responsible for administering the program and deciding which businesses can participate?**
- **How has participation in the program grown since its inception in 2004?**

To answer these questions, we reviewed the original legislation and later changes made by the Legislature, program literature published by the Department of Employment and Economic Development (DEED) and the Department of Revenue (DOR), and documents in DEED's files related to individual JOBZ businesses. We also interviewed program staff at both agencies and local government officials that have been involved with the program.

QUALIFYING FOR JOBZ

To qualify for JOBZ tax breaks, a business must locate in a designated zone and sign a business subsidy agreement with a local government that is participating in

¹ If a business relocated operations to a zone, it would have qualified for the tax breaks if it either: (1) increased employment by 20 percent in its first full year of zone operations, or (2) made a capital investment in the zone equal to at least 10 percent of its gross revenues from the year prior to relocating to the zone. For purposes of calculating gross revenues, only the revenues from the portion of the business being relocated were to be counted.

² *Laws of Minnesota* First Special Session 2003, chapter 21, art. 1. Most of the law is codified in *Minnesota Statutes* 2007, 469.310 – 469.3201.

³ The JOBZ legislation allowed an unlimited number of noncontiguous subzones in each of the ten zones and did not set a minimum size for each subzone.

the program. This section discusses those requirements, as well as any state requirements on the types of businesses that can participate in the program and the amount of employment growth or capital investment they must make to qualify for tax breaks.

Zone Designation

Before businesses could participate in JOBZ, the Department of Employment and Economic Development had to first designate the zones and subzones where businesses could qualify for tax exemptions. The 2003 legislation establishing a JOBZ program required DEED to publish application forms and requirements no later than August 1, 2003. Applications were due by October 15, 2003, and the commissioner of DEED was required to designate the zones by December 31, 2003, with the eligibility for tax breaks beginning January 1, 2004.

The 2003 law allowed the commissioner to designate up to ten zones.⁴ Each zone could consist of an unlimited number of noncontiguous subzones but could not exceed a total of 5,000 acres. Although the commissioner was allowed to reserve one or more of the ten zones for a second round of designations effective on January 1, 2005, the commissioner designated all ten zones during the initial round of selections. However, the commissioner did not designate a full 5,000 acres in each of the ten zones. Only about 29,000 acres were designated in the ten zones. Because the commissioner has the authority to modify the original zone designations, the commissioner could increase the number of acres in each zone up to the 5,000 acre limit. While the commissioner has made numerous modifications to the original zones, only modest increases in total zone acreage have occurred.⁵

Local governments control participation in the JOBZ program.

Local Business Subsidy Agreements

Starting in 2004, businesses locating in a designated zone were eligible for the tax breaks provided in the legislation. To receive the tax breaks, businesses had to enter into a business subsidy agreement with a local government, such as a city, county, or township.⁶ A business subsidy agreement lays out the contractual

⁴ Besides the ten JOBZ zones, the commissioner of DEED was given the authority to designate up to five agricultural processing facility zones. An agricultural processing facility is an operation that transforms, packages, sorts, or grades livestock or livestock products, agricultural commodities, or plants or plant products into goods used for intermediate or final consumption. The size of each agricultural processing facility zone is limited to the property necessary for the facility and ancillary operations, as well as space for expansion in the reasonably foreseeable future. To date, the commissioner has designated one agricultural processing facility zone, which includes two soybean processing plants.

⁵ Chapter 2 will discuss the zone designation and zone modification processes in greater detail.

⁶ The 2003 legislation indirectly required business subsidy agreements by requiring local governments to comply with the state's business subsidy law in administering JOBZ. (See *Minnesota Statutes* 2007, 469.313, subd. 2(5); and 116J.994, subd. 3.) The 2005 Legislature clarified that a business only qualified for JOBZ tax breaks if it had entered a business subsidy agreement. That provision, which is codified in *Minnesota Statutes* 2007, 469.310, subd. 11b, was made retroactive to the beginning of the program.

obligations of both the business and the local government. From a public perspective, one of the main purposes of a business subsidy agreement is to establish the job, wage, and capital investment requirements that a business must meet in order to receive JOBZ tax breaks.

The content of business subsidy agreements for JOBZ is determined by negotiations between local governments and interested businesses. DEED provides local governments with a sample business subsidy agreement. However, local governments have the discretion to use the sample agreement, modify it, or use their own agreement. DEED does not review the details of local business subsidy agreements.

State Requirements

There are few state requirements for program participation.

There are relatively few state restrictions governing the types of businesses that can participate in JOBZ and the amount of employment required to qualify for tax breaks. The wage levels required of JOBZ businesses are also relatively low, although higher wages are needed in order to benefit from a jobs tax credit.

Types of Businesses

Overall, the JOBZ program has been primarily used by manufacturers. But there has also been participation by businesses in other industries such as services, construction, wholesale trade, retail, and utilities.

State law did not initially place any restrictions on the type of commercial or industrial business that could participate in the JOBZ program.⁷ However, in response to participation by some retail businesses and one public utility, the 2005 Legislature prohibited future participation by public utilities and limited the participation of businesses with retail operations in a JOBZ zone.⁸ The restriction on retail participation allows some retail sales by a participating business at its JOBZ location. However, at its location in the zone, the business cannot be primarily engaged in making retail sales to purchasers who are

⁷ Although there were no specific restrictions on the types of businesses that could participate in the program, property in a zone had to be classified as commercial, industrial, or public utility property in order to qualify for property tax exemptions. This meant that some resorts, hospitals, aircraft hangars, and golf courses were not eligible for the property tax exemption. See *Minnesota Statutes* 2007, 272.02, subd. 64; and 273.13, subd. 24.

⁸ For the prohibition on utility participation, see *Laws of Minnesota* First Special Session 2005, chapter 3, art. 7, sec. 12, which is codified in *Minnesota Statutes* 2007, 469.310, subd. 11h. The prohibition on public utility participation applied to any business subsidy agreements entered into after July 14, 2005. For the restriction on retail participation, see *Laws of Minnesota* First Special Session 2005, chapter 1, art. 4, sec. 107, which is codified in *Minnesota Statutes* 2007, 469.310, subd. 11f. The restrictions on retail participation became effective for business subsidy agreements finalized after June 30, 2005.

physically present at that location.⁹ Phone or internet sales or non-retail activities, such as service and repairs, do not count as retail sales for the purposes of this restriction.

DEED does not have policies that limit the participation of various types of businesses other than the requirements of state law. However, DEED has discouraged the participation of retail businesses in several ways. In selecting the initial zones, DEED often removed property designated for retail development from the zones. DEED has also occasionally used its power to approve zone modifications to discourage or prevent the use of JOBZ for some retail businesses. Nevertheless, some purely retail businesses and some businesses which have a mixture of retail and other operations have participated in the program.

Employment and Capital Investment

For most JOBZ businesses, there are no state requirements for minimum increases in employment or capital investment. The employment or investment requirements are determined through negotiations between local governments and businesses and are spelled out in business subsidy agreements.

However, businesses relocating any existing Minnesota operations into a zone must meet certain statutory requirements and sign a relocation agreement with DEED. The initial statutory requirements enacted in 2003 required a relocating business to increase full-time employment in the first full year of operation by at least 20 percent relative to the operations that were relocated or make a capital investment in the zone of at least 10 percent of the gross revenues of the relocated operations in the preceding tax year.¹⁰

The statutory requirements for businesses relocating within Minnesota were strengthened in 2005.

A number of participating businesses met these requirements using the capital investment option and committed to little or no job growth. Alternatively, some small businesses were able to meet the job growth option by promising to increase overall employment by only one or two jobs. As a result, the 2005 Legislature eliminated the capital investment alternative and strengthened the employment growth requirements for relocating businesses signing JOBZ agreements after June 30, 2005. Since then, relocating businesses have been required to increase full-time employment by a minimum of five jobs or 20 percent of the relocated operations, whichever is greater.¹¹

⁹ The Department of Revenue has published Revenue Notice 06-02, which addresses a number of issues regarding the definition of “retail.” However, neither Revenue’s publication nor *Minnesota Statutes* 2007, 469.310, subd. 11f, defines how to measure whether these types of retail operations are the “primary” function of a business. Presumably, the proportion of total sales at the JOBZ location, or the proportion of employees assigned to such retail operations, could be used to measure whether a business qualifies for JOBZ.

¹⁰ *Laws of Minnesota* First Special Session 2003, chapter 21, art. 1, sec. 15.

¹¹ *Minnesota Statutes* 2007, 469.310, subd. 11d. The same legislation also gave the commissioner of DEED the authority to waive the statutory employment requirements for relocating businesses. See *Minnesota Statutes* 2007, 469.310, subd. 11e.

Starting in July 2005, new participants were required to pay a minimum compensation level to all employees in a zone location.

Contractors and subcontractors must pay the “prevailing wage rate” on construction work in a zone.

Compensation Levels

Initially, there were no statewide requirements regarding the wages and benefits paid to workers of JOBZ businesses. State law required local governments to include wage requirements in the business subsidy agreements but did not set minimum wage and benefit levels.¹²

However, the 2005 Legislature enacted a minimum compensation requirement applicable to all JOBZ businesses completing a business subsidy agreement after June 30, 2005. Those businesses are required to pay each employee at its zone location compensation that is equal on an annualized basis to at least 110 percent of the federal poverty level for a family of four.¹³ In addition to wages, state law allows compensation to include benefits that are not mandated by law.¹⁴ Each year, DEED notifies JOBZ administrators regarding any changes in the minimum compensation rate. Beginning on July 1, 2005, the minimum hourly compensation rate was \$10.23 per hour. That rate was updated to \$10.58 per hour on July 1, 2006, and \$10.92 per hour on July 1, 2007.

In addition, one of the tax breaks available to JOBZ businesses—the jobs tax credit—can only be obtained if the business pays an average wage well in excess of the statutory requirement.

Prevailing Wage Rates on Construction

In addition to any requirements on the wages paid by JOBZ businesses to their employees, contractors and subcontractors must pay the prevailing wage rate for any construction work in a JOBZ location.¹⁵ Under current law, if a business receives certain state financial assistance for economic development, including sales tax reductions, then any construction, installation, remodeling, or repairs for which the assistance was provided is subject to the state’s prevailing wage requirements for public construction projects.¹⁶ An October 2004 opinion from the Attorney General’s Office concluded that a JOBZ business could not decline the sales tax reduction on construction materials and thus avoid the prevailing wage requirement on zone construction work.¹⁷

The prevailing wage requirement has been a concern for prospective JOBZ businesses in some parts of the state. They have complained that the requirement forces them to pay substantially more for construction work than they otherwise

¹² *Minnesota Statutes* 2003, 116J.994, subd. 4.

¹³ See *Laws of Minnesota* First Special Session 2005, chapter 1, sec. 107, which is codified in *Minnesota Statutes* 2007, 469.310, subd. 11g.

¹⁴ For example, health care benefits could be counted as compensation. Social security and Medicare contributions, unemployment insurance taxes, and workers compensation payments are required by law and cannot be included to meet the minimum compensation levels required by law.

¹⁵ *Minnesota Statutes* 2007, 116J.871.

¹⁶ *Minnesota Statutes* 2007, 177.42, subd. 6.

¹⁷ Kristine L. Eiden, Chief Deputy Attorney General, Office of the Attorney General, letter to Senator Ellen Anderson and Senator Thomas Bakk, October 12, 2004.

would pay using local construction firms. In fact, the businesses claim that the prevailing wage requirement costs them more than the value of the sales tax exemption on construction materials. However, the Attorney General's opinion prevents them from selectively declining one of the tax breaks available under the JOBZ program in order to be exempt from the prevailing wage requirement. As a result, a few businesses have decided not to participate in the program.

To some extent, the concerns raised by these businesses were confirmed in a 2007 evaluation report by the Office of the Legislative Auditor on prevailing wage rates.¹⁸ We found that problems with the methods used to calculate prevailing wage rates can cause the rates to be unrepresentative of compensation rates paid in some parts of the state. The problems involve both the calculation methods required by state law and inadequate response rates to surveys used to set prevailing wage rates. Our report made recommendations designed to improve survey response rates and suggested ways in which the statutorily mandated calculation method could be modified.¹⁹

Other Requirements

Starting in July 2005, local governments were required to consider a number of factors prior to entering into a business subsidy agreement.

Initially, state law did not require local governments entering business subsidy agreements to conduct any particular analyses of their JOBZ deals. Due to concerns about some of the deals entered into by local governments, the 2005 Legislature required local governments to consider a number of factors prior to entering any JOBZ business subsidy agreement after June 30, 2005.²⁰ The factors include: (1) the wages to be paid by a prospective JOBZ business in comparison to the regional industry average; (2) the number of jobs to be provided by the business relative to overall community employment; (3) the economic outlook for the industry in which the JOBZ business would compete; (4) sales that the JOBZ business would generate from outside the state of Minnesota; (5) the degree to which the business would build on existing regional strengths or diversify the regional economy; (6) the amount of capital investment to be made by the JOBZ business in the zone; and (7) any other criteria the commissioner of DEED deemed necessary.

In response to this statutory requirement, DEED developed a deal evaluator tool that rates each prospective JOBZ deal. The six factors mentioned in state law are included in the deal evaluator. In addition, the evaluator includes: (1) the increase in property tax base that will occur once the JOBZ property tax

¹⁸ Office of the Legislative Auditor, *Prevailing Wages* (St. Paul, 2007).

¹⁹ Prior to the issuance of our prevailing wage report, a JOBZ business owner in Otter Tail County worked with the Minnesota Department of Labor and Industry to improve survey response rates in that county. Because it takes time for a new survey to be conducted and prevailing wage rates to reflect the new survey, these efforts did not reduce construction costs for this owner. However, they have lowered prevailing wage rates and construction costs for subsequent JOBZ businesses in the county. According to city economic development officials, the new rates still result in higher construction costs than without the prevailing wage requirement, but the value of the sales tax exemptions now exceeds these additional costs.

²⁰ See *Laws of Minnesota* First Special Session 2005, chapter 1, sec. 107, which is codified in *Minnesota Statutes* 2007, 469.310, subd. 11c.

exemptions have expired, and (2) the extent to which wages paid by the business exceed the statutory requirement of 110 percent of the federal poverty level for a family of four. DEED has required all local governments to submit a completed deal evaluator when a local government enters a business subsidy agreement.

TAX REDUCTIONS

The JOBZ program provides qualified businesses with substantial state and local tax reductions. This section examines the types of tax reductions offered to JOBZ businesses, the duration of the tax breaks, and the overall size and source of the tax reductions.

Types

JOBZ businesses and certain other businesses are eligible for various tax exemptions.

JOBZ businesses may receive tax reductions for sales and use taxes, property taxes, corporate franchise taxes, individual income taxes, and wind energy production taxes. In addition, other businesses renting or leasing property or equipment to JOBZ businesses may receive certain tax reductions. Finally, contractors and subcontractors constructing buildings or other improvements for a JOBZ business or for the business's landlord may receive sales tax reductions. In providing tax breaks to nonparticipating businesses, policymakers are assuming that JOBZ businesses will benefit by negotiating lower rental rates or construction prices. Each tax break allowed under the JOBZ program is discussed below.

Sales and Use Tax on Construction Materials and Supplies

Sales and use taxes on construction materials and supplies used in, and equipment incorporated in, the construction of buildings and other improvements to real property in a zone are exempt if, after completion, the improvements are used by a JOBZ business. This exemption can be used either by a JOBZ business, a person or business renting the building to a JOBZ business, or contractors or subcontractors either working for the JOBZ business or its landlord.

To buy these items without paying state or local sales or use taxes, the purchaser must give each seller a completed Certificate of Exemption form indicating that the reason for the exemption is JOBZ. The purchaser is not required to indicate the JOBZ business for which the construction materials and supplies are being used. In addition, the certificate does not indicate either the amount of exempt purchases or the tax savings. As a result, the amount of sales tax exemptions received on behalf of a JOBZ business can be difficult to determine.

Sales and Use Tax on Goods and Taxable Services

In addition, purchases of tangible personal property and taxable services by a JOBZ business are exempt from state and local sales and use taxes. To qualify for the exemption, these purchases must be "primarily" used or consumed at the

zone location.²¹ Items that can be purchased exempt from taxation include production equipment, nonproduction equipment, office supplies, and utilities. State law already exempts from sales and use taxes capital equipment for production uses such as manufacturing, fabricating, mining, or refining. But companies must first pay the tax and file a request for a refund. JOBZ businesses need not pay the tax at the point of sale and thus avoid the need to file a refund request.

To buy these goods and services without paying the sales and use taxes, the purchaser must file a Certificate of Exemption, as is the case for construction purchases. However, only a JOBZ business is eligible to purchase these goods and services without paying taxes.

Sales and Use Tax on Motor Vehicles

JOBZ businesses may also purchase motor vehicles without paying applicable state and local sales and use taxes. The purchase is tax exempt if the motor vehicle is principally garaged in the zone and is primarily used as part of, or in direct support of, the person's operations carried on in the zone.²² To claim the exemption, the purchaser must submit a statement at the time of registration indicating that the purchaser is a qualified JOBZ business and has a business subsidy agreement with a local government.

Property Tax on Zone Buildings and Improvements

Property tax exemptions are allowed for buildings but not land.

JOBZ businesses are exempt from some property taxes. The exemption applies only to improvements to real property and personal property classified as commercial/industrial and located in a zone.²³ The exemption does not apply to the land portion of the zone property. The exemption is also not applicable to any levies used to pay general obligation bonds.²⁴ For taxes payable from 2005 through 2007, the exemption did not apply to school district referendum levies approved by voters before the designation of the zones on January 1, 2004.²⁵ However, for taxes payable beginning in 2008, JOBZ businesses will be exempt from paying referendum levies and will instead be required to pay any school district debt service levies included in the debt service levy under *Minnesota Statutes* 2007, 123B.55.²⁶

²¹ According to the Department of Revenue, "primarily" means fifty percent or more.

²² *Minnesota Statutes* 2007, 297B.03.

²³ *Minnesota Statutes* 2007, 272.02, subd. 64a. The term "improvements" applies to any buildings or other property improvements in the zone. It is not intended to distinguish new buildings from existing buildings. The term "improvements" distinguishes buildings or other improvements from the land portion of the property's market value.

²⁴ *Minnesota Statutes* 2007, 272.02, subd. 64d(1).

²⁵ *Minnesota Statutes* 2006, 272.02, subd. 64d(2).

²⁶ *Minnesota Statutes* 2007, 272.02, subd. 64d(2).

Property tax exemptions only cover the portion of a building that is in a zone and is occupied by a JOBZ business.

In Minnesota, properties are assessed in one year, and the property taxes based on that assessment of market value are paid during the following year. As a result, the first year that any JOBZ business could have benefited from property tax exemptions was 2005.²⁷ This is because the first year any JOBZ business could have property in a zone was 2004. In addition, some early JOBZ participants did not complete their construction projects in 2004 and would have first received an exemption during assessment year 2005 or 2006. Consequently, their tax breaks would have started in either 2006 or 2007.

Not all buildings on a parcel of land occupied by a JOBZ business are necessarily in a JOBZ zone. The buildings on a parcel of land, or even an individual building on that parcel, may be split between zone property and fully taxable property. In some cases where a business is expanding an existing operation, the zone has been drawn to exclude existing structures on the parcel of land. If the company is expanding by constructing additional buildings on the same parcel, the new buildings would likely be in the zone, while the existing buildings may be outside the zone. If the company is expanding an existing building, the footprint of the existing building may be excluded from the zone, while expansion to the existing structure is placed in a zone. The intent of such an action is to exclude existing business operations from receiving favorable tax treatment but to provide an incentive for expansions.²⁸

In some cases, a JOBZ business may occupy only a part of the building on a parcel of land. The zone designation would then only apply to the portions of a building that are occupied by a qualified JOBZ business. This would happen if the JOBZ business is renting part of a building or if a JOBZ business owns one of the office condo units on a parcel of land. In these instances, county assessors are supposed to determine the portion of the building that is occupied by the JOBZ business and give a tax exemption to only that portion of the building.

Business Income

JOBZ businesses are allowed an exemption from the individual income tax and the corporate franchise tax, including alternative minimum tax, for income attributable to zone activities. Determining the exemption amount is a three-step process.²⁹

First, the portion of the Minnesota income of a JOBZ business that is attributable to the zone—or “zone percentage”—must be determined. For a business, the

²⁷ State law currently requires that property in a zone can be given a JOBZ exemption during the assessment year only if the business subsidy agreement is signed by July 1 of the assessment year and the JOBZ business begins operations in the zone by July 1 of that year. If those conditions are met, the business would first receive an exemption from certain property taxes during the following year when taxes based on the assessment are due.

²⁸ DEED initiated this general practice when it first designated the zones. During the zone designation process, DEED often—though not always—excluded the footprint of any occupied existing buildings on a parcel of land from a zone if it included the parcel in a zone.

²⁹ The calculation of these tax reductions is codified in *Minnesota Statutes* 2007, 469.316, subd. 3, and 469.317.

Calculating the amount of exempt business income can be complicated.

zone percentage is an average of the percentage of its Minnesota property that is in the zone and the percentage of its Minnesota payroll that is in the zone.³⁰ A company's Minnesota business income is multiplied by the zone percentage to determine the business income attributable to zone activities.

Second, if a JOBZ business relocated Minnesota operations into a zone and entered into a business subsidy agreement after August 31, 2005, the results from the first step must be multiplied by a "relocation payroll percentage" to determine the final exemption amount. Applying this percentage reduces the exemption amount by a fraction equal to the company's payroll from the relocated operations in the last full year prior to the relocation divided by the company's zone payroll for the current tax year. This second step means that businesses that relocated within Minnesota receive an exemption only to the extent that they have increased the payroll of their relocated operations.

Finally, state law places a limit on the exemption amount that is equal to 20 percent times the sum of the company's zone payroll and the adjusted basis of property at the time the property is first used in the zone. This limit replaces the exemption amount determined in the second step if it is less.

The final exemption amount is then deducted from a company's business income before taxes are computed based on that income. If a JOBZ exemption reduces a taxpayer's Minnesota taxable income below zero, the loss cannot be carried over to prior or future years.

Rental Income

Rental income received by individuals and businesses is exempt from income taxes if the income is from the rental or lease of real or personal property used by a qualified JOBZ business and located in a zone.³¹ If the personal property was used both within and outside the zone, the rental income exemption must be prorated based on the portion of the year it was used in the zone.

Capital Gains Income

There are two types of capital gains exemptions. First, individuals may receive a state income tax exemption for capital gains on the sale of an ownership interest in a JOBZ business that is a partnership or corporation. The exemption amount is determined by multiplying a modified zone percentage times the amount of the gain. The modified zone percentage is similar to the zone percentage used in

³⁰ Zone payroll includes payroll that is paid for services performed in the zone or for services performed outside the zone by an employee with an office in the zone, provided that the employee's work outside the zone is incidental to the work the employee performs inside the zone.

³¹ C corporations are not eligible for this exemption. C corporations are those corporations that pay federal corporate income taxes and, in Minnesota, the corporate franchise tax. In contrast, S corporations distribute their earnings to their shareholders who must pay individual income taxes on that income. It is typical for real estate to be owned by S corporations, partnerships, or individuals since it receives more favorable tax treatment in those arrangements. However, there are restrictions on such arrangements. For example, an S corporation must have no more than 100 shareholders.

calculating a business income exemption except that non-Minnesota payroll and property must also be included in the calculation. The modified zone percentage must be at least 25 percent in order for an owner to qualify for an exemption.

Second, capital gains on the sale of real property or tangible personal property are exempt from income taxes if the property was used inside a zone by a JOBZ business. This exemption may be claimed by individuals and businesses that are JOBZ businesses or that rent this property to a JOBZ business.³² If real property was owned prior to the designation of the zone, the capital gains exemption is prorated based on the number of days it was held during the period of zone designation relative to the total number of days of ownership. The capital gains exemption for tangible personal property is prorated based on the number of days the asset was used by a qualified business in the zone relative to the total number of days the property was held.

Jobs Credit

JOBZ businesses are also eligible for refundable jobs credits.

The JOBZ jobs credit provides a refundable tax credit for JOBZ businesses or their owners on income and corporate franchise taxes.³³ The credit is generally not available unless a JOBZ business pays an average wage of more than \$30,000 per year to employees working in the zone. The credit is equal to 7 percent of the difference between: (1) the growth in zone payroll from the base year to the current tax year and (2) \$30,000 multiplied by growth in the number of full-time equivalent (FTE) employees in the zone from the base year to the taxable year. If the growth in the total Minnesota payroll of the JOBZ business from the base year to the current tax year is less than the growth in zone payroll for those years (item 1 above), then the growth in total Minnesota payroll is used instead of the growth in zone payroll.

In calculating the credit, the zone payroll, which consists of the wages and salaries paid to employees, must be adjusted to exclude the compensation paid to any employee that exceeds \$100,000. The \$30,000 and \$100,000 figures initially used in 2004 are adjusted for inflation each year and were \$32,880 and \$109,600 respectively for 2007.

The term “base year” is defined by law as the taxable year beginning during the calendar year prior to the year in which the zone designation took effect.³⁴ Since the zone designations became effective on January 1, 2004, the Department of Revenue has used 2003 as the base year.

³² As with the rental income exemption, C corporations are not eligible for a capital gains exemption.

³³ *Minnesota Statutes* 2007, 469.318.

³⁴ *Minnesota Statutes* 2007, 469.318, subd. 2b.

Wind Energy Production Tax

Finally, any wind energy conversion systems in a zone are exempt from the wind energy production tax. This tax break is not being used by the vast majority of JOBZ businesses.

Duration

Most JOBZ tax breaks end on December 31, 2015.

For nearly all businesses participating in the JOBZ program, the tax breaks last through the end of December 2015.³⁵ Since property tax payments are based on assessments for the previous year, JOBZ businesses will continue to receive property tax exemptions on the property tax bills they receive for 2016.³⁶

A statutory exception to this general rule was made for certain ethanol plants during the 2006 legislative session. For these plants only, the duration of the JOBZ tax breaks was extended through the end of December 2018, or an additional three years, provided that the business subsidy agreement was executed after April 30, 2006.³⁷

For most JOBZ businesses, the duration of the zones and their accompanying tax breaks is no more than 12 years.³⁸ However, the duration of the benefits is declining each year for businesses entering the program. For example, businesses entering the program in 2008—with the exception of ethanol plants—will have no more than eight years of eligibility. As a result, the value of the program to businesses considering an expansion or relocation, and thus to cities as an economic development tool, is declining over time. Some local economic development directors told us that JOBZ may be surpassed by tax increment financing as a more useful tool in attracting business development.

Size and Source

JOBZ provides substantial tax reductions for participating businesses. Table 1.1 shows the estimated reductions for two fictional JOBZ businesses. In the first example, a business in the service industry started with 25 employees in a zone and expected to increase employment by 15 percent annually. The company initially paid its zone employees an average annual wage of \$29,000. The business built a \$1.5 million facility in the zone, had Minnesota taxable income of \$500,000 in 2005, and had 40 percent of its operations in the zone. DEED projected that JOBZ would save this business more than \$2.1 million in state and local taxes over a 12-year period or about \$178,600 annually. The annual

³⁵ *Minnesota Statutes* 2007, 469.312, subd. 5a.

³⁶ *Minnesota Statutes* 2007, 272.02, subd. 64d. The property tax bills received by JOBZ businesses in 2016 will be based on the assessed market value of their property in 2015, which will still exclude the market value of improvements in their zone locations.

³⁷ *Minnesota Statutes* 2007, 469.312, subd. 5b.

³⁸ A business that executed a business subsidy agreement for an ethanol plant in 2006 could be eligible for certain tax breaks for as many as 13 years.

savings to the company amount to more than \$3,500 per worker over the full period. Assuming a discount rate of 5 percent, the present value of the 12-year stream of tax reductions is about \$1.6 million. On a per worker basis, the present value of the savings is about \$30,600.

Table 1.1: Estimated Tax Reductions for Two Fictional JOBZ Firms

Service Company		Manufacturing Company	
Type of Tax	Average Annual Reductions ^a	Type of Tax	Average Annual Reductions ^a
Corporate Income Tax	\$ 39,800	Corporate Income Tax	\$232,000
Sales and Use Tax	80,600	Sales and Use Tax	53,600
Property Tax	41,000	Property Tax	223,200
Jobs Credit	17,200	Jobs Credit	181,700
Total Reductions per Year	\$178,600	Total Reductions per Year	\$690,600
Total Reductions over 12 years	\$2,143,200	Total Reductions over 12 years	\$8,287,200
Reductions per worker per year ^b	\$3,500	Reductions per worker per year ^b	\$6,500
Present value of total reductions ^c	\$1,554,000	Present value of total reductions ^c	\$6,159,000
Present value per worker ^b	\$30,600	Present value per worker ^b	\$57,700
Assumptions for Service Company		Assumptions for Manufacturing Company	
<ul style="list-style-type: none"> • 40 percent of operations in zone • Property valued at \$1.5 million in 2004 and increasing 1 percent annually • Minnesota taxable income of \$0.5 million in 2005, increasing 15 percent annually • 25 full-time jobs in the zone in 2005, increasing 15 percent annually • Average wage of \$29,000, growing 5 percent annually • Construction purchases of \$1.5 million in 2004 • Ongoing purchases of taxable goods and services of \$1 million in 2005, increasing 5 percent annually 		<ul style="list-style-type: none"> • 20 percent of operations in zone • Property valued at \$8 million in 2004 and increasing 1 percent annually • Minnesota taxable income of \$10 million in 2005, increasing 5 percent annually • 100 full-time jobs in the zone in 2005, increasing 3 percent annually • Average wage of \$50,000, growing 3 percent annually • Construction purchases of \$10 million in 2004 • Ongoing purchases of taxable goods and services of \$0.4 million in 2005, increasing 4 percent annually 	

^a The tax reductions are rounded to the nearest \$100.

^b We used the average number of workers over the life of the JOBZ zone term to calculate the reductions per worker per year and the present value of reductions per worker.

^c The present value of the 12-year stream of tax reductions was calculated using a discount rate of 5 percent per year.

SOURCE: Office of the Legislative Auditor, analysis of Department of Employment and Economic Development brochure.

The amount of tax reductions received by a JOBZ business depends on a number of factors.

In the second example, a manufacturing business spent \$10 million on a facility in a zone, employed 100 employees in the zone initially, and paid an average annual wage of \$50,000 in the zone. The company expected to increase employment by 3 percent annually. The business also had Minnesota taxable income of \$10 million in 2005, and had 20 percent of its operations in the zone. DEED projected that JOBZ would save this business a total of nearly \$8.3 million in state and local taxes over a 12-year period or about \$690,600 annually. The annual savings to the company amount to more than \$6,500 per worker over the full period. Assuming a discount rate of 5 percent, the present value of the 12-year stream of benefits is about \$6.2 million. On a per worker basis, the present value of the savings is about \$57,700.

While these examples are illustrative of the possible tax savings for JOBZ businesses, the reductions vary significantly for individual businesses. The size of the tax reduction will depend on a number of factors including: (1) the amount of construction materials and supplies purchased or used in Minnesota; (2) the annual amount of other purchases usually subject to Minnesota sales taxes; (3) the net taxable Minnesota income of the business; (4) the share of its Minnesota payroll and property located in the zone; (5) the value of zone property usually subject to property taxes; (6) local property tax rates; (7) the average wages paid to zone employees; and (8) the growth in zone payroll relative to the payroll of relocated operations prior to location in the zone.

In the remainder of this section, we examine the available information on the aggregate size of the tax reductions available to JOBZ businesses. We also discuss the average reduction per JOBZ business and the variation in reductions by business. Because state law classifies state tax return information as nonpublic data, we are not able to provide information on individual businesses. Data on property taxes are public, but information on taxes by parcel is maintained by counties and is not available in one database. As a result, the information provided on property tax reductions is also limited to aggregate data.

Aggregate JOBZ Tax Reductions in Minnesota

The Department of Revenue has estimated that tax reductions for JOBZ businesses totaled close to \$46 million during the first three years of the JOBZ program. As Table 1.2 indicates, sales tax reductions for construction materials and supplies were the largest source of reductions during each of these years. This occurred because construction is usually the first step for an expanding JOBZ business. The potential for income tax reductions or sales tax reductions on ongoing purchases of goods and services does not begin until after the completion of construction and the start of operations. Furthermore, property tax exemptions are delayed until 6 to 18 months after a business begins operations in a zone.

Table 1.2: Tax Reductions for JOBZ Businesses by Type of Tax, 2004-07

Tax	2004		2005		2006		2007
	Amount (in millions)	Percent	Amount (in millions)	Percent	Amount (in millions)	Percent	Amount (in millions)
Sales Tax on Construction Materials	\$4.6	72%	\$ 5.5	42%	\$ 9.7	37%	NA
Sales Tax on Ongoing Purchases	0.9	14	3.7	28	5.7	22	NA
Income/Corporate Franchise Taxes	0.8	13	1.5	11	6.1	23	NA
Jobs Credit	0.1	2	1.5	11	1.5	6	NA
Property Tax	0.0	0	1.1	8	3.1	12	\$5.8
Totals	\$6.4	100%	\$13.2	100%	\$26.1	100%	NA

NOTE: Sales tax reductions on ongoing purchases include reductions on purchases of goods and taxable services, as well as motor vehicles.

SOURCE: Department of Revenue.

During the first three years of the JOBZ program, businesses have received about \$46 million in tax reductions.

As more businesses finished construction and began operations, the percentage of tax reductions from sales tax savings on construction materials declined between 2004 and 2006. Sales tax reductions for construction materials decreased from 72 to 37 percent of total tax reductions. In contrast, the share of tax reductions from sales tax exemptions for ongoing purchases of goods and services increased from 14 to 22 percent. Similarly, the share from tax reductions on business income increased from 13 to 23 percent. Property tax reductions, which were not possible in 2004, were about 12 percent of the total reductions in 2006.

It is somewhat difficult to predict how aggregate tax reductions will change in future years. However, some growth in the total reductions is likely to continue for several years beyond 2006, despite the likely decline in sales tax reductions for construction materials. There are several reasons for this expected growth. First, additional businesses entered the JOBZ program in 2006 and 2007, although not at the same rate as in the first two years of the program. These businesses will likely benefit from construction tax reductions in 2007 and 2008. Second, other types of tax reductions grew significantly between 2004 and 2006. In particular, reductions in sales taxes on ongoing purchases of goods and services, income and corporate franchise taxes, and the jobs credit grew significantly. Absent a significant economic downturn affecting JOBZ businesses, continued growth in these types of reductions is likely. That growth will be fueled by increased activity at JOBZ businesses that began operating in 2004 through 2006, as well as new activity at the businesses that signed business subsidy agreements in 2006 and 2007 once they begin operating.

Finally, property tax reductions are growing significantly. As Table 1.3 shows, property tax reductions for JOBZ businesses grew from \$1.1 million in 2005 to \$3.1 million in 2006 and \$5.8 million in 2007. Final figures for 2008 are not yet available. Based on the growth in market value exemptions for JOBZ, we would

Table 1.3: JOBZ Market Value and Property Tax Reductions, 2005-08

Taxes Payable Year	JOBZ Market Value (in millions)	Reductions from State Property Tax Levy (in millions)	Reductions from Local Levies (in millions)	Total Property Tax Reductions for JOBZ Businesses (in millions)
2005	\$32.7	\$0.3	\$0.7	\$1.1
2006	104.2	1.0	2.1	3.1
2007	200.8	1.9	3.9	5.8
2008	299.4	NA	NA	NA

NOTE: Unlike other JOBZ tax exemptions, property tax exemptions do not reduce tax revenues. Instead they cause levy amounts to be shifted to other types of property.

SOURCE: Department of Revenue.

expect 2008 property tax reductions to be at least in the \$8.5 million to \$9.0 million range.

Beyond 2008 or 2009, it is more difficult to forecast the trend in aggregate tax reductions. The trend will depend in part on the number of new firms entering the program. Given the current program restrictions that end tax breaks after December 31, 2015, the number of new entrants is likely to continue the decline that started in the second year of the program. In addition, aggregate tax reductions in the future will depend on the economic viability of JOBZ businesses. If they prosper, tax reductions may continue to grow. If their sales and employment fall or they close operations, tax reductions would decrease as income, purchases, and jobs decline and as some companies lose their eligibility for the program.

Tax Reductions per JOBZ Business

The average tax reduction per business has been about \$75,000 per year.

Based on the first two years of the program, the Department of Revenue estimated the average annual tax reduction to be about \$50,000 per business, excluding property tax reductions. However, due to the substantial growth in tax reductions during 2006, DOR staff now estimate that the annual tax reduction per business was close to \$70,000 during the first three years of the program. If property tax reductions are also included, the average annual tax reduction per business was about \$75,000 during the 2004-06 period.

The future trend in average tax reduction beyond 2006 is somewhat unclear. On the one hand, we would expect a significant decline in the sales tax reductions on construction materials at some point. On the other hand, strong growth occurred in property tax reductions in 2007 and is expected for 2008. Average tax reductions will continue to increase if the growth in property tax breaks and other tax breaks unrelated to sales taxes exceeds the likely decline in sales tax reductions on construction materials and supplies.

Unless there is a significant economic downturn, we think the average annual tax reduction per JOBZ business is unlikely to fall below the \$75,000 figure. We estimated that the average annual property tax reduction per business was between \$27,000 and \$30,000 in 2006 and 2007 for those businesses actually receiving a property tax exemption.³⁹ In addition, the average tax reduction from income taxes, sales taxes on ongoing business purchases, and the jobs credit was about \$45,000 per business in 2006. Even without sales tax savings from construction purchases, the average annual reduction per business is likely to be close to \$75,000.

An annual average of \$75,000 per JOBZ business means that the total tax reductions over the entire term of the JOBZ zone would be about \$900,000 per business for those businesses that signed a business subsidy agreement in 2004. Using the same annual average, the total amount of tax reductions for a business signing a JOBZ agreement in 2008 would average about \$600,000. The reductions are less because there are fewer years left in the life of the zones.

These averages mask considerable variation in the amount of subsidies received by various businesses. Available data for 2005 indicate that many businesses had relatively minor tax reductions while a small percentage of businesses had very large tax reductions. Table 1.4 shows that 4 percent of the JOBZ businesses reporting their tax reductions to DOR accounted for 49 percent of the total reported reductions. Conversely, about 44 percent of the JOBZ businesses accounted for less than 2 percent of the total reported reductions.

The size of tax reductions varies significantly across JOBZ businesses.

It would be inappropriate to assume, however, that the reductions reported for 2005 are representative of the reductions for a particular business over the full JOBZ term. There is reason to believe that the total reductions per business over the life of the JOBZ zone will vary significantly across businesses. But it is likely that some of the businesses that reported little or no tax reduction in 2005 will have much greater reductions in future years. Some of the businesses reporting little or no tax reduction in 2005 may have signed business subsidy agreements in late 2005, may not have begun construction on new facilities, or may not have occupied rented facilities. In addition, the figures presented in Table 1.4 do not include property tax reductions.

³⁹ As noted earlier, there is no statewide database on parcels of property subject to property taxes. We used the known total property tax savings for 2005, 2006, and 2007 and estimated the number of JOBZ businesses receiving a property tax exemption for those years to obtain an estimate of the reduction per business receiving the exemption. To estimate the number of businesses receiving an exemption, we examined other data such as the date of the business subsidy agreement and the benefit date or operations start date. Supporting evidence for our estimates can be obtained by dividing the total estimated property tax reductions for 2008 by the total number of active JOBZ businesses at the end of 2007. The figure obtained using that method is \$27,200.

Table 1.4: Size of Tax Reductions Received by JOBZ Businesses, 2005

Tax Reductions	Percentage of JOBZ Businesses	Percentage of Total Tax Reductions
\$0	18%	0%
\$1 to \$10,000	27	2
\$10,001 to \$25,000	16	4
\$25,001 to \$50,000	16	9
\$50,001 to \$100,000	8	9
\$100,001 to \$250,000	11	28
Over \$250,000	<u>4</u>	<u>49</u>
Totals	100%	100%

NOTE: The tax reductions in this table exclude any property tax reductions.

SOURCE: Office of the Legislative Auditor, analysis of Department of Revenue data.

State and Local Shares of Tax Reductions

About 93 percent of tax breaks have been from state taxes.

Most of the tax reductions offered by the JOBZ program come from state government sources. They include state sales taxes, income taxes, corporate franchise taxes, jobs credits, and the state general property tax levy. Local sources include local sales taxes and the majority of property tax levies.⁴⁰ Over the first three years of the program, about 93 percent of JOBZ tax reductions were from state sources, while 7 percent came from local sources. The local share has grown from 1 percent in 2004 to 9 percent in 2006.

The tax reductions from local sources were small during the first several years of the program for a number of reasons. Property tax reductions were not possible in 2004 and were relatively limited in 2005 due to the time it takes before an exemption becomes effective. Although the local share of property tax reductions was 67 percent during the first three years of the program, local property tax reductions were only about 6 percent of the total tax reductions. In addition, reductions from local sales taxes are small because most cities in which JOBZ businesses are located do not have a local sales tax. Furthermore, the local sales tax rate is considerably smaller (usually 0.5 percent) than the state sales tax rate (6.5 percent). Overall, local sales tax reductions accounted for about 1 percent of all tax reductions during the first two years of the JOBZ program.

We expect the local share of JOBZ tax breaks to increase in the future as property tax reductions grow. Although it is unclear how much growth one should expect in the local share, we do not expect the overall local share to grow to more than about one-third of the overall tax reductions in any given year.

⁴⁰ The property tax reductions received by JOBZ businesses do not reduce the amount of taxes collected by the state and the various political subdivisions levying property taxes. Instead, other taxpayers pay an increased share of the property tax levies.

To continue receiving tax reductions, a JOBZ business must continue to meet the requirements in its business subsidy agreement.

Even if property tax reductions accounted for half of the reductions in a future year, the overall local share of tax reductions would probably only be about one-third of all tax reductions since about one-third of the property tax payments are due to the state general levy.

COMPLIANCE MONITORING

To continue receiving JOBZ tax incentives, a participating business must continue to operate in its zone location and fulfill the employment and capital investment requirements specified in its business subsidy agreement and, if applicable, its relocation agreement. Usually, an agreement gives a business a deadline by which it must make any capital investments and start meeting the job and wage requirements. In some cases, this deadline is a specific date; in others, the business is allowed a certain time period after the start of operations in the zone to meet the requirements. At a minimum, the state's business subsidy statute requires that all agreements include wage and job goals to be met within two years of the start of operations.⁴¹

Ongoing compliance monitoring may be conducted by the local government that signed the business subsidy agreement with a JOBZ business. Local officials are in a better position than state agencies to know whether a JOBZ business has ceased operating in a zone location or has significantly cut its workforce.

However, even if a local government does not monitor compliance on an ongoing basis, monitoring is required by the state's business subsidy law once each year.⁴² Under that law, each JOBZ business must report to the appropriate local government by March 1 of each year on its progress in meeting its contractual obligations for the previous year. The local government, in turn, must report to DEED on the progress of the JOBZ business by April 1. The report must provide the information outlined in the business subsidy law.⁴³ These reports are provided on a form prepared by DEED and called the Minnesota Business Assistance Form (MBAF).

Under the JOBZ laws, the commissioner of DEED has the authority to change the required time or times by which reports must be filed, as well as the information required to be provided in the reports.⁴⁴ Using that authority, the commissioner has required all JOBZ businesses (and their local government partners) to file annually and has modified the report content slightly.⁴⁵

A JOBZ business that is not meeting, or is not expected to meet, its employment, wage, or capital investment obligations may request an extension. Under state

⁴¹ *Minnesota Statutes* 2007, 116J.995, subd. 4.

⁴² *Minnesota Statutes* 2007, 116J.994, subd. 7 and 8.

⁴³ *Minnesota Statutes* 2007, 116J.994, subd. 7.

⁴⁴ *Minnesota Statutes* 2007, 469.320, subd. 1 and 2.

⁴⁵ The commissioner has not modified the timing of the progress reports from that required by the business subsidy law.

A noncompliant business may be removed from the program and required to repay some previously received tax reductions.

law, the commissioner of DEED may grant an extension of up to one year for such businesses.⁴⁶

If a JOBZ business ceases operations in the zone or fails to meet the requirements in its business subsidy agreement, then the business is no longer eligible for the program.⁴⁷ DEED has removed businesses from the program following its review of the annual progress reports. Other businesses have been removed when their noncompliance was reported through correspondence or phone calls by local governments to DEED.

When a business ceases to operate in a zone or fails to meet the requirements of its business subsidy agreement, the business must repay the tax benefits it received in the two years prior to the date it became noncompliant.⁴⁸ These repayments or “clawbacks,” as they are often called, may be waived in whole, or in part, by the commissioner of Revenue. In considering waiver requests, the commissioner must consider whether requiring repayment is in the best interest of the state or local government units and whether the business ceased operating for reasons beyond its control such as a natural disaster, unforeseen industry trends, or the loss of a major supplier or customer.⁴⁹

PROGRAM OPERATION AND ADMINISTRATION

The operation and administration of the JOBZ program is a shared responsibility among two state agencies, local government officials, county tax officials, and others. Table 1.5 lists the responsibilities of the various agencies and entities that play a role in the JOBZ program.

Local Governments

The effectiveness of the JOBZ program is highly dependent on local governments. A business cannot enter the JOBZ program without signing a business subsidy agreement with a local government. A business subsidy agreement is the main legal document governing the terms of participation in the program and includes the employment, wage, and capital investment obligations that the business must meet to continue receiving JOBZ tax subsidies. Because there are relatively few state requirements for participation, local governments play the key role in determining whether it is in the public’s best interest for a particular business to participate in the JOBZ program.

⁴⁶ [Minnesota Statutes](#) 2007, 469.319, subd. 1.

⁴⁷ *Ibid.*

⁴⁸ *Ibid.*

⁴⁹ [Minnesota Statutes](#) 2007, 469.319, subd. 5.

Table 1.5: JOBZ Administrative Responsibilities

Local governments	<ul style="list-style-type: none"> • Market program to businesses in conjunction with DEED • Negotiate and sign business subsidy agreements with businesses • Monitor business performance in meeting JOBZ requirements • Receive and review annual progress reports from businesses • File annual business progress reports with DEED
DEED	<ul style="list-style-type: none"> • Determines location of JOBZ zones and subzones; approves requested modifications • Markets program to businesses in conjunction with local governments • Negotiates and signs relocation agreements for businesses relocating any existing Minnesota operations to a JOBZ zone; approves waivers of statutory relocation requirements as appropriate • Receives and reviews annual reports from local governments on the progress of businesses in meeting the employment, wage, and capital investment requirements in their business subsidy agreements • Approves one-year extensions of time for businesses to meet JOBZ requirements as appropriate • Removes businesses from program for noncompliance with business subsidy or relocation agreements • Provides technical assistance to local governments and businesses • Promotes use of the JOBZ program • Provides policymakers and legislators with information on program performance
DOR	<ul style="list-style-type: none"> • Prepares new state tax forms and schedules reflecting JOBZ laws • Receives tax returns claiming JOBZ benefits • Audits individual and business tax returns^a • Pursues repayment of tax subsidies (except property tax) when businesses cease operating in a zone or are removed from the JOBZ program for noncompliance • Waives all or part of the required repayments of tax subsidies as appropriate • Estimates the amount of statewide JOBZ tax savings for businesses • Provides technical assistance to DEED, local governments, county tax officials, and businesses
County tax officials	<ul style="list-style-type: none"> • Determine the estimated market value of a property and the portion that receives a JOBZ tax exemption • Calculate property taxes for all taxpayers including JOBZ businesses • Pursue repayment of property tax subsidies when businesses cease operating in a zone or are removed from the JOBZ program for noncompliance

^a DOR does not specifically target JOBZ businesses for reviews or audits; they are as likely as any other businesses to receive additional scrutiny.

Because of their role in negotiating and approving business subsidy agreements, local governments are the key points of contact for interested businesses. Some local governments market the program to potential businesses either themselves or cooperatively with other local governments. Others rely on DEED's efforts or "word of mouth" to attract business interest in their city or township.

As discussed in the previous section, local government officials also monitor the progress of JOBZ businesses in meeting the employment, wage, and capital investment requirements in their business subsidy agreements. Under state law, a local government must report to DEED on the annual progress of each JOBZ business with which it has a business subsidy agreement.⁵⁰

In some parts of the state, local governments use local or regional economic development agencies or larger local government units to assist them in operating and administering the JOBZ program. The economic development agencies may be responsible for marketing JOBZ to potential businesses, evaluating business applications for JOBZ, negotiating business subsidy agreements, and monitoring the progress of participants.⁵¹ Even when much of the administration is performed by an outside party, the local government governing body must approve all business subsidy agreements.

Department of Employment and Economic Development

The Department of Employment and Economic Development plays a number of roles in the operation and administration of the JOBZ program. In part, DEED is a regulator by enforcing certain statutory requirements. The agency also provides technical assistance to local governments and businesses. In addition, DEED is a promoter for the program and markets its availability to businesses. Finally, DEED provides information to policymakers and the public on the impact of JOBZ.

Regulation

As a regulator, DEED has broad authority to implement policies and regulations for the program without following the statutory requirements for state agency rulemaking. However, DEED has not exercised that authority in any significant manner, such as specifying what businesses may participate in the program or requiring local governments to conduct rigorous analyses of potential business deals. Instead, DEED has limited its role to those functions specifically outlined in law.

For example, DEED must enter a relocation agreement with any business that relocates any existing Minnesota operations into a JOBZ location. The purpose

DEED has not played a significant role in regulating business entry into the program.

⁵⁰ *Minnesota Statutes* 2007, 116J.994, subd. 8.

⁵¹ Technically speaking, these functions are performed by a subzone administrator, which may be an elected official of the local government, an employee of the local government, or an employee of an unaffiliated economic development agency or another local government.

DEED promotes the JOBZ program, provides technical assistance, and monitors business compliance.

of the relocation agreement is to ensure the business's commitment to meeting the statutory employment requirements for relocations within Minnesota. The commissioner of DEED also has the authority to waive the statutory requirements for relocating businesses. DEED does not review and approve business subsidy agreements but may occasionally flag an agreement if the business is not eligible for JOBZ under state law.

DEED also reviews the progress reports submitted by local governments and determines whether businesses are complying with their business subsidy agreements. DEED provides the forms that businesses and local jurisdictions use for annual reporting and receives and publishes these reports on its web site. If a report indicates that a firm is not meeting its obligations, DEED staff contact local officials for confirmation and, if necessary, remove the business from the program. Upon request, the commissioner of DEED may extend, for up to one year, the time a business has to meet its obligations under its business subsidy agreement or relocation agreement.

Technical Assistance

DEED also provides technical assistance to local governments and businesses. For local governments, DEED provides sample business subsidy policies, sample business subsidy agreements, tools to calculate the value of JOBZ to the local community, statutory interpretations, and general assistance. For businesses, DEED provides information on the JOBZ program, answers questions, and provides a tax subsidy calculator that estimates the tax savings for a business.

Promotion

Finally, DEED promotes the JOBZ program to businesses, policymakers, and the public. DEED does some limited marketing of the program to businesses that are potential users of the program. The agency has also put together media events and prepared promotional literature that highlight some of the most successful JOBZ businesses.

Public Information

In addition, the agency provides information on the program's impact and effectiveness to legislators and the public. DEED prepares annual reports on the program's employment and wage impact. In addition, the agency surveys businesses and asks them about the impact of JOBZ on their business location and expansion decisions. The surveys also attempt to measure the satisfaction of JOBZ businesses with the program and its administration.

Department of Revenue

The Department of Revenue is responsible for administering the state tax system. As the state tax administrator, DOR has revised existing tax forms to reflect the JOBZ exemptions and credits enacted into law and developed new forms or schedules specific to JOBZ. DOR is also responsible for reviewing and auditing state tax returns for accuracy. Those efforts may include JOBZ exemptions and

The Department of Revenue is responsible for pursuing any required repayments of state tax breaks.

credits, although these JOBZ items are only a few of the many items that DOR may examine or audit.

DOR also has some specific JOBZ functions. DOR is responsible for pursuing repayment of tax benefits (with the exception of property taxes) from businesses that cease operating in a zone or are terminated from the program for noncompliance by DEED. The commissioner of Revenue has the power to waive some or all of the repayment if the commissioner determines that such an action would be in the best interests of the state.

There are also several other JOBZ activities carried out by DOR. For research and policy purposes, DOR estimates the amount of tax savings received by JOBZ businesses. DOR provides technical assistance to local tax officials, DEED, local governments, and businesses with questions about the program. In addition, DOR has provided information about the property tax aspects of the JOBZ program in its manual for county auditors and treasurers.

Counties

County tax officials also play a role in administering the JOBZ program. They assess the value of all taxable property and determine tax rates and tax bills based on the levies set by local taxing jurisdictions. For parcels occupied by JOBZ businesses, they determine the amount of tax exempt market value and calculate the taxes owed on those parcels. In addition, county officials are responsible for pursuing any repayments of property taxes due when a business ceases operating in a zone or is removed from the JOBZ program.

PROGRAM ACTIVITY

Through the end of 2007, local governments had signed more than 350 JOBZ subsidy agreements.

Over 350 cities and townships in Minnesota have acreage in one of Minnesota's JOBZ zones. Over 29,300 acres have been designated for use in the JOBZ program. As of the end of 2007, 152 cities and townships had a JOBZ business with an active business subsidy agreement located within their jurisdictions.

Since the program began in January 2004, cities and townships have entered into about 352 business subsidy agreements. As Table 1.6 indicates, 319 agreements are still in effect. Twenty-one projects were never completed and are considered inactive. In addition, DEED has terminated 12 JOBZ businesses from the program for failing to comply with the requirements of their business subsidy agreements. In most cases of noncompliance, the business did not hire the required number of employees in the necessary time frame. Thus far, the commissioner of Revenue has waived repayment requirements for two

More than 10 percent of the agreements signed in 2004 or 2005 are no longer in effect.

Table 1.6: Number of JOBZ Business Subsidy Agreements and Their Status by Year, 2004-07

Year	Total Number of Agreements ^a	Inactive Agreements ^b	Noncompliant Agreements ^c	Active Agreements	Percentage of Inactive or Noncompliant Agreements
2004	134	8	7	119	11%
2005	106	11	4	91	14
2006	71	2	1	68	4
2007	41	0	0	41	0
Total	352	21	12	319	9% ^d

^a The final number of JOBZ agreements for 2007 may exceed the number listed in this table. The above number is based in part on the list of active deals on DEED's web site as of December 21, 2007. There is a lag between the time a local government completes a deal and the time it appears on the web site. As a result, there may be some agreements for the last several months of 2007 that have not yet been reported to DEED.

^b One business had both an inactive agreement in one city and an active agreement in another. After signing an agreement in one city, the business changed its plans and decided to locate in another Minnesota city using JOBZ.

^c One business had both a noncompliant agreement in one city and an active agreement in another. The company moved in order to obtain additional and less costly space.

^d This percentage reflects actions taken by DEED as of December 21, 2007. However, DEED has not yet begun to review the progress reports that cover 2006 employment and were due from local governments on April 1, 2007. As a result, there will likely be additional noncompliant or inactive projects beyond the number in this table as DEED begins to review the reports. We are also aware of additional businesses that are now noncompliant but were not required to meet employment goals until sometime in 2007. Their noncompliance may not be detected until some time after progress reports are filed in April 2008.

SOURCE: Office of the Legislative Auditor, analysis of data from the Department of Employment and Economic Development.

noncompliant businesses. Each of these businesses has continued to operate in Greater Minnesota and is requesting reinstatement to the JOBZ program.⁵²

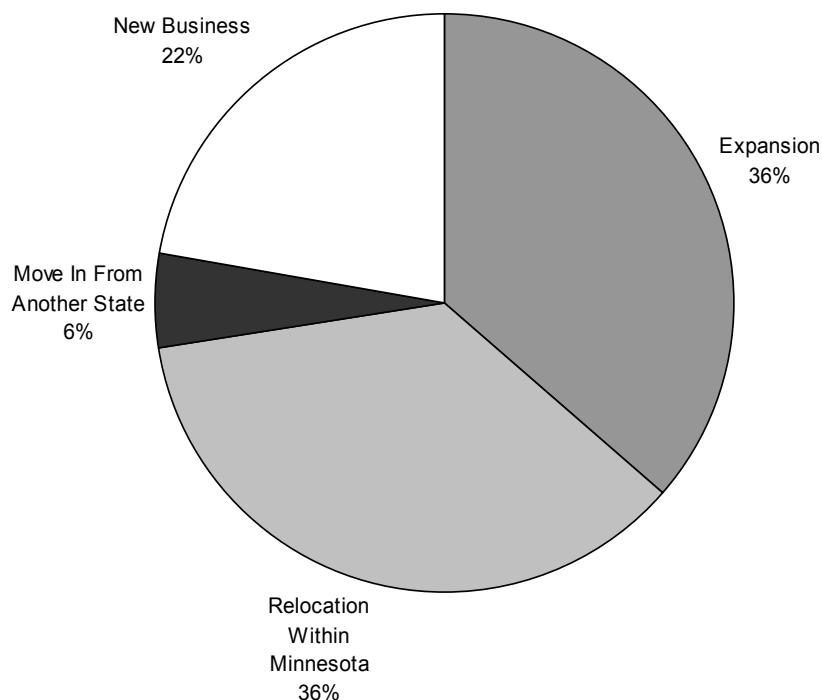
Most of the JOBZ businesses have been either expansions or relocations, while few have been existing businesses that moved in from out of state. As Figure 1.1 shows, 36 percent of the JOBZ businesses have been expansions, while 36 percent have been relocations from within Minnesota. The expansions include existing Minnesota businesses that have expanded at their existing sites, as well

⁵² Reinstatement to the JOBZ program is possible in these two cases since the commissioner of Revenue has waived repayment obligations. Without a waiver or an actual repayment of its obligations, *Minnesota Statutes* 2007, 116J.994, subd. 6, prevents a business from receiving additional business subsidies for five years after the date on which it first failed to meet the terms of its business subsidy agreement. In these two cases, DEED is considering the use of its authority under *Minnesota Statutes* 2007, 469.320, subd. 3, to shorten the duration of the applicable subzones. DEED management says the shortened duration would be commensurate with the extent to which actual job creation has fallen short of the requirements in the original business subsidy agreements.

as Minnesota and non-Minnesota businesses that have expanded their businesses with an additional site in a JOBZ zone. About 22 percent of the JOBZ businesses are considered new businesses that were formed by either Minnesota or non-Minnesota residents. Businesses moving into Minnesota from other states account for 6 percent of all JOBZ businesses.

Figure 1.1: Types of JOBZ Agreements, 2004-2007

Only a small share of the JOBZ businesses have moved into Minnesota from other states.



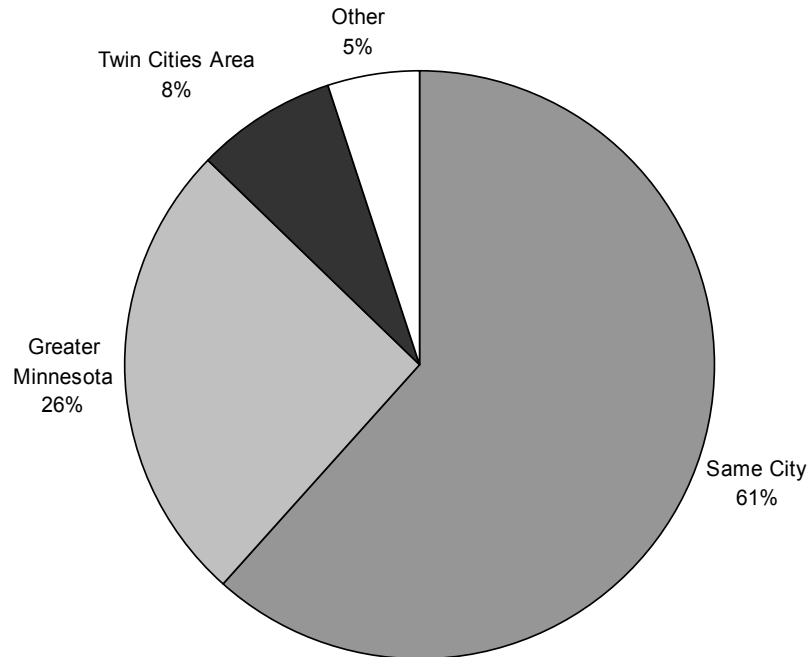
NOTE: Figure depicts 326 business subsidy agreements. Businesses dropped from Department of Employment and Economic Development's "List of Completed Deals" prior to May 2007 are excluded.

SOURCE: Office of the Legislative Auditor, analysis of information from the Department of Employment and Economic Development.

Most JOBZ businesses that relocated from one site in Minnesota to a Minnesota JOBZ zone did not move very far. As Figure 1.2 indicates, 61 percent of the relocations within Minnesota involved moving from one part of a city to another part of the same city. About one-fourth of the relocations were from another Greater Minnesota city, and 90 percent of these were from a city or township close to the city or township to which the business relocated.⁵³ Only 8 percent of the relocations were from the Twin Cities metropolitan area. About 5 percent were from a combination of different sites with about half moving from both Minnesota and non-Minnesota sites.

⁵³ We defined a "close" or "nearby" city as one within 50 miles of the city in which the JOBZ business was located. Most of these moves were from much closer than 50 miles.

Figure 1.2: Previous Location of JOBZ Businesses that Relocated Within Minnesota, 2004-2007



Most JOBZ businesses that relocated within Minnesota did not move very far.

NOTE: Figure depicts 117 business subsidy agreements. Businesses dropped from Department of Employment and Economic Development's "List of Completed Deals" prior to May 2007 are excluded.

SOURCE: Office of the Legislative Auditor, analysis of information from the Department of Employment and Economic Development.

According to DEED, JOBZ businesses had created 3,669 full-time equivalent jobs and helped retain more than 2,000 existing jobs by the end of 2005. Progress reports submitted to DEED by local governments indicate that, by the end of 2006, these figures had grown to 5,459 new jobs and 4,507 retained jobs. The average hourly wage level was \$14.78 for new jobs and \$14.95 for retained jobs, while the average hourly benefits were \$2.52 and \$2.99, respectively. In addition, the progress reports indicate that JOBZ businesses had made a capital investment in JOBZ zones across Greater Minnesota of \$1.3 billion. Slightly less than half of that investment came from investments in land and buildings, and slightly more than half came from equipment.⁵⁴

⁵⁴ These job and investment numbers should be viewed with caution. We point out in Chapters 3 and 4 that the numbers likely overstate the economic impact of JOBZ on Greater Minnesota.

Zone Selection

SUMMARY

Although state law required the Department of Employment and Economic Development (DEED) to consider economic distress when designating zones, the JOBZ program has not been targeted to economically disadvantaged parts of Greater Minnesota. DEED was able to include more than 350 cities and townships in the program because state law permitted each of the ten zones allowed to include an unlimited number of noncontiguous subzones. In addition, DEED and local governments worked to consolidate all of the subzone requests into just ten applications. Some more economically disadvantaged regions of the state have not benefited as much from JOBZ as other parts of Greater Minnesota.

Some critics of JOBZ have argued that the program has not targeted its efforts to the parts of Greater Minnesota most in need of an economic development boost. They say that, in designating JOBZ zones, the Department of Employment and Economic Development was supposed to target rural areas with the greatest level of economic distress. Even some legislators who supported the program in 2003 have expressed concern that JOBZ has not benefited the areas most in need of employment growth. Some have suggested that relatively prosperous cities in Greater Minnesota, such as Rochester and St. Cloud, should not have been included in the JOBZ program.

This chapter examines the legislation passed in 2003 and the processes used by DEED to designate and modify zones. We also compare the location of jobs at JOBZ businesses with incidence of economic distress across Greater Minnesota. In particular, we address the following questions:

- **What requirements did state law place on the zone selection process? To what extent did state law require DEED to designate JOBZ zones based on need or economic distress?**
- **What process and criteria did DEED use in establishing JOBZ zones? How has DEED modified the zones since their original establishment?**
- **In selecting and modifying zones, has DEED followed the requirements of state law?**
- **Have the jobs created by the JOBZ program been more likely to be located in relatively prosperous communities or in communities with higher levels of economic distress?**

The issues raised in this chapter will suggest a possible new direction for JOBZ. However, we will reserve any discussion of recommendations until Chapter 4.

BACKGROUND

In establishing enterprise zones that offer tax exemptions, many states have targeted the zones to areas of economic distress. The main reasons for targeting are generally ones of priorities and fairness. Those areas with the largest unemployment rates or lowest wages are most in need of economic help. In addition, it would be unfair to use economic incentives to benefit relatively prosperous communities without first assisting less prosperous ones.

The benefits of economic development incentives can be greater if they are targeted to areas with higher unemployment rates.

There are also some good economic reasons for targeting the use of economic development incentives to areas of greater economic distress. The economic and social benefits of incentives will be greater if they reduce unemployment rates, increase the wages of local residents, reduce the need for social services, and increase the utilization of underutilized public infrastructure.¹ While incentives may sometimes accomplish one or more of these results in a more prosperous community, they are more likely to produce these larger benefits in a less prosperous one. Timothy Bartik, an economist who maintains that economic development incentives can produce economic growth, cautions policymakers that the “social benefits of growth will be much reduced” if any of the following circumstances apply: (1) the incentives are used in a labor market with low unemployment rates; (2) the jobs created by the incentives are relatively low wage jobs; (3) there are few local workers available for the jobs and nonresidents get most of the jobs; and (4) the businesses require a significant investment in public infrastructure or cause significant environmental costs.²

STATUTORY REQUIREMENTS

The JOBZ legislation introduced in 2001, and again in 2003, recognized the desirability of targeting incentives to communities with greater levels of distress. The legislation allowed the commissioner of the Department of Employment and Economic Development to designate up to ten zones across Minnesota. Each zone could consist of no more than six noncontiguous subzones whose total acreage was 5,000 acres or less.³ The bills required DEED to consider various need and success criteria in determining where to designate the zones. The purpose of these criteria was to “yield the most economic development and revitalization of economically distressed rural areas of Minnesota.”⁴ The need criteria included measures of median household income, average weekly wages, median sales prices of houses, population loss, recent sudden or severe job loss

¹ Timothy J. Bartik, “Solving the Problems of Economic Development Incentives,” in Ann Markusen, ed., *Reining in the Competition for Capital* (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2007), 110-111. Alternatively, see Timothy J. Bartik, “Solving the Problems of Economic Development Incentives,” *Growth and Change* 36, no. 2 (Spring 2005): 145.

² Bartik, “Solving the Problems of Economic Development Incentives,” 111.

³ See Minnesota Legislature 2003, *House File 3*, as introduced, or *Senate File 496*, as introduced.

⁴ See Minnesota Legislature 2003, *House File 3*, as introduced, sec. 13, or [Minnesota Statutes](#) 2007, 469.314, subd. 1a.

State law allowed DEED to designate ten JOBZ zones, but each could have an unlimited number of subzones.

or closing of businesses, and other factors. The success criteria focused on factors such as the strength and viability of the development plan submitted by an applicant, the local public and private commitment to the development of the zones, and the extent to which development is directed at and is likely to produce high-paying jobs.

Prior to passing the JOBZ legislation, however, the 2003 Legislature modified the original bills in several important ways. For example, the original bills allowed residents of zones to receive income tax exemptions and applied to any business located in a zone. The final legislation did not apply to income earned by individuals unless it was business income of a JOBZ business or rental income from renting to a JOBZ business. In addition, the bills introduced in 2003 appeared to allow any businesses located in a zone to receive tax breaks. The final legislation indirectly required businesses to qualify by signing a business subsidy agreement.

The legislation enacted in 2003 maintained the language requiring DEED to consider need and success criteria in designating ten zones each of 5,000 acres or less. Table 2.1 lists the need and success criteria in state law. However, the enacted legislation allowed an unlimited number of noncontiguous subzones in each zone.⁵ This provision allowed DEED to include property from a large number of cities and townships in each zone as long as the total acreage in each zone did not exceed 5,000 acres.

The key DEED manager who worked on the JOBZ legislation and initially ran the program told us this change was made so that Minnesota could implement the program statewide at the outset rather than as a pilot project. He was referring to the tendency of some other states to implement a targeted program initially but to later weaken the targeting criteria and expand the program to more prosperous communities and regions.⁶ Others have suggested that DEED and others sought to weaken the targeting requirement in the JOBZ legislation in order to obtain sufficient legislative support for passage.

The legislation enacted in 2003 also allowed the commissioner of DEED to modify the boundaries of a zone and subzone if the commissioner determines that a zone or subzone is failing to meet its performance goals.⁷ State law does not prevent the commissioner from increasing the size of a zone initially established in 2004, provided that the total acreage in the zone does not exceed 5,000 acres.

⁵ *Minnesota Statutes* 2007, 469.312, subd. 2.

⁶ For information on states that have weakened the targeting criteria in their economic development programs, see Alyssa Talanker and Kate Davis, with Greg LeRoy, *Straying from Good Intentions: How States are Weakening Enterprise Zone and Tax Increment Financing Programs* (Washington, DC: Good Jobs First, August 2003).

⁷ *Minnesota Statutes* 2007, 469.320, subd. 3.

State law required DEED to consider various need and success criteria in designating the zones.

Table 2.1: Need and Success Criteria Required to be Considered in Designating JOBZ Zones

Need Criteria	Success Criteria
<ul style="list-style-type: none"> • The percentage of the population that is below 200 percent of the poverty rate, compared with the state as a whole • The extent to which the area's average weekly wage is significantly lower than the state's average weekly wage • The amount of property in or near the proposed zone that is deteriorated or underutilized • The extent to which the median sale price of housing units in the area is below the state median • The extent to which the median household income of the area is lower than the state median household income • The extent to which the area experienced a population loss during the 20-year period ending the year before the application is made • The extent to which an area has experienced sudden or severe job loss as a result of closing of private businesses or other employers • The extent to which property in the area would remain underdeveloped or nonperforming due to physical characteristics • The extent to which the area has substantial real property with adequate infrastructure and energy to support new or expanded development • The extent to which business startup or expansion rates are significantly lower than the respective rate for the state 	<ul style="list-style-type: none"> • The strength and viability of the proposed development goals, objectives, and strategies in the development plan • Whether the development plan is creative and innovative in comparison to other applications • Local public and private commitment to development of the proposed zone and the potential cooperation of surrounding communities • Existing resources available to the proposed zone • How the designation of the zone would relate to other economic and community development projects and to regional initiatives or programs • How the regulatory burden will be eased for businesses operating in the proposed zone • Proposals to establish and link job creation and job training • The extent to which the development is directed at encouraging, and that designation of the zone is likely to result in, the creation of high-paying jobs

SOURCE: [Minnesota Statutes](#) 2007, 469.314, subd. 2 and 3.

ZONE SELECTION AND MODIFICATION

Zone Selection

In establishing the initial zones, DEED took applications from interested parties. State law allowed one or more local government units, or a joint powers board, to apply for designation of an area as a zone.⁸ DEED encouraged cities and townships to cooperate and submit regional applications. DEED also hoped to limit the total applications to ten, which was also the maximum number of zones allowed. With only ten applications, DEED could approve all of them, and the program could be offered throughout most of Greater Minnesota.

Because all the requests for zone designation were consolidated into ten applications, need did not play a role in the designation of zones.

Ultimately, only ten applications were submitted to DEED. More than 350 cities and townships from 78 of the 80 eligible counties in Greater Minnesota were included in those ten applications.⁹ DEED used the required need and success criteria to rate the applications. However:

- **Economic distress, or need, was not a factor in the designation of zones because the number of applications did not exceed the maximum number of allowed zones.**

The ratings of the ten zones did not matter because DEED did not have to exclude any applicants from the program.

DEED did remove some land from the proposed zones and subzones. The agency generally removed land if it was primarily intended or zoned for retail uses. DEED also excluded property that lacked the necessary public infrastructure, such as roads and utilities, or required extensive pollution cleanup. DEED attempted to focus the program on land that was ready for development for commercial and industrial businesses.

The ten zones approved by DEED included a total of about 29,000 acres. DEED established over 1,150 separate subzones in more than 350 cities and townships. The vast majority (86 percent) of Greater Minnesota cities with a population over 2,000 have JOBZ acreage.¹⁰ Even the relatively prosperous cities of Rochester and St. Cloud were included in the program, although negotiations were necessary in order for St. Cloud to be included in a zone.

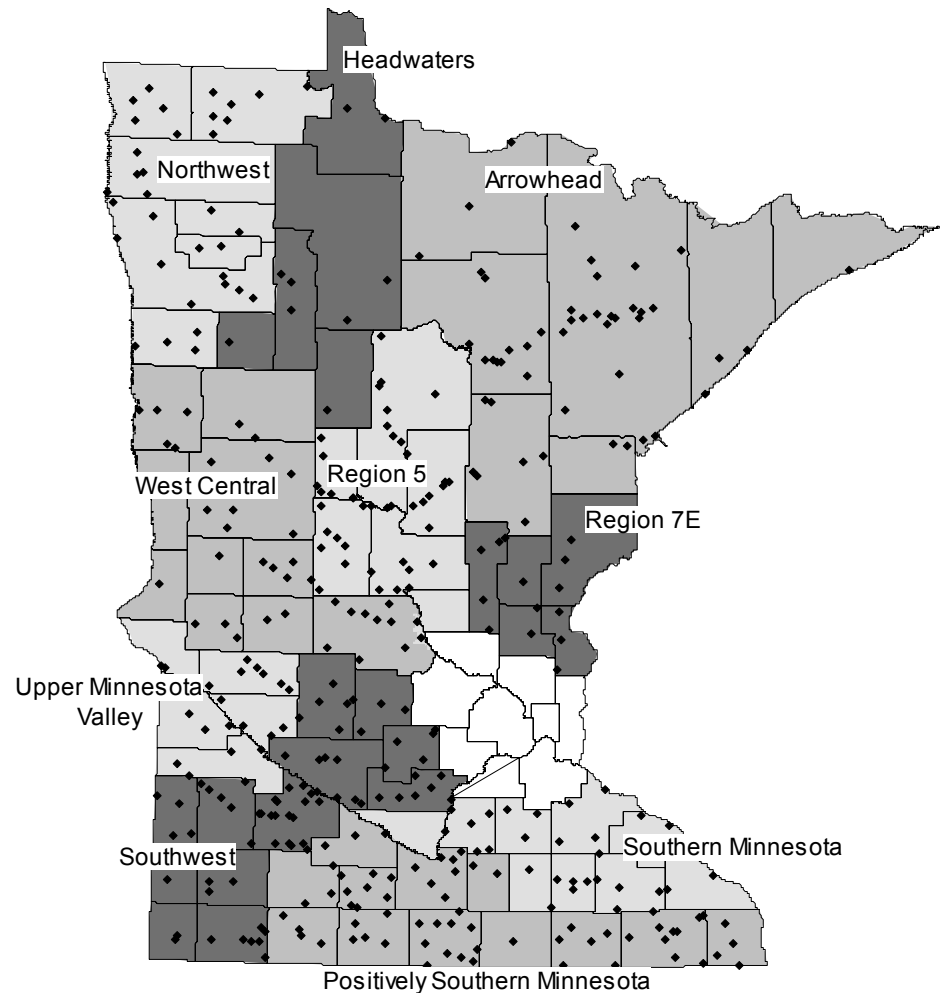
It is not possible to show the zone territories on a map in this report. The boundaries of each zone consist of many small noncontiguous subzones scattered throughout a region of the state. Often, one city contains many subzones. However, Figure 2.1 shows the regions which received a zone designation and the cities and townships with subzones in each region.

⁸ *Minnesota Statutes* 2007, 469.313, subd. 1.

⁹ Local governments in Sherburne and Wright counties did not apply for zone designation. DEED staff say that they discouraged participation by these two counties due to their strong growth and relatively low levels of economic distress.

¹⁰ This calculation excludes cities in Sherburne and Wright counties, which are not participating in the JOBZ program.

Figure 2.1: Cities and Townships with JOBZ Subzones by JOBZ Region



NOTE: Most of the cities and townships shown have multiple subzones within their boundaries. The seven metropolitan counties are excluded from JOBZ by law. No communities in Wright County or Sherburne County are participating in JOBZ. Sartell and St. Cloud are in Region 5, while the rest of Stearns County is in the West Central zone. Lake County and Koochiching County have subzones that are not in a city or township; these are not shown above.

SOURCE: Department of Employment and Economic Development.

Zone Modification

Since establishing the zones effective January 1, 2004, DEED has modified them numerous times in response to requests from local governments on behalf of interested businesses. Three types of modifications worth noting are:

- (1) exchanges of zone property for nonzone property within a community;
- (2) transfers of zone property from one JOBZ community to another JOBZ community in the region; and
- (3) transfers of zone property from a JOBZ

community to a community in the region that never had JOBZ acreage.¹¹ In the process of making changes, DEED has increased the overall zone acreage by a relatively small amount. Most of the changes have involved exchanges or transfers.

Most of the modifications occur in response to business requests. For example, a business may be interested in expanding on or moving to particular parcels of land that are not in a JOBZ zone. DEED prefers that the affected community request an exchange of some of its own zone property for the nonzone property if possible. In that case, the local government asks DEED to remove the JOBZ designation from property within its jurisdiction that is not currently being used by a JOBZ business and place the zone designation on the property where the business wants to expand or locate. If a local government does not have enough remaining JOBZ acreage to accommodate the needs of the business, DEED advises the local government to ask other communities in the region to transfer some of their unused JOBZ acreage for this purpose.

In a few cases, businesses have been interested in locating or expanding in a city or township that did not initially participate in the program. In those instances, DEED generally expects the affected local government to ask other communities in that region to donate unused JOBZ acreage for the project.

Overall, we conclude that:

- **DEED has implemented and administered the JOBZ program so that it is available throughout Greater Minnesota and is not targeted to economically distressed parts of the state.**

DEED has frequently moved subzones to accommodate the location preferences of businesses.

In addition, DEED has used the program to accommodate the location preferences of businesses. The initial focus on property ready for development and the modifications of zones have made JOBZ flexible and accommodating to businesses. Unlike many enterprise zones across the country, JOBZ does not have zones that are fixed in place. DEED has allowed the zones to move to meet business preferences.

This flexibility has both advantages and disadvantages. JOBZ has the advantage of being able to meet the location needs of businesses. The program is not asking businesses to locate in particular areas but is moving the program where the businesses prefer to go. This flexibility, along with JOBZ's significant tax savings, has enabled the program to get strong participation from businesses.

In addition, the availability of the program throughout Greater Minnesota may have helped keep some business expansions from occurring outside the state. For example, St. Cloud has used JOBZ to attract several large expansions that would likely have occurred in other states if JOBZ were not available in the

¹¹ DEED has also made technical modifications to subzones. These sometimes occur when a business's plans change slightly, and the precise location of an expansion on a parcel or parcels of land is altered.

There are both advantages and disadvantages to allowing widespread participation in the JOBZ program.

St. Cloud area.¹² If the program had been targeted to economically distressed areas, St. Cloud may not have been allowed to participate in the program.

DEED staff have also suggested to us that distressed areas may benefit from JOBZ businesses operating in other parts of the state. They say that some businesses supplying inputs to JOBZ businesses may be from distressed areas and may experience growth because of the increased activity at JOBZ businesses elsewhere in the state. While this is possible, it is very difficult to verify.

The main disadvantage of allowing widespread participation in the program is that some more distressed areas have benefited little from the program while more prosperous areas have used the tax incentives. As we discussed earlier, the social benefits of these incentives would be higher if they targeted more distressed parts of Greater Minnesota.

Another potential disadvantage of zone flexibility is that it may result in the JOBZ program simply chasing business development. Unless the program has strict procedures to exclude development that would occur anyway, the program could simply be attracting businesses that are about to expand. By offering to put the subzones wherever businesses prefer, DEED could be facilitating the use of the program by businesses that do not need the subsidies and would expand in Greater Minnesota without them. This issue will be discussed at greater length in Chapter 4.

STATUTORY COMPLIANCE

As noted earlier, some critics of the program's lack of targeting have wondered whether DEED followed state law in designating the initial zones. They have questioned whether DEED used the statutorily mandated need factors in designating the zones. Based on our review of the zone designation process, we conclude that:

- **DEED complied with state law in its designation of JOBZ zones.**

In particular, DEED complied with state law requiring it to consider various need and success criteria when making zone designations. DEED rated the applications using the required criteria, but the ratings were meaningless because of the number of applications. DEED was able to award each applicant a zone because there were only ten applications and state law allowed the commissioner to designate up to ten zones.

In addition, the 5,000 acre restriction for each zone was not a significant constraint. Because DEED could approve an unlimited number of subzones in each zone, DEED was able to spread the 5,000 acres across many communities in each region.

¹² This rationale for including St. Cloud in the program would not apply, however, to all of the businesses using JOBZ in St. Cloud.

JOBZ AND ECONOMIC DISTRESS

In this section, we examine how JOBZ has affected communities of varying sizes and locations. We also examine how communities with different levels of economic distress have been affected by JOBZ. Our primary way of measuring the impact of JOBZ is by using figures reported to DEED on the number of jobs created by each JOBZ business. These figures are reported by local governments which receive them from businesses. In Chapters 3 and 4, we raise serious concerns about the accuracy of these numbers and their ability to measure the real net job growth induced by tax incentives. However, these self-reported numbers represent the best available information we could use to examine the geographic impacts of JOBZ.

Geographic Impact of JOBZ

JOBZ has had different impacts on the various regions, counties, cities, and townships that make up Greater Minnesota. In fact:

- **Some parts of Greater Minnesota appear to have benefited from the JOBZ program much more than other areas.**

Table 2.2 shows the reported new jobs created by JOBZ firms as of the end of 2006 as a percentage of 2003 private employment in each JOBZ region.¹³ The

Table 2.2: Reported New Jobs at JOBZ Businesses by Region, End of 2006

Some regions in Greater Minnesota have benefited more from JOBZ than others.

Region	Reported New Jobs as a Percentage of 2003 Private Employment	Percentage Difference from the Greater Minnesota Average
Northwest	.68%	-1%
Headwaters	.13	-81
Arrowhead	.27	-60
West Central	.74	8
Region 5	1.13	66
Upper Minnesota Valley	.37	-45
Region 7E	.92	35
Southwest	1.38	102
Positively Southern Minnesota	1.10	60
Southern Minnesota	.54	-22
Stearns and Benton Counties	.38	-44
Greater Minnesota Averages	.68%	0%

NOTE: This table excludes the Twin Cities metropolitan area and Sherburne and Wright counties, which do not have JOBZ zones.

SOURCES: Office of the Legislative Auditor, analysis of data from the Department of Employment and Economic Development and the Minnesota State Demographic Center.

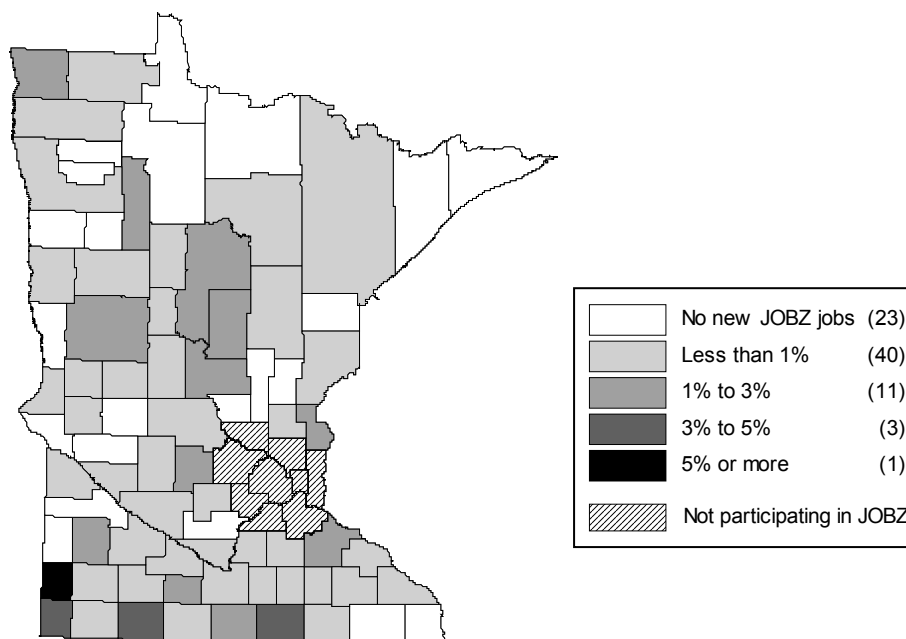
¹³ The regions listed in Table 2.2 are the same as those in Figure 2.1, except that the table shows Stearns and Benton counties separately because some communities in Stearns County are in the West Central region while others are in Region 5. St. Cloud, which is in Region 5, has JOBZ sites in both Stearns and Benton counties.

JOBZ regions benefiting most from the program are in southern Minnesota (Southwest and Positively Southern Minnesota) and in central Minnesota north of the Twin Cities metropolitan area and St. Cloud (Region 5, Region 7E, and West Central Minnesota). However, for portions of northern Minnesota (Headwaters and Arrowhead), the reported job growth from the JOBZ program has been significantly below the average for Greater Minnesota. Reported job growth from the JOBZ program was also well below average for the Upper Minnesota Valley region and for Stearns and Benton counties.¹⁴

The impact on counties within a region also varies significantly. For example, the above average impact in the Southwest region was fueled by JOBZ businesses in Pipestone, Rock, and Lyon counties. Five of the 12 counties in that region had a combined total of only four new jobs reported by JOBZ businesses at the end of 2006. Similarly, even though JOBZ had an average impact in the Northwest region, the impact in Kittson County was high and exceeded by only five other counties in the state. Figure 2.2 shows how the employment impact varied across Greater Minnesota on a county level.

Figure 2.2: Reported New Jobs Created in JOBZ Zones 2004-06 as a Percentage of Total 2003 Private Employment, by County

The impact of JOBZ has varied significantly from county to county.



NOTE: The number of JOBZ-related jobs is based on reports to DEED by local governments. We express serious concerns about the accuracy of these numbers in Chapters 3 and 4. However, these numbers represent the only available information on job growth across all JOBZ businesses.

SOURCES: Office of Legislative Auditor, analysis of Minnesota Business Assistance Forms and data from the Department of Employment and Economic Development's Labor Market Information Office.

¹⁴ The relative impact on the regions could change as businesses that signed JOBZ deals in 2006 and 2007 start operations and add employees. However, we looked at the new jobs promised by JOBZ firms as of early November 2007 and did not find much difference from the results presented above.

Table 2.3 provides information on the relative impact of JOBZ for cities and townships with different populations. The percentage of new jobs reported by JOBZ businesses that were in cities and townships with 3,000 people or less at the end of 2006 was 21 percent. However, as the table indicates, close to half of the population in Greater Minnesota (49 percent) was in cities and townships of this size.¹⁵ In contrast, cities with populations between 10,001 and 20,000 accounted for 35 percent of the new jobs reported at JOBZ businesses and only 13 percent of the population. Similarly, cities and townships with populations between 3,001 and 5,000 had 22 percent of the jobs but just 10 percent of the population.

Table 2.3: Percentage of New Jobs at JOBZ Businesses by Size of City or Township, End of 2006

The smallest cities and townships have benefited less from JOBZ than medium-sized jurisdictions.

Population of Cities and Townships	Percentage of July 2005 Population in Greater Minnesota	Percentage of Reported New Jobs at JOBZ Businesses
0 to 3,000	49%	21%
3,001 to 5,000	10	22
5,001 to 10,000	9	9
10,001 to 20,000	13	35
20,001 to 50,000	9	4
Over 50,000	10	9
Totals	100%	100%

NOTE: This table excludes the population in the Twin Cities metropolitan area and in unorganized territories in Greater Minnesota.

SOURCES: Office of the Legislative Auditor, analysis of data from the Department of Employment and Economic Development and the Minnesota State Demographic Center.

The apparent success of local governments in the 3,001 to 5,000 population range and in the 10,001 to 20,000 range in attracting JOBZ businesses is not shared by all cities in those ranges. For example, among cities and townships ranging from 3,001 to 5,000 in population, just 17 of the 61 governmental units had new jobs at JOBZ businesses at the end of 2006. Furthermore, five cities (Pipestone, Wyoming, Jackson, Blue Earth, and Luverne) alone accounted for nearly three-fourths of the new jobs for cities and townships of that size.

These differences in impact across the state may be due to a number of factors. For example, some cities or areas of the state may not be as active as others in pursuing JOBZ deals. Also, some cities or areas of the state may have more difficulty in getting businesses to locate in their parts of the state. For example, some areas with poor growth prior to JOBZ may face significant challenges in attracting businesses that cannot be addressed by JOBZ alone. Finally, the differences in impact, particularly at the county or city level, may be influenced

¹⁵ The population figures exclude cities and townships in the 7-county Twin Cities metropolitan area and unorganized territory in Greater Minnesota.

by one or two JOBZ businesses that have added a significant number of new jobs. Because many of the JOBZ agreements have included relatively few new jobs, a few agreements involving a large number of jobs can make a large difference in the relative rankings of impact.

Overall, the impact of the new jobs added by JOBZ is relatively modest even if we assume that the data are valid and accurate. As of the end of 2006, the new jobs reported at JOBZ businesses were only about two-thirds of one percent of the total private employment in Greater Minnesota in 2003, just prior to the program's start. However, the JOBZ jobs represent 16 percent of the growth in private employment in Greater Minnesota between 2003 and 2006.¹⁶ Whether the figures on reported new jobs at JOBZ businesses are accurate or are a valid reflection of net job creation due to JOBZ is a separate issue that we discuss in Chapters 3 and 4.

Measures of Economic Distress

We examined a number of measures of economic distress, including: (1) the percentage of the population living under 200 percent of the federal poverty level; (2) the average unemployment rate for the period 2000 through 2003; (3) the percentage change in population between 1982 and 2002; (4) median household income for 1999; and (5) median sales prices for existing homes in 2001 and 2002.¹⁷ Because the last two measures are highly correlated with the first measure, we focused primarily on the first three measures listed above.

Table 2.4 presents regional information on these measures of economic distress, or need, and repeats the previously presented information on reported new jobs at JOBZ businesses. The table indicates that:

- **Some regions of Greater Minnesota with higher levels of economic distress, or need, have experienced lower than average benefits from JOBZ.**

For example, prior to the start of the JOBZ program, northern Minnesota (Headwaters, Arrowhead, and Northwest regions) had high levels of economic distress. Northern Minnesota had the highest unemployment rates prior to the start of the JOBZ program, above average percentages of population under 200 percent of the poverty level, and population loss over the previous two decades in two of the three regions. However, northern Minnesota, particularly the Headwaters and Arrowhead Regions, has benefited less from JOBZ than other parts of Minnesota. Similarly, the Upper Minnesota River Valley region experienced the greatest population loss of any region and had above average

¹⁶ For both of these calculations, we excluded private employment in Sherburne and Wright counties where there are no JOBZ zones.

¹⁷ Most of these measures were among the need criteria that state law required DEED to use in designating zones. We used the average unemployment rate as a proxy for the extent to which an area has experienced sudden or severe job loss as a result of the closing of private businesses or other employers. Unemployment rate data were readily available, could be easily obtained at the county level, and are commonly used by economists in discussing economic distress in a region.

Table 2.4: Measures of Economic Distress Compared with JOBZ Jobs, by Region

Region	Measures of Economic Distress			Reported New Jobs at JOBZ Businesses at End of 2006 as a Percentage of 2003 Private Employment
	Average Unemployment Rates, 2000-03	Percentage of Population Living Below 200% of the Poverty Level	Population Growth Rate, 1982-2002	
Northwest	5.6%	30%	-8%	.68%
Headwaters	5.6	38	19	.13
Arrowhead	5.7	29	-4	.27
West Central	4.2	30	6	.74
Region 5	5.3	33	18	1.13
Upper Minnesota Valley	4.6	30	-16	.37
Region 7E	5.4	23	42	.92
Southwest	4.0	27	-1	1.38
Positively Southern Minnesota	4.0	28	-4	1.10
Southern Minnesota	3.8	20	21	.54
Stearns and Benton Counties	4.1	25	26	.38
Sherburne and Wright Counties	4.2	16	84	NA
Greater Minnesota Averages	4.6%	26%	11%	.68%
Twin Cities Area Averages	3.7%	18%	32%	NA
Statewide Averages	4.1%	22%	22%	.25%

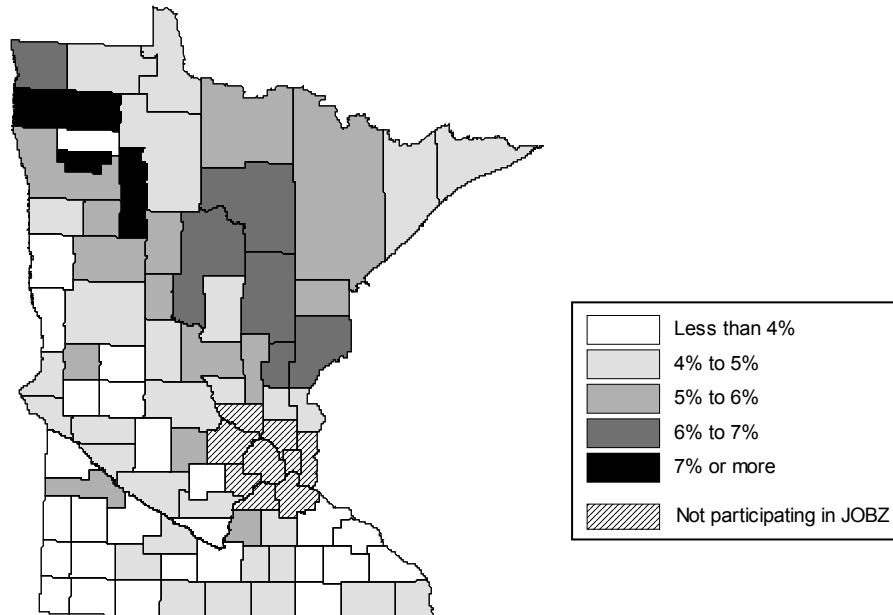
SOURCES: Office of the Legislative Auditor, analysis of data from the Department of Employment and Economic Development and the Minnesota State Demographic Center.

levels of distress as measured by the other two measures. But this region has received fewer employment benefits from JOBZ than average for Greater Minnesota.

As we indicated earlier for the employment impact from JOBZ, the levels of economic distress can vary significantly within a region. Figures 2.3 and 2.4 provide county level information on two measures of economic distress. Figure 2.3 shows the average unemployment rates prior to JOBZ, while Figure 2.4 indicates the percentage gain or loss in population over a two decade period prior to JOBZ. These figures can be used along with Figure 2.2 to examine the relationship between new jobs reported by JOBZ businesses and the preexisting levels of economic distress.

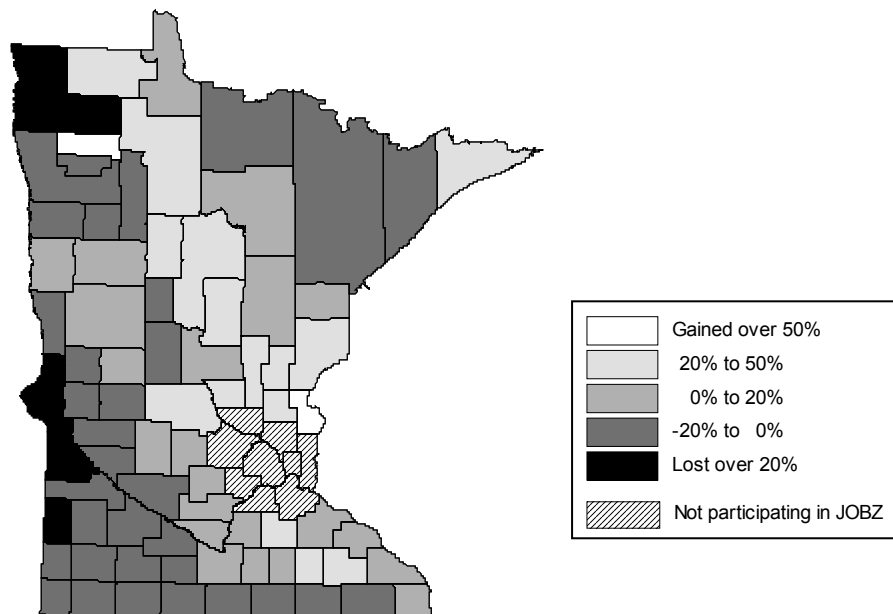
JOBZ has helped some economically distressed regions much more than others.

Figure 2.3: Average Unemployment Rate by County, 2000-2003



SOURCE: Office of the Legislative Auditor, analysis of data from the Department of Employment and Economic Development's Labor Market Information Office.

Figure 2.4: Population Change by County, 1982-2002



SOURCE: Office of the Legislative Auditor, analysis of data from the Minnesota State Demographic Center.

To more precisely examine this relationship, we calculated the statistical correlation between reported new jobs at JOBZ businesses and our three measures of economic distress using county level data. The correlation coefficients shown in Table 2.5 confirm that the JOBZ program has not been targeted to areas of economic distress or need. In particular, the data show that:

- **There is little or no relationship between the level of economic distress, or need, in a county and the new jobs created by JOBZ businesses.**

In all three cases, there is only a weak correlation between the preexisting levels of economic distress and the new jobs reported by JOBZ businesses. For two of the three measures, the correlation coefficients suggest that there is a slight tendency for areas with higher levels of economic distress to have experienced less of the employment benefits from JOBZ. Higher unemployment rates and higher shares of population having incomes below 200 percent of the poverty level both indicate higher levels of economic distress. For these two measures, higher levels of economic distress are associated with lower levels of JOBZ employment as a percentage of 2003 private employment. For the third measure, population loss, the relationship is reversed. Higher levels of population loss are a measure of economic distress. Higher rates of population loss (or lower rates of population growth) have a tendency to be associated with slightly higher levels of JOBZ employment.

Table 2.5: Correlations between New Jobs Reported by JOBZ Businesses and Measures of Economic Distress

Measures of Economic Distress	Correlation Coefficients ^a
Average Unemployment Rates, 2000-03	-.128
Population Living at Less Than 200 Percent of the Poverty Level	-.033
Population Loss, 1982-2002	.097

NOTE: A coefficient of 1.0 means there is perfect correlation between two variables. A correlation coefficient of 0.0 indicates a complete absence of correlation. A positive correlation means that higher levels of economic distress are associated with higher levels of reported new jobs by JOBZ businesses as a percentage of private employment in the base year (2003). A negative correlation means that higher levels of economic distress are associated with lower levels of reported jobs by JOBZ businesses.

^a The correlation coefficients measure the relationship between various measures of economic distress and the number of new jobs reported by JOBZ businesses at the end of 2006 as a percentage of private employment in 2003. We used county-level data and only included counties in Greater Minnesota. Sherburne and Wright counties were excluded because they are not participating in the JOBZ program.

SOURCES: Office of the Legislative Auditor, analysis of data from the Department of Employment and Economic Development and the Minnesota State Demographic Center.

There is little or no relationship between a county's level of economic distress and the impact of JOBZ.

The information in Table 2.6 suggests that the JOBZ program's lack of targeting to economically disadvantaged areas should be of particular concern. Table 2.6 shows the relationship between private job growth in Greater Minnesota from 2003 to 2006 and various measures of economic distress, or need, in or prior to 2003. The correlation coefficients listed in the table indicate that higher levels of economic distress prior to 2003 are associated with lower rates of growth in private employment since 2003. In other words, counties with greater economic needs have experienced somewhat lower rates of private sector job growth during the life of the JOBZ program. The strength of the statistical relationships in Table 2.6 is greater than in Table 2.5, and the relationship between unemployment rates and private employment growth is statistically significant.

Table 2.6: Correlations between Measures of Preexisting Economic Distress and Growth in Private Employment between 2003 and 2006

Counties with greater economic needs have experienced lower job growth during the life of the JOBZ program.

Measures of Economic Distress	Correlation Coefficients ^a
Average Unemployment Rates, 2000-03	-.252
Population Living at Less Than 200 Percent of the Poverty Level	-.213
Population Loss, 1982-2002	-.189

NOTE: A coefficient of 1.0 means there is perfect correlation between two variables. A correlation coefficient of 0.0 indicates a complete absence of correlation. A positive correlation means that higher levels of economic distress prior to 2003 are associated with higher rates of growth in private employment between 2003 and 2006. A negative correlation means that higher levels of preexisting economic distress are associated with lower rates of growth in private employment after 2003.

^a Only counties with JOBZ zones are included in this analysis.

SOURCES: Office of the Legislative Auditor, analysis of data from the Department of Employment and Economic Development and the Minnesota State Demographic Center.

Administration

SUMMARY

We found significant problems with the administration of the JOBZ program. Business subsidy agreements used by local governments are often poorly worded and sometimes fail to require the creation or retention of promised jobs. The local agreements, as well as the relocation agreements used by the Department of Employment and Economic Development (DEED), do not adequately define key terms such as “full-time equivalent employees” or “benefits.” Furthermore, some agreements have required the creation of very few new jobs.

DEED’s process to monitor business compliance with job and wage requirements is slow and based on questionable information. The forms used to collect information on the employment and wages at JOBZ businesses are confusing, lack sufficient instructions, and do not gather all of the information needed. The reports received by DEED are self-reported, unverified, and often overstate actual employment.

As discussed in Chapter 1, administration of JOBZ is decentralized and responsibility is dispersed. DEED, the Department of Revenue (DOR), and local government officials around the state all have important obligations under the law. In this chapter, we assess how these different entities have carried out their responsibilities to manage the JOBZ program. Specifically, we ask:

- **Has the program been effectively administered?**
- **Are businesses in the program meeting their obligations?**
- **If businesses fail to meet their obligations, are they identified and removed from the program? Are the tax incentives they have received repaid to state and local jurisdictions as required?**

To answer these questions, we reviewed the JOBZ statute and the state’s business subsidy law.¹ We examined program documents for over two hundred JOBZ deals and conducted interviews with DEED staff, DOR staff, and local officials who have been involved with the JOBZ program. We reviewed the tax filings of numerous businesses and individuals claiming JOBZ tax benefits on their 2004 or 2005 Minnesota tax returns. Finally, we collected data reported to DEED by JOBZ businesses and local jurisdictions and compared this information with data drawn from the state’s Unemployment Insurance system.

¹ Unless otherwise noted, in this chapter we use the terms “business subsidy law” and “business subsidy statute” to refer to [Minnesota Statutes](#) 2007, 116J.993 – 116J.995, and we use the terms “JOBZ law” and “JOBZ statute” to refer to [Minnesota Statutes](#) 2007, 469.310 – 469.3201.

ADMINISTRATIVE STAFFING AND POLICIES

In this section, we describe two aspects of JOBZ administration that have been characteristic of the program as a whole. In the following sections, we examine three key facets of program administration: initial entry into the program, compliance monitoring, and administration of tax exemptions.

Roles and Responsibilities

DEED, DOR, cities and townships, and county property tax officials share joint responsibility for administering JOBZ. As a result, administration of the program faces inherent challenges of communication and coordination. However, these challenges have been exacerbated by further division of responsibilities within each of these entities. We found that:

- **Administration of JOBZ is fragmented across two state agencies and numerous local governments and also within these state agencies.**

As shown in Table 1.5, different administrative tasks are statutorily delegated to different government entities. However, responsibilities are divided within each entity as well. Within DEED, different groups of staff have handled program entry and zone designation, reporting and monitoring, compliance review, and marketing and promotion.² Within DOR, responsibility is divided among staff based on tax type. At the local level, responsibilities are often divided among local or regional economic development officials, city administrative staff, and county property tax officials.

The administrative structure for JOBZ creates problems.

Some DEED staff attributed the fragmentation of responsibility within DEED to a lack of resources.³ As a result, administrative tasks were parceled out to multiple different working groups that had to add JOBZ to their existing responsibilities.

Rules and Guidelines

The JOBZ statute specifically exempts DEED from complying with the Administrative Procedure Act with regard to its program responsibilities.⁴ Additionally, although each local government is required to draft and approve a local business subsidy policy before it can enter into a business subsidy

² In November 2007, DEED created a new JOBZ and Business Finance Unit and began to transfer many program functions to this group. Because it was just being organized, we were mostly unable to evaluate the performance of this new unit.

³ There is no specific ongoing appropriation of funds to DEED and DOR for JOBZ administration. The Legislature appropriated \$130,000 to DEED and \$82,000 to DOR for program administration in fiscal years 2004 and 2005. *Laws of Minnesota* First Special Session 2003, chapter 21, art. 1, sec. 27. Those funds were rolled into the base funding levels of the agencies in subsequent years.

⁴ *Minnesota Statutes* 2007, 469.314, subd. 6.

agreement to provide JOBZ tax subsidies, there are few specific requirements for what should be in the policies and they are usually general in nature.⁵

In examining the activities of local governments, we found that:

- **The Legislature and DEED have provided few guidelines for local governments to follow in administering JOBZ.**

The JOBZ law makes local governments the initial gatekeepers of the JOBZ program. Local governments, not DEED, decide whether a business is promising a large enough increase in jobs and capital investment to deserve the tax breaks provided by the program. Further, the law gives local governments wide discretion to use JOBZ as an economic incentive for businesses. There are no minimum requirements for participation unless a business is relocating into a zone from another Minnesota location.

Local officials decide how to administer the program with limited state guidance.

DEED has published on its web site a set of general procedures for local governments to follow and it provides worksheets to evaluate potential deals and sample documents to serve as the basis of local policies and agreements. However, DEED has made few suggestions for how large a commitment should be made by JOBZ businesses. DEED staff told us that if they determine an agreement is contrary to the JOBZ law, they notify the city and advise it to modify the agreement appropriately. Otherwise, DEED does not approve or disapprove a business's entry into the program unless (1) completion of the deal requires a DEED-sanctioned change to a city's assigned subzones, or (2) the business is moving at least some employees to the subzone site from another Minnesota location, in which case it must sign an additional agreement with DEED to participate in the program.⁶

Once a business has entered the JOBZ program, DEED and local governments are jointly responsible to ensure that the business meets the commitments it made when entering the program. Again, local governments receive little guidance in how to carry out their responsibilities—neither the JOBZ statute nor DEED addresses how local governments should verify business performance.

Though the absence of a rule-making process may have contributed to DEED's speed in rolling out the program in the fall of 2003, the lack of rules and guidelines has made program administration confusing for some local governments. In our interviews, several local officials asked us if their interpretation of their responsibilities was correct.

More importantly, inadequate guidance for local governments has produced substantial differences in how local governments administer the program. Although some local governments have developed careful guidelines and

⁵ *Minnesota Statutes* 2007, 116J.994, subd. 2.

⁶ The commissioner of DEED also has the authority to waive some of the legal requirements for entry into JOBZ upon determining that a business will substantially meet the goals of the program. *Minnesota Statutes* 2007, 469.310, subd. 11e.

procedures, we demonstrate below that many others have carried out their obligations weakly or not at all.

ENTRY INTO THE JOBZ PROGRAM

Businesses enter the JOBZ program by signing business subsidy agreements with local governments. If an existing Minnesota business relocates into a JOBZ zone, it must also sign a separate relocation agreement with DEED. These agreements define most of the obligations that businesses must meet to receive JOBZ tax benefits.⁷ DEED has also required local government officials to fill out a summary data form and, after the 2005 legislative changes, a “deal evaluator” worksheet.

Business Commitments

Local officials often grant JOBZ tax breaks to businesses that make minimal commitments.

Both the language of the JOBZ statute and DEED’s administrative choices have given considerable autonomy to local governments. Cities, townships, and counties are free to negotiate any agreement that does not conflict with the law—a local government can grant the full panoply of JOBZ tax breaks to a start-up business intending to create only one job.

In reviewing the agreements made by local governments, we found that:

- **Most JOBZ agreements require only a small number of new jobs to be created.**

From the start of the program through June 30, 2007, more than two-thirds of JOBZ agreements required just 10 or fewer new jobs to be created. Nearly half of the total required 5 or fewer jobs. In 11 percent of the cases, either a single new job was required or there were no job creation requirements at all. Changes to the JOBZ law that took effect in 2005 required relocating businesses to create at least five new jobs, but as shown in Figure 3.1, some nonrelocating businesses have still entered the program with little or no job creation.

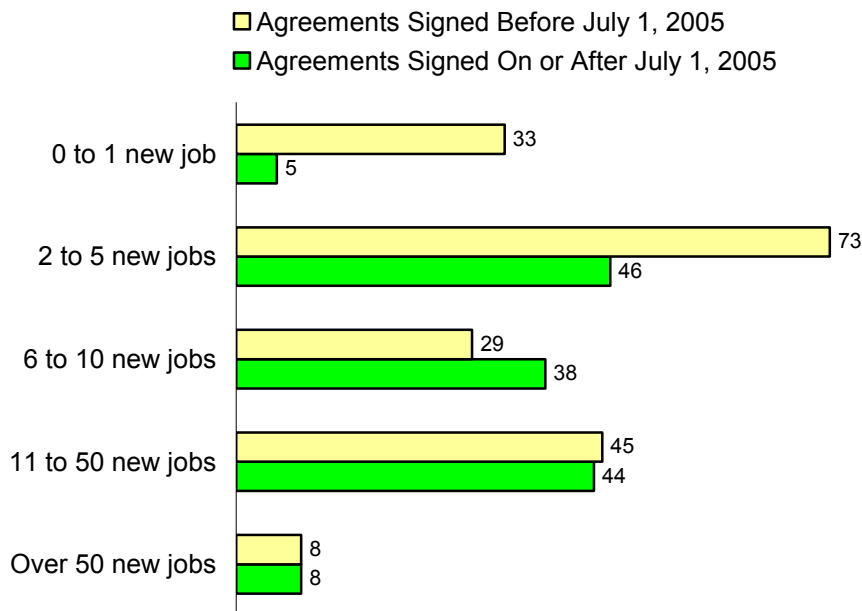
Some individual agreements listed negligible requirements:

- Two agreements negotiated by one city stated that the businesses would “endeavor” to create a certain number of new jobs. In five agreements negotiated for two different cities by the same local economic development agency, the businesses “estimated” the creation of a specific number of “employment opportunities.”

⁷ In 2005, the Legislature passed a few requirements that apply to all JOBZ businesses regardless of the language in their individual agreements. These provisions do not apply to businesses that entered the program prior to July 1 of that year. *Minnesota Statutes* 2007, 469.310, subd. 11; *Laws of Minnesota* First Special Session 2005, chapter 1, art. 4, sec. 107.

Figure 3.1: JOBZ Agreements by Number of New Jobs Required, January 2004 – June 2007

Nearly half of JOBZ businesses are required to create five jobs or less.



NOTE: Legislation affecting the requirements for JOBZ businesses took effect on July 1, 2005. Chart covers all 330 valid agreements made during this time period, including businesses later removed from the program by DEED. Agreements are categorized by date signed, not by deadline; some businesses have several years (or no deadline at all) to create the new jobs required in their agreements.

SOURCE: Office of the Legislative Auditor, analysis of individual business subsidy agreements.

- One agreement which required a business to hire 18 new employees also stated that the firm was required to retain only 45 of its existing 70 employees.
- Three agreements did not commit the businesses to either hire any new employees or retain their existing employees, requiring only that they pay a minimum wage level.⁸

JOBZ Agreements

We reviewed all of the business subsidy agreements that have been submitted to DEED since the program began on January 1, 2004. We found that:

⁸ In one of these cases, a separate relocation agreement with DEED did require the company to retain its existing employees.

- **Many JOBZ business subsidy agreements are poorly worded and some do not provide a sufficient legal basis to require the creation or retention of promised jobs.**

Although local governments are required to send copies of JOBZ agreements to DEED, the agency does not have the authority to approve or disapprove these agreements. DEED has a sample business subsidy agreement that it urges communities to use, but local governments may write their own agreements with language and provisions of their own choosing.

Some of the agreements negotiated by local governments have been tightly constructed and have held companies to higher standards than the sample agreement provided by DEED. However, in other instances, the agreements are missing key provisions or contain grammatical inconsistencies or ambiguous phrases that obscure the requirements businesses must meet. We describe several of the problems we identified below.

Deadlines

Some JOBZ agreements have no deadlines, and others do not require businesses to keep the jobs they create.

Of the 352 business subsidy agreements listed in Table 1.6, we identified 15 different agreements in which no deadlines were given for the creation of new jobs. In most of these cases, businesses were required to create new jobs “during the Job Zone term,” that is, at some point between the agreement date and December 31, 2015, when JOBZ tax subsidies expire. These agreements are not consistent with the state business subsidy statute, which requires that agreements contain specific goals to be met within two years of the benefit date.⁹ In a few other agreements, companies were required to create some jobs within a short period after the agreement date, and then additional jobs sometime “during the Job Zone term.”

Retention of New Employees

We found over 60 business subsidy agreements that required businesses to hire new employees by a certain deadline, but did not require the businesses to maintain the new positions throughout the length of the JOBZ program.¹⁰ After meeting their deadlines by hiring new employees, most of these companies are under no obligation to maintain that level of employment and could eliminate those positions at any time without affecting their JOBZ status. Under some of these business subsidy agreements, it would even be possible for businesses to reduce overall employment from their date of entry into the program and still qualify for JOBZ tax benefits through 2015. One business subsidy agreement specifically stated that the company needed to retain new employees for only two years after receiving a certificate of occupancy for the JOBZ facility.

⁹ *Minnesota Statutes* 2007, 116J.994, subd. 4. We also found some agreements that had specific deadlines but that gave businesses more than two years to meet their job creation requirements.

¹⁰ Some of these businesses signed separate relocation agreements with DEED that do require the retention of jobs. However, in many of those cases, the relocation agreement does not require as many new jobs as the business subsidy agreement.

Retention of Preexisting Employees

Some JOBZ agreements do not contain provisions requiring businesses to retain the jobs existing at the time they entered the program; the agreements refer only to the number of new positions the company must create. When businesses use JOBZ to expand, failure to require the businesses to retain their existing workforce can create a loophole.

Expansions occur when a business continues to use an existing (nonzone) facility while opening a new facility at a JOBZ location. In such a situation, the business is not required to sign a relocation agreement with DEED as long as it (1) does not cease operations in its original facility, and (2) does not reduce employment in its original facility (or any other Minnesota location) within one year of starting operations in the addition.¹¹ However, depending on the language of the agreement with the local government, the business may have up to *two* years to meet its hiring obligations in the zone.¹²

As a result, a business that expands into a JOBZ location could technically stay in compliance with its business subsidy agreement by juggling its employees between zone and nonzone locations without a net increase in employment.

For example, one JOBZ business with approximately 50 employees wished to expand its business and negotiated a JOBZ agreement with a Minnesota city in December 2005. Under the terms of the agreement, the business is required to hire 13 new employees within two years of occupying the JOBZ site. Because the agreement makes no mention of the preexisting 50 employees, the business could technically meet its obligation by terminating 13 of its existing employees and rehiring them to new positions in the JOBZ site.

Under the law, such a transfer would be considered a relocation requiring a separate agreement with DEED—but only if it took place within one year of the start of operations in the JOBZ zone. Because the business has two years from the occupation of the JOBZ location to meet its obligations, it has a one-year window to transfer employees from one location to the other as it wishes. Thus, the business can potentially receive JOBZ tax benefits through 2015 without increasing its total employment at all.¹³

¹¹ This requirement holds if the employees in the zone are “engaged in the same line of business” as the employees in the existing facility. *Minnesota Statutes* 2007, 469.310, subd. 12.

¹² *Minnesota Statutes* 2007, 116J.994, subd. 4.

¹³ The example is an actual JOBZ agreement, but the described scenario is hypothetical. In fact, since this business did not occupy the JOBZ site until several months after the agreement was signed, it will not reach its deadline for creating new jobs until after the publication of this report. We were unable to determine if any businesses have taken advantage of this loophole; it would not be readily apparent from the annual reports filed with DEED or from examination of unemployment insurance filings.

Requirements for wages and benefits are often unclearly stated.

Wage Requirements

Many agreements require businesses to pay an average compensation amount to the employees in the zone but do not indicate how that average is to be calculated. It is not clear, for example, if overtime pay is to be included in the calculation or if the wages paid to part-time and full-time employees should be weighted by the number of hours worked. Agreements are sometimes written so that the average wage applies only to the number of new employees specified in the agreement. In such an instance, it is not clear whether all new employees must be included in the calculation if the business hires more employees than its minimum commitment.¹⁴ One agreement set a specific wage and benefit level but stated without further explanation that it would be “increased in line with inflationary trends in the area.”

Definitions of Key Terms

In reviewing the compliance of businesses with their business subsidy agreements (discussed in more detail below), we found that:

- **Important terms that define business obligations are not clearly defined or left undefined in business subsidy agreements, relocation agreements, and the JOBZ statute itself.**

Only rarely have business subsidy agreements or relocation agreements clearly defined the terms listed below. As a result, it is difficult to determine if some businesses are meeting their obligations because the obligations themselves are ambiguous.

FTE Business subsidy agreements routinely state a firm’s hiring goal as a number of “full-time” or “FTE” jobs. However, we found no agreements that defined how many hours of work in a week or a year constitute a full-time equivalent job. An internal DEED memo suggested that one FTE should be equal to 2,080 hours of employment in a year, but this figure has never been distributed to JOBZ businesses or local governments.¹⁵ In addition, it is not clear whether a firm is permitted to count overtime hours in its calculation of FTE.¹⁶

¹⁴ Due to legislative changes in 2005, all businesses entering JOBZ after July 1, 2005, must pay all zone employees minimum compensation of 110 percent of the federal poverty level for a family of four. However, some local governments have chosen to set a higher average or minimum compensation level in their business subsidy agreements.

¹⁵ Although the JOBZ statute does define full-time equivalent employees as “the equivalent of annualized expected hours of work equal to 2,080 hours,” this definition applies only to the section of the law dealing with the jobs credit (discussed in more detail later in this chapter). Therefore, this statutory definition only applies when calculating a specific tax credit earned by businesses that employ higher-wage workers. *Minnesota Statutes* 2007, 469.318, subd. 2. The business subsidy law gives no definition of “full-time equivalent.”

¹⁶ The JOBZ tax schedule developed by DOR excludes overtime hours (defined as hours in excess of 2,080 hours per year) from the measurement of FTEs used to calculate the JOBZ Credit.

When key terms in JOBZ agreements are undefined, a business's obligations are ambiguous.

Employee/Job In at least one instance, a JOBZ business has used workers employed by a staffing company to meet its hiring goals. It is unclear from either the statute or the agreement the businesses signed whether such workers constitute “employees” or whether a business that agrees to “create” a certain number of “new jobs” can do so through a subcontractor. It is also unclear if the latter wording would enable a business to satisfy its JOBZ commitments by using independent contractors instead of hiring employees.

Retain Most business subsidy agreements and nearly all relocation agreements require firms to “retain” or “maintain” the new jobs created until the end of the JOBZ term in 2015. However, it is not clear how strictly these terms should be interpreted. For example, if a company drops below its employment targets temporarily through normal turnover, the agreement does not indicate how long it has to replace departing employees before falling out of compliance with its agreement.

To cite another example, examination of unemployment insurance data indicates that a few firms in the JOBZ program have a clear pattern of seasonal employment, with lower employment totals in the first quarter of each year. DEED has decided that such patterns are acceptable as long as the total number of hours worked over the course of a year can be converted to a full-time equivalency equal to the firm’s hiring goal. However, there is no language in the agreements to support such an interpretation, and they could be interpreted to preclude such an arrangement.

Benefits The JOBZ statute, the sample business subsidy agreement, and the sample relocation agreement require JOBZ firms to pay each zone employee a compensation package, “including benefits not mandated by law,” equal to at least 110 percent of the federal poverty level for a family of four.¹⁷ Business subsidy agreements and relocation agreements do not indicate how the monetary value of such benefits should be calculated. Although some benefits such as vacation leave and health insurance are routinely calculated as monetary amounts, others are more difficult to quantify, such as free parking, unpaid maternity leave, or permitted use of company equipment for private purposes. A few agreements clearly state that a company may count only health insurance benefits toward its required compensation package, but most agreements do not specify any particular benefits to be included or excluded.

Benefit Date Several business subsidy agreements require firms to meet their commitments within one or two years of the “benefit date,” defining the term as the date that the business receives the subsidy or simply by referencing the business subsidy law, which contains similar wording.¹⁸ However, the exact date on which a JOBZ business “receives” its subsidy is somewhat unclear since no payment is ever made to the business; it simply pays less in taxes than it would otherwise. The statute defines benefit date more narrowly in instances where the subsidy involves the use of equipment or improvements to property. However, in

¹⁷ *Minnesota Statutes* 2007, 469.310, subd. 11g.

¹⁸ *Minnesota Statutes* 2007, 116J.993, subd. 2.

some cases, the business which uses equipment or improves the property is not the JOBZ business itself, but rather the property owner.

Conformity With Law

We also found that:

- **Some business subsidy agreements contain clauses that are inconsistent with the JOBZ law.**

These instances appear to reflect confusion between the JOBZ statute and the business subsidy statute. Such clauses may be unenforceable, but in our view, it would be best if they did not appear in the agreements at all. We describe three examples below.

Clarifications to the JOBZ law made by the 2005 Legislature are not reflected in some agreements.

First, numerous business subsidy agreements include a clause stating that the local government may independently extend the deadline for a business to meet its goals, apparently drawing from the language of the business subsidy law.¹⁹ However, the JOBZ law gives the authority to extend the period for meeting job and wage goals to the commissioner of DEED, not to local governments.²⁰ The Legislature clarified the relationship between the two statutes in 2005, indicating that the repayment provisions of the JOBZ law prevail over any conflicting section of the business subsidy law.²¹ Nonetheless, we found examples of business subsidy agreements containing the extension clause signed after the change to the law was passed.

Second, several business subsidy agreements state that in the event that the business falls out of compliance with the agreement, it will pay back a prorated portion of the tax benefits received. For example, a business that had created half the number of jobs required by the agreement would pay back half of the amount of the tax benefits received. As with the clauses regarding extensions, these provisions appear to be taken from the business subsidy law but conflict with the JOBZ statute. The law states that a defaulting business must “repay the amount of the total tax reduction” received during the two years before it ceased to operate in the zone location.²² Only the commissioner of Revenue is given the authority to reduce this repayment amount.²³ Again, despite the clarification passed by the 2005 legislature, we found similar provisions in some business subsidy agreements signed after July 1, 2005.

¹⁹ “The grantor, after a public hearing, may extend for up to one year the period for meeting the wage and job goals under subdivision 4 provided in a subsidy agreement.” *Minnesota Statutes* 2007, 116J.994, subd. 6.

²⁰ *Minnesota Statutes* 2007, 469.319, subd. 1.

²¹ *Laws of Minnesota*, First Special Session 2005, chapter 1, art. 4, sec. 109, codified in *Minnesota Statutes* 2007, 469.319, subd. 6.

²² *Minnesota Statutes* 2007, 116J.994, subd. 6; 469.319, subd. 1. As discussed later in this chapter, DEED and DOR have interpreted “ceased to operate” to mean that a business has ceased to operate in compliance with its business subsidy agreement or relocation agreement.

²³ *Minnesota Statutes* 2007, 469.319, subd. 5.

Third, a few business subsidy agreements state that in the event a business does not meet its goals, it must repay the tax assistance it has received to the local government unit with which it signed the agreement. Such provisions contradict the JOBZ statute, which states that such repayments must be made to the respective taxing authorities—state tax subsidies must be repaid to the state, local property tax subsidies must be repaid to the county, and local sales tax subsidies must be repaid to the jurisdictions where the purchases were made.²⁴

DEED's Sample Agreement

Some problems in business subsidy agreements were repeated in many areas around the state. We concluded that:

- **Some unclear wording in business subsidy agreements can be traced to the sample agreements provided by DEED to local jurisdictions.**

On its web site, DEED has provided a sample business subsidy agreement for the use of local governments. The agreement is intended to be a complete legal document; local governments need only to fill in the name and address of the business and the specific job and capital investment commitments it is making.

Although the sample agreement does set specific deadlines and requires the retention of new jobs throughout the period a company receives JOBZ tax breaks, it fails to define many key terms. The agreement uses, but does not adequately define, terms such as “FTEs,” “jobs,” “employees,” “retain,” “maintain,” and “benefits.”

In addition, the sample agreement provided by DEED has been poorly edited. Grammatical inconsistencies that appear within the sample agreement have been replicated in agreements signed by many businesses and local governments. Some of these inconsistencies make interpretation of the agreements difficult.

As of January 2008, the sample agreement contained the following paragraphs, which obscure the statutory requirement that a participating business repay tax benefits received if it does not meet its obligations. These errors have persisted through at least two revisions of the sample agreement going back to 2004.²⁵

Whereas, compliance with provisions of the Minnesota business subsidy statutes (M.S. § 116J.993 – 116J.995) require the following, the parties agree that: . . .

F. A description of the financial obligation(s) of the qualified business to repay all JOBZ related tax benefits obtained if it does not meet the goals identified in this agreement, and as defined in M.S. § 469.319. . . .

**DEED's sample
JOBZ agreement
has been poorly
edited.**

²⁴ *Minnesota Statutes* 2007, 469.319, subd. 3 and 4.

²⁵ We cannot be sure whether this language was in the original sample business subsidy agreement because DEED has not retained a copy. It appears in revisions dated September 2004 and July 2006.

H. A description of the financial obligation(s) of the qualified business related to other business subsidies provided to the qualified business, as governed by the Business Subsidy statute at M.S. § 116J.993 – 116J.995, and to repay [sic] tax benefits obtained if it does not meet the goals identified in this agreement, and as defined in and in [sic] M.S. § 116J.994 Subd. 6.

I. A commitment to continue to [sic] operations in the jurisdiction where the subsidy is used for the duration of the job zone term.

As written, the business does not actually agree to repay tax benefits if it does not comply with the terms of the agreement. Instead, it agrees to a “description” of its obligation.

Further, the sample agreement provided by DEED during at least part of 2005 used the following language to require that relocating businesses retain preexisting jobs:

Where area job loss in a zone has been specific and demonstrable, «NumRetainedJobs» jobs shall be retained during the Job Zone Term and within the subzone boundary

DEED’s sample agreement may never have been reviewed by an attorney.

Read literally, this formulation could suggest that a business’s commitments are contingent on the performance of the local economy. As with the paragraphs quoted above, this wording appeared in multiple business subsidy agreements signed in different locations across the state.

DEED staff were unable to tell us whether the sample business subsidy agreement was reviewed by an attorney at the time it was initially drafted. DEED has not had an attorney review its subsequent revisions of the agreement.

Deal Evaluator

In addition to reviewing business subsidy agreements and relocation agreements, we also reviewed the other documents local governments submit to DEED in connection with JOBZ agreements. We found that:

- **The deal evaluator worksheet that DEED requires local governments to complete is easily manipulated to achieve an acceptable score. DEED does not review the worksheets it receives to ensure that the numbers entered are reasonable.**

The deal evaluator is an online worksheet developed by DEED to ensure that local governments consider the factors listed in the JOBZ statute when

DEED does not check whether local officials thoroughly evaluate potential JOBZ agreements.

negotiating business subsidy agreements.²⁶ The evaluator asks local officials to rate how important each factor is to the community, to provide overall community goals for job growth and capital investment, and to enter information about the proposed JOBZ deal. The evaluator then calculates a numerical score based on how well the deal matches the community's preferences.

Because the deal evaluator allows the local official to set the value placed on each factor, it is trivial to choose values high enough to ensure that a project meets DEED's minimum score. If a certain set of values produces a low score, one can simply rerun the worksheet and experiment until the desired score is reached.

DEED staff told us that aside from checking the overall score, they paid little attention to the specific values entered in the worksheet. We found that in some instances DEED has ignored extreme values entered by some local officials. Examples included:

- One city with a population of over 10,000 listed its citywide target for job growth as 0.002 percent, which would be less than a single job.
- Another city listed its citywide target for growth in its property tax base as 4,000,000 percent.
- A third city claimed that the amount of growth estimated as a result of the proposed project—0.01 percent—actually exceeded the city's 5 percent target for property tax base growth.

Recommendations

To address the concerns cited above, we make the following recommendations:

RECOMMENDATION

The Legislature should require that DEED review and approve all JOBZ business subsidy agreements before they can take effect. The separate relocation agreements could be discontinued if DEED makes sure that business subsidy agreements for relocating businesses include the statutory requirements.

Even though the JOBZ program provides extensive state tax breaks to companies that participate, state government does not always have a formal role in

²⁶ "Prior to execution of the business subsidy agreement, the local government unit must consider the following factors: (1) how wages compare to the regional industry average; (2) the number of jobs that will be provided relative to overall employment in the community; (3) the economic outlook for the industry the business will engage in; (4) sales that will be generated from outside the state of Minnesota; (5) how the business will build on existing regional strengths or diversify the regional economy; (6) how the business will increase capital investment in the zone; and (7) any other criteria the commissioner deems necessary." *Minnesota Statutes* 2007, 469.310, subd. 11c.

Adequate state oversight would ensure that agreements are written more carefully.

determining which businesses enter the program or what standards they must meet. As a result, wide variations exist in the quality of the agreements reached. Adequate state oversight would ensure that business subsidy agreements are written carefully enough to actually require businesses to meet their commitments. Additionally, as we describe in more detail in Chapter 4, the lack of a state perspective has allowed businesses to enter the program when tax subsidies appear to produce little or no benefit to the state. DEED should have the responsibility for determining which businesses are worthy of state subsidies.

Although DEED's relocation agreements have occasionally forced companies to meet stricter requirements when business subsidy agreements have been weak, many businesses entering the program do not relocate and thus are not required to sign such agreements. Putting the statutory requirements for relocating businesses directly into the relevant business subsidy agreements would be a better approach. Requirements for JOBZ businesses would be clearer for all parties if they were listed in a single agreement. The current system of separate agreements complicates the monitoring and compliance processes by suggesting that local governments are responsible for monitoring one set of obligations while state government is responsible for monitoring another set. Some local government officials told us that they had no role in monitoring compliance with relocation agreements, although DEED staff told us the opposite.

RECOMMENDATION

DEED should ensure that business subsidy agreements contain meaningful but realistic requirements for businesses.

Businesses that relocate employees into a JOBZ site from another Minnesota location must make a minimum commitment to increase employment by 20 percent of the number of relocated employees or 5 jobs, whichever is greater. However, there is no minimum commitment for start-up businesses, businesses that stay in their current location and expand into a JOBZ location, or businesses that move in from outside the state. As a result, some businesses are receiving extensive tax breaks for little or no job creation.

DEED should ensure that requirements for JOBZ businesses are not set too low.

DEED should review business subsidy agreements submitted by local governments to determine whether requirements have been set so low that a business could receive tax subsidies without making much impact on the local or state economy. DEED should pay particular attention to agreements that require very few jobs, though there are some circumstances where a subsidy may be warranted (for example, if an agreement required the creation of 2 or 3 unusually high-paying jobs in an economically disadvantaged rural area). The Legislature may also wish to consider setting minimum criteria for all JOBZ agreements, not just for relocations from within Minnesota.

DEED should also ensure that all agreements contain deadlines of two years or less for the creation of new jobs and that all agreements require businesses to retain new positions throughout the period in which they receive tax breaks. In addition, DEED should review agreements more closely to ensure they do not contain provisions that conflict with the JOBZ and business subsidy statutes.

Although we are aware of a few instances in which DEED notified local governments that agreements should be rewritten to conform with the law, we found many other examples of inappropriate language that were not caught by DEED staff. Finally, in order to prevent businesses from juggling employees between zone and nonzone locations, DEED should require that business subsidy agreements specify how many employees an expanding JOBZ business has in its neighboring nonzone location and clearly indicate that the business must increase its overall citywide employment in order to comply with the agreement.

RECOMMENDATION

DEED should rewrite the sample business subsidy agreement to define key terms and correct grammatical errors. DEED should have revisions to the agreement reviewed by an attorney.

The lack of definitions for terms such as “FTE” and “employee” makes enforcement of the agreements more difficult for DEED, DOR, and local officials and makes compliance more complicated for the businesses in the program. These terms should be understood in the same way for all JOBZ businesses statewide.

As a matter of sound business practice, a binding legal agreement should be reviewed by attorneys for both parties. However, many local governments have been reluctant to spend money to have their own attorneys review the sample agreement, acting under the assumption that it had already been vetted at the state level. Unfortunately, this has not been the case. In fact, a few local governments told us that they had modified the sample agreement on the advice of their attorneys. The agency should ensure that sample legal documents that it distributes are legally sound.

RECOMMENDATION

DEED should discontinue use of the deal evaluator.

DEED staff told us that they pay little attention to the deal evaluator other than to ensure that the score received is above a minimum threshold. Several local government representatives we spoke with around the state agreed that one could make the score as high as one wanted and that they did not consider the evaluator to be a useful tool. Since neither DEED nor local officials appear to find the worksheet useful and since it can be easily manipulated to provide an acceptable score, we do not see any value in continuing to require its use.

COMPLIANCE MONITORING

As described in Chapter 1 and earlier in this chapter, responsibility for enforcing compliance with JOBZ agreements and the JOBZ statute is shared among DEED, DOR, and local officials. Local officials submit annual reports to DEED, which uses these reports to identify companies that may be out of compliance with their

**Local officials
report to DEED
on business
compliance
with JOBZ
agreements.**

agreements. After confirming its information with local officials, DEED offers noncompliant companies the opportunity to request an extension of time to meet their obligations. If a business does not receive an extension or fails to meet its goals within the additional time, DEED sends a notice to the company declaring it out of compliance with the JOBZ program and forwards the information to DOR so it can pursue repayment of tax benefits.

In this section, we focus primarily on DEED's role in the compliance process. We address the role of DOR in the next section.

DEED's Procedures

In our review of DEED's compliance activities, we found that:

- **DEED's procedures for enforcing JOBZ compliance are inefficient and do not identify noncompliant businesses in a timely manner.**

According to the JOBZ and business subsidy laws, companies receiving JOBZ subsidies are required by March 1 of each year to file reports for the previous calendar year with local governments; the local governments, in turn, must file reports with DEED by April 1.²⁷ As shown by the timeline in Table 3.1, DEED staff did not complete their initial review of the reports covering calendar year 2005—due April 1, 2006—until early December 2006. DEED staff attributed this delay partly to local governments that did not file reports on time or filled them out incorrectly. DEED sent official letters removing nine noncompliant businesses from the JOBZ program on April 23, 2007, more than 15 months after the end of the reporting period.

The compliance process for performance by businesses during calendar year 2006 had not yet been completed as of January 18, 2008. DEED staff told us at that time that they had begun in December 2007 to review the reports covering calendar year 2006, and they had not yet completed their additional inquiries after their initial review of the reporting forms.

DEED's delay in monitoring JOBZ compliance essentially grants an extension to every business.

Because of the statutory requirement that businesses meet at least some goals within two years, a substantial number of businesses that entered the program in 2004 reached deadlines during 2006. However, the delay in the compliance process essentially grants all businesses an extension of one to two years, whether they request one or not. When DEED identifies a business that may not have been meeting its requirements in 2006, it asks the local government to provide current information on a business's performance. If the current information (i.e., as of January 2008) shows that the business is meeting its obligations, DEED takes no further action.

²⁷ *Minnesota Statutes* 2007, 469.320, subd. 1; and 116J.994, subd. 7-8.

Table 3.1: Timeline for DEED's Compliance Process, 2006

March 1, 2006	Deadline for businesses to file Minnesota Business Assistance Forms (MBAFs) covering activity during calendar year 2005 with local administrators.
April 1, 2006	Deadline for local administrators to file MBAFs covering activity during calendar year 2005 for each JOBZ agreement with DEED.
December 4, 2006	DEED sends letters to local subzone administrators indicating that MBAF data suggest that a JOBZ business in their jurisdiction is out of compliance with its agreement. DEED requests that administrators update MBAF data as of November 30, 2006. After review of responses, DEED identifies nine businesses that are out of compliance with their agreements.
February 7, 2007	DEED sends notices to subzone administrators for some of the nine businesses, stating that the businesses are out of compliance. DEED advises the administrators that the businesses can seek an extension of up to one year from the original deadline to reach its goals.
April 23, 2007	DEED sends notices to the nine businesses stating that they are out of compliance with their agreements and stating the date on which each company ceased to be a "qualified business" under the JOBZ statute. DEED sends copies of the notices to DOR and county auditors.

SOURCE: Office of the Legislative Auditor, review of Department of Employment and Economic Development files.

DEED has the authority to remove companies from the program at any time for failing to meet their obligations, but it has exercised this authority inconsistently. Upon notification by local authorities, DEED notified DOR and a county auditor regarding one noncompliant business in May 2006. However, another city notified DEED that a local business was noncompliant and forwarded a request from the business for an extension in March 2006. DEED did not act on the information until it began its compliance review process in December 2006.

We also found that:

- **Failure to promptly remove a noncompliant business from the JOBZ program can enable the business to receive additional tax breaks that cannot be recovered by local governments or the state under current law.**

Four businesses that DEED removed from the program in April 2007 received property tax reductions that cannot be recovered by the state. The businesses became noncompliant as of the deadlines in the agreements they had signed, which ranged from December 2004 to April 2006. According to the JOBZ

A few businesses received tax breaks to which they were not entitled due to DEED's slow process.

statute, a business that does not meet its goals must repay tax subsidies received “during the two years immediately before it ceased to operate in the zone.”²⁸ (DEED and DOR have interpreted this phrase to include instances where a firm stopped complying with its agreement, whether or not the firm continued in business in the zone location.) Because DEED's process took so long to declare the businesses out of compliance, they received property tax subsidies after the dates that they were out of compliance. These tax breaks are not subject to recovery by the state or the county. Their property tax exemptions will not be removed until tax year 2008.

Reporting By Local Governments and Businesses

Our review of DEED's compliance process also determined that:

- **The form used to monitor compliance with JOBZ agreements does not provide sufficient instructions, fails to define important terms, and does not effectively gather needed information.**

After the passage of JOBZ, DEED modified its existing reporting form, the Minnesota Business Assistance Form (MBAF), to enable it to serve the needs of the JOBZ program. The same form is used by businesses to report to local governments and by local governments to report to DEED. We identified numerous problems with this form.

Hour and Wage Details

Many business subsidy agreements and DEED's standard relocation agreement define a business's obligations in terms of full-time equivalent employees. However, the MBAF does not ask for the number of hours worked by part-time employees, nor does it indicate that part-time employees should be listed in full-time equivalent terms, making it impossible to calculate the number of full-time equivalents a company employs.

Further, the MBAF asks for wages rounded to the nearest dollar. Such rounding could cause DEED to incorrectly conclude that some noncompliant firms are meeting their obligations. If a JOBZ business is required by its agreement to pay employees at least \$11.00 per hour but it pays some or all of these employees

²⁸ *Minnesota Statutes* 2007, 469.319, subd. 1.

The reporting form DEED requires local governments to submit is flawed.

\$10.50 per hour instead, the reporting form filed with DEED would show all employees receiving \$11.00 per hour.²⁹

Instructions

The MBAF asks about job creation and retention in a confusing manner. In order to determine whether businesses have created the required number of new jobs since entering the program, the form asks businesses to classify zone employees under the categories “full-time,” “part-time,” and “job retention.” Nowhere does the form specify that companies and local officials should report only “new” jobs—those created since the business entered the JOBZ program—in the first two categories. Some firms or local officials have interpreted “full-time” and “part-time” to include all employees. As a result, hundreds of jobs have been double-counted.

For example, local officials in one city reported on a 2007 MBAF that a firm which had relocated into a JOBZ zone had 206 retained employees and 339 full-time employees, which suggests a total of 545 employees. However, the official who completed the form told us that the city intended to report that the firm had 339 total employees, of which 206 were retained. In another example, local officials in another city reported on a 2007 MBAF that a start-up meat processing plant had 329 retained employees and 329 full-time employees, or a total of 658. However, the official completing the form intended to report that the business had 329 total employees, all of which had been retained since the previous report submitted to DEED in 2006. Comparisons between unemployment insurance filings and MBAF reports suggested that such misunderstandings occurred in other instances as well.

In addition, although DEED staff told us that only employees working in the zone are supposed to be reported on the form, the instructions on the form do not state this. At least 56 companies which did not relocate (and therefore should not have had any retained employees in the zone) reported at least some retained employees on their 2007 MBAFs, suggesting that their reporting forms may include employees both from zone locations and nonzone locations.

Further, the MBAF does not specify a time period or ask those completing the form to list a date on which the information was valid. The wording of the business subsidy law indicates that annual reporting by businesses should cover the preceding calendar year, but the form asks for only a total number of

²⁹ DEED administrators told us this format is required by the business subsidy statute, which states that the business subsidy reports must include “the hourly wage of each job created with separate bands of wages” and “the sum of the hourly wages and cost of health insurance provided by the employer with separate bands of wages.” *Minnesota Statutes* 2007, 116J.994, subd. 7. However, the JOBZ statute authorizes the commissioner to prescribe, without limitation, “(1) the required time or times by which the reports must be filed; (2) the form of the report; and (3) the information required to be included in the report.” *Minnesota Statutes* 2007, 469.320, subd. 2; 469.313, subd. 2(5); and 116J.994, subd. 8b.

employees and is not designed to show how employment may have increased or decreased over the course of a year.³⁰

Finally, the question on the MBAF about capital investment is poorly worded and could easily be interpreted to include investments made in the subzone prior to its designation as a JOBZ site.

Definition of Key Terms

Like JOBZ agreements, the reporting form does not define key terms.

Like business subsidy agreements and relocation agreements, the MBAF does not define important terms such as “full-time,” “employee,” and “benefits.” With regard to the latter, the JOBZ statute requires businesses entering the program after June 30, 2005, to pay a certain minimum amount for combined wages and benefits, but specifically excludes benefits mandated by law (such as unemployment insurance).³¹ Conversely, the business subsidy statute mandates that businesses report the “sum of the hourly wages and cost of health insurance provided by the employer.”³² However, the form asks only for undefined “hourly benefits” without clarification.

The MBAF also asks for a benefit date, giving the same definition as provided in the business subsidy statute. As noted in the discussion of business subsidy agreements above, this definition is unclear in the context of JOBZ. The form does not directly ask for the date the business began operations in the zone, which is the date used to set the firm’s job creation deadline in many business subsidy agreements and relocation agreements.

Multiple Obligations Listed in Agreements

The MBAF asks firms to provide information on the job and wage requirements listed in their agreements. However, there is only room given for one set of obligations, even though some businesses must meet more than one set of requirements. In some instances, business subsidy agreements and relocation agreements have different requirements. In other cases, businesses negotiated agreements with multiple obligations, such as setting both an average wage level and a minimum wage level or requiring more than one increase in employment over a span of several years.

Independent Verification

Compounding the problems above, DEED has given scant guidance to local government officials about how carefully to examine the information provided by companies. Our interviews with local government officials across the state suggested that the amount of independent verification varies widely. Some local officials simply accept the numbers provided by company officials without

³⁰ *Minnesota Statutes* 2007, 116J.994, subd. 7b.

³¹ *Minnesota Statutes* 2007, 469.310, subd. 11g.

³² *Minnesota Statutes* 2007, 116J.994, subd. 7b(3).

question; others insist on examining the company's payroll records or unemployment filings.³³

Accuracy

Using information reported in unemployment insurance filings, we conducted our own independent verification of the information reported on MBAFs by firms that entered the JOBZ program in 2004 or 2005.³⁴ Although issues involving multiple locations and incomplete data meant that we could not make comparisons in every instance, we were still able to conclude that:

- **Information reported to DEED on the number of employees and wages paid by JOBZ firms is frequently inconsistent with information reported by those same firms to the unemployment insurance system.**

In one-third of the cases we checked, reports sent to DEED showed more workers than in businesses' unemployment insurance filings.

There were 238 JOBZ agreements reached in 2004 and 2005 by 232 different firms.³⁵ We retrieved the information nearly all of these businesses had filed with the unemployment insurance (UI) system since 2001. However, it was impossible to use this data to check the accuracy of MBAF forms in some instances because businesses did not distinguish between multiple locations in their UI filings. In addition, a legislative change that took effect in January 2005 allowed businesses to remove from UI filings any employees holding at least a 25 percent ownership share, meaning that up to four full-time employees reported on a firm's MBAF could be missing from its UI records.³⁶

After accounting for such difficulties, we identified 175 businesses where the UI data appeared reliable enough to use as a check on the employment numbers reported to DEED as part of the 2007 MBAF reporting cycle for JOBZ firms.³⁷ In 58 of these 175 cases, local governments reported in the MBAFs that businesses either (1) had at least four more total FTEs than the businesses listed

³³ In at least one instance, a local official told us that he keeps copies of the company unemployment filings and considers them public records. DEED Unemployment Insurance staff we consulted suggested that this practice is not consistent with state statutes regarding data privacy. *Minnesota Statutes* 2007, 268.19, subd. 1.

³⁴ Due to the nature of unemployment insurance data, we were only able to check the performance of JOBZ firms with regard to number of employees and wages paid. We were unable to independently examine whether businesses were meeting capital investment targets.

³⁵ One business signed a second agreement with the same local government after circumstances changed; a few businesses signed more than one agreement for separate facilities.

³⁶ *Minnesota Statutes* 2007, 268.035, subd. 20(28).

³⁷ We also excluded businesses where (1) no MBAF was filed with DEED or (2) an MBAF was filed but the firm subsequently left the JOBZ program prior to June 30, 2007.

in their UI filings, or (2) had at least four more new FTEs than the increase in employment shown over the same time period in UI filings.³⁸

This number is a very conservative estimate. We used the highest job FTE total found in the UI data across three quarterly reporting periods to measure employment at the end of 2006; similarly, we used the lowest FTE total found in the UI data across three quarters surrounding the date of the JOBZ agreement in order to measure overall increase in employment.³⁹ In addition, it is unlikely that every single business had four full-time employees with a 25 percent ownership stake in the business. Running the analysis with the four-job cushion removed (which would likely overstate the number of inconsistent MBAF reports) produced a figure of 105 out of 175 firms where MBAF jobs reported exceeded UI jobs reported for at least one of the two measures above.

Analysis of the UI data also indicated that:

- **DEED’s compliance process may fail to identify a significant number of businesses that are not meeting their commitments.**

Reports filed with DEED may not identify all of the businesses that do not meet their JOBZ obligations.

Overall, our analysis of the UI data suggested that approximately one-third of the businesses that had reached deadlines listed in their agreements by the start of 2007 may not have been meeting their JOBZ obligations. MBAF reports for the same period indicated that only 11 percent of businesses were out of compliance.

Jobs

We conducted two analyses using information from the UI system to check whether DEED’s compliance procedures had correctly identified businesses that had not met their hiring targets.

First, we reviewed the performance of firms at the end of 2005 to determine whether businesses that did not meet their obligations according to the UI data were identified by DEED as part of its 2006 compliance procedures (described in Table 3.1).

Of the 238 JOBZ agreements reached in 2004 and 2005, only 103 required firms to meet some employment obligations as early as December 31, 2005. (In over half of these cases, the obligation was to retain preexisting employees.) Relying primarily on the MBAFs, DEED’s compliance checks identified nine businesses that had not met their obligations. Eight of these businesses were removed from

³⁸ With regard to the MBAFs, by “total FTEs” we are referring to the number of employees listed as “full-time” plus the number of employees listed under “job retention.” By the number of “new employees” on the MBAF, we are referring to the number of employees listed under “full-time.” As discussed earlier in this section, we found these terms to be misleading. However, this interpretation is what DEED has used to check compliance with JOBZ agreements.

³⁹ We calculated FTEs from the UI data by assuming that one FTE was equal to the number of non-holiday hours for full-time state employees for each reporting period. Except in a couple of instances where we were familiar with specific local information, we assumed that all zone employees were employed by the JOBZ business and not by staffing companies or subcontractors.

**DEED's
procedures for
verifying the size
of a business's
workforce may
be insufficient.**

the program; the ninth claimed that its business subsidy agreement had contained incorrect information and negotiated an arrangement with DEED to stay in the program.

Using UI data for early 2006, we identified an additional 7 firms beyond the 10 identified by DEED that may not have been meeting their job creation or retention obligations. Five of the seven firms we identified were still out of compliance as of early 2007 according to their UI filings. Of the remaining two, one had met its obligations by the beginning of 2007. The other appears to drop below its obligations seasonally; it did not have the required number of employees in the first quarters of 2005, 2006, or 2007, but increased employment during other parts of the year.

Of the seven firms that we identified, three had been flagged for further inquiry through DEED's compliance process because the information submitted on the MBAFs suggested that the firms were not meeting their obligations. However, after seeking information from local government officials, DEED decided the firms were actually in compliance. Nonetheless, information from UI filings indicates that two of these firms continued to be out of compliance as of early 2007.⁴⁰ The third had improved its performance dramatically and was easily surpassing its obligations.⁴¹

In a second analysis using UI data, we reviewed the performance of firms at the end of 2006 and compared the results to the initial information reported on the MBAFs received in 2007. At the time of our analysis, DEED had not yet begun to check compliance using the 2007 reports, so we could not compare their final conclusions to more recent UI data. However, because DEED uses the MBAFs as its starting point, we assessed whether UI data analysis provided more information than review of the 2007 MBAF submissions alone.

We identified 22 firms that did not show enough FTE employees in their UI filings to meet their JOBZ commitments as of the end of 2006. In 13 of these 22 cases, the MBAFs covering the same period indicated that these businesses had met their JOBZ obligations.

We also identified an additional 39 businesses whose employment numbers were below their JOBZ requirements, but for which we felt further inquiry was necessary because of the limitations of the UI data. By comparison, MBAFs suggested that compliance might be questionable in only 2 of these 39 cases. These companies mostly fell into two categories:

- Businesses that used JOBZ to expand existing operations. As noted above, some JOBZ agreements make it possible for businesses to meet

⁴⁰ DEED later determined that one of these three businesses had, in fact, been out of compliance all along. The business was removed from the JOBZ program in 2007.

⁴¹ We also identified an additional nine businesses that appeared to be below their hiring targets according to the UI data but which might have met their obligations if some of their employees were owners working full time (who need not be reported on UI filings). Two of these firms were flagged for further investigation by DEED and determined to be in compliance.

their obligations by moving employees from their original (non-JOBZ) location to their JOBZ location after the first year of JOBZ operations. Thus, though UI information indicates that the businesses did not increase employment enough to meet their obligations, they may be technically in compliance.

- Businesses that were below their employment target by four or fewer employees. Because businesses are not required to report to UI any employees holding at least a 25 percent ownership stake in the firm, a business may have up to four such employees that would not appear in UI filings.

Wages and Benefits

In addition to looking at the overall number of FTEs employed, we also used the UI data to examine whether businesses were paying the minimum wages and benefits required by their agreements. However, the information provided by UI filings was difficult to use for this purpose. State law requires that all JOBZ businesses entering the program after June 30, 2005, provide employees with a total compensation package—including both wages and benefits—above a certain minimum threshold. However, UI filings do not include any information about employee benefits. Also, many agreements signed before July 2005 were written in such a way that wage and benefit goals applied to some employees but not others. Finally, as noted previously, a substantial number of firms do not distinguish between non-JOBZ locations and JOBZ locations in their UI filings.

Some businesses may not be paying the minimum wages and benefits required by their agreements.

These difficulties limit the confidence that we have in drawing conclusions about wages from the UI data. Nonetheless, after reviewing their UI filings for late 2006 and early 2007, we identified 11 JOBZ businesses for which we felt further inquiry was warranted. In some instances, JOBZ agreements required these businesses to pay a minimum wage excluding benefits; in others, at least some employees (often part-time) were being paid wages so low that they would have had to receive more than 30 percent of their base wage in benefits in order to meet the minimum threshold required by statute.

Recommendations

We conclude this section of the chapter with the following recommendations:

RECOMMENDATION

DEED should streamline its compliance review process to produce more timely information about the progress of JOBZ businesses. DEED should move promptly to either remove noncompliant businesses from the program or provide an extension if warranted.

DEED's current approach to assessing compliance takes too long. In at least two instances, DEED asked firms if they would like to request extensions so long after their deadlines that the extensions would have already expired had they

been granted. The business subsidy statute requires local governments to review the reports provided by businesses, add additional information, and forward the information to DEED within one month.⁴² DEED should devote sufficient resources to JOBZ compliance so that it can perform at least a preliminary review of the compliance data in a similar time frame.

RECOMMENDATION

The Legislature should enact a stronger penalty for local governments that do not file required reports on time.

DEED staff told us that they were hampered in performing compliance reviews more quickly because many local governments did not submit MBAFs on time. The business subsidy law allows local government officials to fine businesses up to a total of \$1,000 for late filing of business subsidy reports.⁴³ However, DEED is not authorized by law to similarly fine local government officials for failing to file their reports with DEED. A local government may not sign another JOBZ agreement or grant any other business subsidies until a form is submitted, but DEED's experience suggests that this penalty is not enough of a deterrent to encourage prompt reporting.⁴⁴

DEED should restructure its compliance process and revamp its reporting form.

RECOMMENDATION

DEED should develop a compliance review process triggered by the deadlines listed in business subsidy agreements.

DEED's current process is tied to a once-a-year reporting process, regardless of when the deadline falls for meeting an agreement. As a result, if a business has a January deadline for meeting its obligations, it need not report on its success or failure until March 1 of the following year, and the local government would not notify DEED until a month after that. Businesses and local governments should be required to report on progress in meeting commitments within 30 and 60 days, respectively, of each deadline specified by a business subsidy agreement.

RECOMMENDATION

DEED should revamp the business subsidy reporting form.

The Minnesota Business Assistance Form is flawed, as evidenced by the discrepancies we found between MBAF-reported data and UI-reported data. We found more than one instance where MBAFs overstated employment by

⁴² [Minnesota Statutes](#) 2007, 116J.994, subd. 7-8.

⁴³ [Minnesota Statutes](#) 2007, 116J.994, subd. 7d.

⁴⁴ [Minnesota Statutes](#) 2007, 116J.994, subd. 8a.

hundreds of jobs simply because those completing the form did not correctly interpret its vague instructions.

At the very least, DEED should change the form so that it (1) clearly states for what time period employment is being reported, (2) clearly distinguishes between employees that work in the zone and those that work in other facilities, (3) clearly distinguishes between new and retained employees, (4) elicits information about the hours worked by part-time employees, (5) more clearly defines the time period in which capital investments were made, (6) asks for the date that the business began operations in the zone, (7) asks for the name of the property owner, and (8) asks for the UI identification number of the business.⁴⁵ In addition, instructions for the form should carefully define terms such as “full-time,” “benefits,” and “employee.”

DEED should also consider restructuring the layout of the employment information on the form by asking businesses to list each position, the precise wages and benefits earned by each employee in that position, the number of hours worked, and whether the position was created after the business began operations in the JOBZ location.

However, a drawback to this layout is that it would make public release of the MBAFs somewhat more complicated. By law, all MBAFs are posted on DEED’s web site.⁴⁶ The detailed information we suggest above could not be simply released to the public because personal salary information about some individual employees could easily be deduced. If DEED proceeds in this direction, it should clarify how the information provided by businesses would be summarized for public access before publishing revised forms.

RECOMMENDATION

The Legislature should require businesses to attest to the accuracy of their business subsidy reports.

Business owners should face penalties if they make false claims in their reports to local governments.

Although a business can be penalized for failing to submit a business subsidy report, there is no statutory penalty for misstating the number of employees or the amount of wages on a report. Because of our concerns about the accuracy of the data submitted on MBAFs to date, we believe it is appropriate to ask business owners to attest to the information that they provide in their reports to local governments. The business owner would then be subject to perjury penalties for knowingly making a false claim.

⁴⁵ Unemployment insurance identification numbers are not public information and would need to be removed or redacted before the MBAFs are made publicly available. *Minnesota Statutes* 2007, 268.19, subd. 1.

⁴⁶ *Minnesota Statutes* 2007, 116J.994, subd. 9.

DEED should review companies' unemployment insurance filings as part of its compliance process.

RECOMMENDATION

DEED should use information from unemployment insurance filings to periodically check the performance of JOBZ businesses. DEED should require participating businesses to file their unemployment insurance data in a manner that would simplify compliance checking.

DEED's unemployment insurance division already receives quarterly data on employees and wages from nearly every company in the state. DEED's JOBZ staff should take advantage of this data resource to provide an additional check on the performance of JOBZ businesses.

In order to most effectively use this information, DEED should require businesses that take part in the JOBZ program to provide all relevant UI identification numbers in their annual reporting, distinguish their JOBZ sites as separate locations (or "units") in their unemployment filings, and use a consistent approach to reporting hours worked.

RECOMMENDATION

The Legislature should authorize the State Auditor to use state tax data and unemployment insurance data in ongoing audits of JOBZ compliance.

Among the amendments to the JOBZ statute passed by the 2005 Legislature was a provision requiring the State Auditor to perform annual audits of the JOBZ program, including individual agreements.⁴⁷ However, the State Auditor was not authorized to use the nonpublic data necessary to do a thorough audit. The 2007 Legislature passed a provision giving the State Auditor such authority in the omnibus tax bill, but the bill was vetoed by the Governor for reasons unrelated to JOBZ.⁴⁸

Because of our concerns about the accuracy of information reported by businesses and local governments, we strongly support an ongoing audit process. Our evaluation found the state tax data and the unemployment data to be extremely helpful; the Legislature should authorize the State Auditor to make use of these data.

ADMINISTRATION OF TAX EXEMPTIONS

The extensive set of tax exemptions provided to JOBZ businesses requires involvement from several divisions of DOR. County assessors also play a role in JOBZ administration because of the property tax breaks received by participating businesses or their landlords. In this section, we look first at the procedures that all JOBZ businesses follow to claim their tax exemptions, then at the procedures

⁴⁷ *Minnesota Statutes* 2007, 469.3201.

⁴⁸ Minnesota Legislature 2007, *House File 2268, Second Engrossment*, art. 6, sec. 25.

in place to handle situations where businesses do not meet their obligations or leave the program for other reasons.

Tax Forms

Businesses and individuals claiming JOBZ exemptions on individual and corporate taxes file Schedule JOBZ with DOR.⁴⁹ In addition, participating businesses are asked each year to file Form M500, the JOBZ Tax Benefit Report. However, there is currently no requirement to file Form M500, and some companies have not done so. We found that:

- **Because there is no requirement to file the M500 tax form and because the form is not designed for some recipients of tax incentives, the Department of Revenue may not receive complete information about recipients of JOBZ tax benefits.**

If a business does not file Form M500, DOR has no record of any sales tax exemptions the firm receives. Without such information, DOR would encounter greater difficulty in securing repayment of taxes received from noncompliant firms. In addition, DOR uses information from the M500 forms to estimate the overall cost of the JOBZ program to the state; this task is complicated by the failure of some firms to file the forms.

Businesses are not required to report some of the tax exemptions they receive.

Although the M500 is intended primarily to capture information about the sales tax benefits received through the JOBZ program, it is designed only for participating businesses. Under the law, others can also claim JOBZ benefits on sales tax purchases, most notably property owners that construct a building to be used by a participating business.⁵⁰ As a result, tax exemptions received by landlords may not be fully reported to DOR.

Some property owners have filed M500 forms, particularly those closely affiliated with the participating business (for example, when the owners of a company also own the property through a separate business entity). However, it is impossible to determine what proportion of property owners has filed M500 forms because neither DEED nor DOR has compiled a list of property owners eligible for JOBZ benefits.

In addition to examining the M500 forms, we also reviewed JOBZ tax schedules that were filed with DOR for tax years 2004 and 2005. Schedule JOBZ is required for most businesses and individuals that receive JOBZ tax exemptions for corporate income tax, corporate franchise tax, individual income tax, capital gains tax, partnership taxes, estate taxes, minimum fees, or the JOBZ jobs credit. We found that:

⁴⁹ Partners, S corporation shareholders, and beneficiaries of an estate or trust do not complete the JOBZ schedule.

⁵⁰ See *Minnesota Statutes* 2007, 297A.68, subd. 37b.

- **The Schedule JOBZ tax form contains an error in how it directs taxpayers to calculate the corporate franchise tax exemption and business income tax exemption.**

As described in more detail in Chapter 1, the JOBZ statute limits exemptions to only the new activities a business began after locating in a JOBZ subzone. Further, this exemption is limited to 20 percent of the sum of the zone payroll and the adjusted basis of the property at the time the zone property was first used by the business. The Schedule JOBZ tax form incorrectly directs businesses to apply the 20 percent cap too early in the calculations. As a result, it is possible that some businesses received a smaller exemption than they were entitled to.⁵¹

In addition, we found that:

- **Some businesses filing the Schedule JOBZ with their tax forms appear to have made mistakes in calculating the JOBZ jobs credit.**

The JOBZ jobs credit is a refundable credit available to JOBZ businesses that pay their zone employees an average wage over \$32,880.⁵² It is calculated through a complex formula that takes into account a company's zone payroll, its total Minnesota payroll, its Minnesota payroll in 2003, and the number of employees in the zone.⁵³

Some businesses have mistakenly claimed in tax forms to have had employees in a zone before the program began.

The most common mistake made by businesses involves providing information on the number of jobs or the amount of payroll they had in the zone in 2003. Technically speaking, no business was located in a zone in 2003, since zones did not exist until 2004 and particular subzones may not have been created until just before a business signed a business subsidy agreement. However, some businesses that expanded at their existing location (for example, by building another facility on their property) have apparently claimed they had payroll or jobs in the zone in 2003. In most such instances, the boundaries of the zone only include any new buildings or additions added after they became JOBZ businesses and do not include existing buildings that were previously occupied.

Beyond the errors made by specific businesses, we also recommend in Chapter 4 that the Legislature and DOR reconsider how the jobs credit is calculated.

⁵¹ Because the calculation only applies to businesses that relocated to a JOBZ site after August 31, 2005, only about 40 JOBZ businesses could possibly be affected. The actual number that received an inaccurate exemption amount may be much smaller.

⁵² This figure is for 2007; the wage level was set at \$30,000 for 2004 and is adjusted yearly for inflation.

⁵³ The formula excludes salaries over \$109,600 per year in the calculation of zone payroll. This amount was set at \$100,000 for 2004 and is adjusted yearly for inflation.

Procedures for Noncompliant Businesses

As described above, DEED made its first set of noncompliance determinations in April 2007.⁵⁴ Because DOR is still in the process of recovering funds from this initial group of businesses, we were unable to fully evaluate its performance in seeking repayment of tax benefits. However, we did review the initial steps DOR and other agencies have taken to secure the reimbursements required by statute. We found that:

- **Communication between DOR, DEED, local governments, and county tax officials is not sufficient to implement an effective repayment process when businesses are removed from JOBZ.**

Because of the many JOBZ tax breaks, multiple state and local officials must be involved when a company has to make repayments.

Because of the wide range of tax benefits received by JOBZ businesses, multiple state and local officials must be involved to effectively pursue repayment from businesses that are removed from (or voluntarily leave) the program. DEED must determine when a business is no longer in the program and notify DOR and local officials. DOR and county tax officials must determine the extent of tax subsidies received by the business over the two-year period preceding its departure. Local city or economic development officials often serve as the primary contacts with the business and would play a key role in appealing a decision by either state agency or requesting an extension or waiver.

Our conversations with officials at all levels of this process revealed inadequate communications regarding the status of JOBZ businesses. Some local officials have not notified DEED about businesses that have changed their plans and never began operations in a zone. DEED staff have not routinely checked with local governments to determine whether JOBZ businesses have begun operations. Within DOR, sales and property tax specialists have not received notification when firms enter the program, although DEED sends copies of all business subsidy agreements and they are filed in the DOR Commissioner's office. County tax officials told us that they were uncertain how to proceed with regard to pursuing repayment of property tax subsidies and hoped for further guidance from DOR.

We were particularly concerned by communication difficulties between DEED and DOR with respect to businesses that have stopped participating in the program. DEED staff have used two separate classifications for businesses that have not met their obligations. In instances where a business started operations in a zone and received tax benefits, DEED has declared the firm to be "out of compliance" and has formally notified DOR through a letter to the commissioner so that it could pursue repayment of tax benefits received. However, if local officials inform DEED that the business never started operations in the zone (usually because business circumstances changed), DEED has not declared the

⁵⁴ A single business was declared out of compliance in April 2006 after a city informed DEED it had cancelled its JOBZ agreement.

**Department of
Revenue staff
have kept track of
which businesses
are in the
program by
frequently
checking the
DEED web site.**

business to be “out of compliance.” Instead, DEED has used terms such as “inactive,” “never operated in a zone,” or “never happened.”⁵⁵

For inactive firms, DEED has not sent a formal letter to the business itself stating that it is out of compliance, nor has it necessarily sent a formal letter to the commissioner of Revenue to indicate that the firm is no longer eligible to receive JOBZ benefits. DEED staff told us that when they receive copies of local government resolutions canceling business subsidy agreements, copies of those resolutions are forwarded to DOR staff, and that this serves as notification that the businesses are no longer eligible for JOBZ. However, several DOR staff told us that they monitor companies leaving JOBZ by regularly checking the list of completed deals posted on the DEED web site and keeping track of changes, rather than through any notification process. DOR staff in both the property tax and sales tax divisions asked us during the course of our evaluation to compare their lists with ours to ensure that they were aware of all businesses no longer participating in the program.

As noted above, DEED notified DOR in April 2007 of nine businesses that were not in compliance with their JOBZ agreements. We reviewed the materials provided by DEED to DOR and concluded that important information was not included with this notification. In one example, a business had been forced to move out of the zone by its landlord but had then met its original obligations in a nonzone location. Such background information would be useful to DOR in considering whether to grant a waiver of repayment.

In another case that we examined, a property owner built a building in a zone and received property tax benefits under JOBZ, but the JOBZ business never moved into the building and was classified by DEED as an inactive agreement. Despite proper reporting by local economic development officials, DEED staff apparently did not realize that any tax benefits had been incurred until our inquiries prompted them to review the situation again. DEED had not notified DOR or local tax officials that action was necessary to seek repayment.⁵⁶

As part of our review of whether local and state agencies were meeting their statutory responsibilities, we also found that:

- **State laws regarding the repayment of tax subsidies are not clear and allow some noncompliant businesses to continue receiving subsidies.**

Two provisions in the JOBZ statute are ambiguous and could be interpreted in more than one way. A third provision, combined with existing property tax law,

⁵⁵ We referred to these as “inactive agreements” in Table 1.6.

⁵⁶ Staff at the local economic development office notified DEED in March 2006 that the building should not continue to be tax exempt. After no action had been taken over several months, they called the county assessor directly and persuaded him to place the property back on the tax rolls. In December 2007, the county assessor told us that he had yet to receive official notification from either DEED or DOR that the property had been removed from the JOBZ program.

enables businesses that have been removed from the program to continue to receive property tax benefits that cannot be recovered.

According to the JOBZ statute, a business that does not meet its obligations must repay tax benefits received during the two years “immediately before it ceased to operate in the zone.”⁵⁷ However, the law does not clarify how the repayment time period is to be calculated when a business fails to meet its obligations but continues to operate in its zone location. DEED and DOR have interpreted “ceased to operate” to mean that the firm has ceased to operate in compliance with its agreement and have notified businesses that they will need to repay tax benefits received for the two years prior to the date they ceased to comply with the agreement.

Another ambiguous section of the JOBZ statute is in a provision protecting the tax-exempt status of existing zone businesses in the event that DEED decides to remove the zone designation.⁵⁸ This section of the law appears to have been written as part of a previous version of the legislation, in which very few JOBZ locations would be created and acreage would be scarce. The intent of the section was to address situations where a subzone had little business activity and DEED chose to transfer acreage to a different location. However, the wording of the statute does not distinguish between possible reasons for changing the zone designation; it could be interpreted as protecting a business’s tax exemptions even when DEED removes a zone designation because the business has not met its obligations.

Current law allows businesses removed from JOBZ to continue receiving property tax breaks for 6 to 18 months.

Lastly, current law requires a business to repay up to two years of property tax benefits if it is removed from the JOBZ program—however, the business could subsequently receive 6 to 18 months of property tax exemptions which could not be recovered. This odd outcome is due to the interaction of the JOBZ statute and provisions of the state property tax code. According to DOR’s tax manual for county auditors and treasurers, if a business was ruled out-of-compliance between July 1, 2006, and October 14, 2006, it would be required to repay property tax benefits it had received during 2005 and the first half of 2006. However, property tax exemptions would then continue for the business during the second half of 2006 and all of 2007.

⁵⁷ *Minnesota Statutes* 2007, 469.319, subd. 1.

⁵⁸ *Minnesota Statutes* 2007, 469.320, subd. 4.

Recommendations

RECOMMENDATION

The Legislature should modify the JOBZ law to:

- *Require all JOBZ businesses to annually submit the M500 tax form in order to remain in the program;*
 - *Require that noncompliant businesses repay any property tax benefits they may receive after the date they cease to meet their obligations;*
 - *Clarify that businesses are subject to the repayment provisions of the statute if they remain in the zone but do not fulfill their obligations; and*
 - *Clarify that the provision protecting businesses from having a zone moved out from underneath them does not protect businesses that are out of compliance with their agreements.*
-

The 2007 Legislature passed a provision that penalized JOBZ businesses for failing to file the M500 tax form, but the bill was vetoed for unrelated reasons after conclusion of the session.⁵⁹ We recommend that the Legislature pass this provision again to ensure that DOR has the information it needs to pursue repayment of taxes when businesses are removed from JOBZ.

The Legislature should clarify ambiguous provisions of state law.

If DEED streamlines its compliance procedures as recommended earlier in this chapter, a business would be less likely to receive unrecoverable property tax breaks after being removed from the program. However, the Legislature should effect a more complete solution to this anomaly. The JOBZ law should be rewritten to require repayment of any tax subsidies received after the date a business ceases to meet its obligations, in addition to subsidies received during the preceding two years.

Additionally, the Legislature should address the sections of the statute described above that are ambiguous and need clarification.

RECOMMENDATION

DEED should stop using the “inactive” classification and treat all businesses as either active JOBZ participants or out of compliance.

Businesses that end their involvement with JOBZ before beginning operations in a zone often receive no tax benefits, but our evaluation showed that this is not

⁵⁹ Minnesota Legislature 2007, *House File 2268, Second Engrossment*, art. 6, sec. 8.

universally true. DEED should not assume that a business in this situation has not received tax benefits and therefore treat it differently than businesses that are out of compliance. Even when a business has clearly not received tax benefits, DEED's process for dealing with "inactive" businesses leaves these projects in awkward limbo and has led to confusion regarding the current status of some JOBZ businesses.

RECOMMENDATION

DEED should provide more complete information to DOR, county tax officials, and the public about businesses entering and leaving the JOBZ program.

DEED should always formally notify DOR and county officials when a business is not meeting the terms of the business subsidy agreement and is no longer eligible for JOBZ tax subsidies, regardless of whether DEED believes the business has actually begun receiving such subsidies. Staff at DOR have been unable to acquire such information consistently and have resorted to checking the DEED web site frequently in order to keep track of businesses that may have left the program.

The list of JOBZ agreements on DEED's web site should also note businesses removed from the program.

The list of "Completed JOBZ Deals" posted regularly on the agency's web site provides no information about businesses that drop out of the program; they simply disappear from the list. To better inform the public, this document should include all agreements ever submitted to DEED with notations regarding the current status of each JOBZ business.

When a business is removed from JOBZ or chooses not to start operations in a zone after signing a business subsidy agreement, DEED should provide more information to DOR and county tax officials than simply the name and location of the business. At a minimum, notification should include the names of the property owner and any others that may have received tax benefits related to the business's JOBZ status, all available information on whether and when the business operated in the zone, a summary of the reasons the business was removed from the program, background information that may be relevant to a waiver request, and contact information for a DEED staff person and local government representative familiar with the situation.

RECOMMENDATION

DOR should revise the M500 tax form to make it more easily usable by individuals and entities that receive JOBZ benefits but are not themselves participating businesses.

The JOBZ law provides some tax breaks for individuals and businesses other than the participating business, such as the property owner, investors in the business, and individuals who earn capital gains by selling a share of the business. The M500 tax form for the reporting of sales tax benefits received through JOBZ is not, however, designed to be used by entities other than the

JOBZ business. DOR should adjust the form and its instructions so that tax benefits received by others can be more easily reported on this form. DOR should send the form annually to property owners, in addition to the participating businesses that already receive it.

RECOMMENDATION

DOR should correct the calculation error on the Schedule JOBZ tax form.

DOR staff have acknowledged the existence of the error and have assured us that they will take steps to promptly correct the form.

RECOMMENDATION

DOR should review the calculation of the JOBZ jobs credit on the Schedule JOBZ forms filed by participating businesses and consider further clarification of the instructions.

Our review of tax returns filed with DOR by JOBZ businesses suggested that some businesses were not using appropriate definitions for FTEs, payroll, and base year zone amounts. Although all tax forms for 2006 were not yet available, we found enough incorrectly calculated tax credits on 2005 forms that we would advise DOR to review submitted forms carefully.

The instructions for the form are accurate; in our opinion, businesses should be able to follow them. However, if DOR finds that businesses continue to frequently miscalculate tax credits for tax years 2006 and 2007, it should consider adding even more detailed explanations of how to determine the correct amount of the credit.

RECOMMENDATION

DOR should increase its outreach to county property tax officials to improve their understanding of how to pursue repayment of JOBZ tax benefits from noncompliant businesses.

Although DOR has published guidelines in its manual for county auditors and treasurers, county tax officials we spoke with expressed considerable confusion regarding their responsibilities when a business in their jurisdiction leaves the JOBZ program. The agency can and should do more. A simple improvement would be to send a letter to county tax officials when a firm is removed from JOBZ to outline procedures, direct attention to the discussion in the manual, and provide contact information for relevant DOR staff.⁶⁰

The Department of Revenue should revise the Schedule JOBZ tax form and improve its communication with local officials.

⁶⁰ This letter would be in addition to, not instead of, an official notification of removal from the program sent by DEED.

Effectiveness

SUMMARY

Reports from the Department of Employment and Economic Development (DEED) overstate the impact of JOBZ on employment and business investment in Greater Minnesota. The employment data used by DEED are suspect, and DEED's estimates fail to consider what businesses would have done without JOBZ breaks. In fact, DEED's surveys indicate that two-thirds of participating businesses would have expanded to some extent in Greater Minnesota without JOBZ tax breaks. About one-fourth of this group say that the subsidies had no impact on how much they expanded in Greater Minnesota. Furthermore, providing JOBZ subsidies to some businesses may not have had much effect on overall employment because the participants compete with existing Greater Minnesota businesses for the same local or regional customers in the state.

Although providing a precise estimate of the impact of JOBZ would be difficult, it is clear that the program should focus more on those business projects most likely to generate economic growth for Greater Minnesota. Cities and townships make decisions about business participation with few state guidelines or requirements and no constraints on the amount of state tax expenditures that can be used for JOBZ. Cities and townships lack a regional or state perspective on the benefits of subsidizing particular businesses and bear only a small share of the costs. The JOBZ program has some value as an economic development tool but needs to be used more selectively or be limited to use in economically distressed areas.

The main purpose of JOBZ has been to increase employment in Greater Minnesota, particularly in economically distressed areas. As we saw in Chapter 2, the JOBZ program has not been targeted to economically distressed areas. But proponents claim that the program has been beneficial in creating jobs in Greater Minnesota. In this chapter, we examine the effectiveness of the JOBZ program in creating new jobs. We also consider whether the JOBZ program is designed and operated in a manner that maximizes its job creation potential and minimizes unneeded subsidies. In particular, we examine the following issues:

- What have national economic studies concluded about the impact of enterprise zone and other tax incentives?
- How has the Department of Employment and Economic Development measured the impact of JOBZ on employment and wages? What are the shortcomings of DEED's approach?
- Can the impact or effectiveness of the JOBZ program be more accurately measured?

- **Is the JOBZ program designed and operated to maximize its job creation potential and minimize unnecessary costs? How could the JOBZ program be changed to improve its impact?**

In answering these questions, we reviewed employment and investment data submitted by JOBZ businesses and participating local governments and examined employment information submitted to DEED for unemployment insurance purposes. We also reviewed state and national studies that have looked at the economic impact of enterprise zones and tax incentives. We also conducted extensive interviews with officials who operate the JOBZ program at the local government level. Finally, we reviewed the survey responses submitted by JOBZ businesses to DEED.

NATIONAL STUDIES

In this section, we summarize the results of economic studies that have examined the impact of enterprise zones or other tax incentives on employment.¹ Although the JOBZ program is somewhat unique, we think it is important to discuss what economists have concluded about the impact of other programs or efforts to reduce taxes on businesses. In addition, it is useful to note the types of studies that best isolate the impact of tax reductions on employment.

Enterprise Zones

As is the case for JOBZ, measuring the impact of an enterprise zone program is difficult because the impact of tax breaks on employment must be separated from the impact of other factors. Employment in a zone or at a JOBZ business could be increasing because of general growth in the economy, conditions in a particular industry, or because the businesses in a zone have been successful in meeting the needs of customers. Tax breaks may only be a relatively minor factor in explaining employment growth.

According to Hirasuna and Michael, there have been three different types of studies that have looked at the impact of enterprise zones on employment or per capita income. The types of studies include: (1) surveys, (2) shift-share analysis, and (3) regression analysis.² Hirasuna and Michael point out that regression analysis is more likely than the other types of studies to produce valid results.³ Surveys, for example, tend to show larger increases in employment or income than other types of studies, but do not enable researchers to determine how much of the increase in zone employment is due to tax breaks as opposed to other

¹ Our discussion of the literature on enterprise zones relies heavily on the literature review conducted by Don Hirasuna and Joel Michael of the Minnesota House Research Department. See Don Hirasuna and Joel Michael, *Enterprise Zones: A Review of the Economic Theory and Empirical Evidence* (St. Paul: Minnesota House of Representatives Research Department, January 2005).

² *Ibid.*, 10.

³ *Ibid.*, 11.

economic factors.⁴ Studies that use surveys also must rely on the opinions expressed by businesses, development officials, or other respondents who may be biased or unreliable.⁵ Shift-share analysis is more sophisticated than survey research and is able to control for some factors affecting zone employment. But, according to Hirasuna and Michael, shift-share analysis makes some simplistic assumptions, fails to control for certain factors affecting zone employment, and can only compare two time periods.⁶

Regression analysis is better suited for measuring the impact of various factors on zone employment. In addition, regression analysis is able to measure the impact of various factors over many years. As a result, Hirasuna and Michael reviewed the results from those studies of enterprise zones that used regression analysis.

Hirasuna and Michael called the results from these more sophisticated studies to be “mixed and inconclusive.”⁷ However, they also said that most of the studies suggest there is “no significant or prolonged increases in employment from enterprise zones.”⁸ Six of the ten studies they reviewed found that enterprise zones had no effect on employment. Four of the ten studies found that enterprise zones increased employment or decreased unemployment rates. But two of these four studies also found that the positive impact of enterprise zones was only temporary.⁹

Thus, despite widely ranging results:

- **Most of the more sophisticated research has not found that enterprise zones have an impact on employment or income.**

According to Hirasuna and Michael, however, some research suggests that larger financial incentives than are typically used in enterprise zones may be necessary to attract business interest and increase employment. They also say that areas with fewer barriers may be more successful. Barriers such as blight, pollution cleanup, a lack of skilled laborers, or poor access to customers may limit the impact of enterprise zones.¹⁰

Tax Incentives

While JOBZ provides tax breaks like other enterprise zones elsewhere, it is different than most enterprise zones in several key respects. First, it provides tax

Most rigorous studies have found that enterprise zone programs have little lasting impact on employment.

⁴ *Ibid.*, 10.

⁵ *Ibid.*, 10.

⁶ *Ibid.*, 10.

⁷ *Ibid.*, 11.

⁸ *Ibid.*, 11.

⁹ *Ibid.*, 11.

¹⁰ *Ibid.*, 13.

State and local business tax reductions have a modest effect on interstate business location decisions.

breaks that are greater than those provided in most states except those in Michigan, Pennsylvania, and New York.¹¹ Second, as we demonstrated in Chapter 2, the JOBZ program has few requirements about where a subzone may be located other than it cannot be in the Twin Cities metropolitan area. Unlike enterprise zones in some other parts of the country, JOBZ zones are not restricted to blighted or distressed areas.

For both of these reasons, the JOBZ program could potentially provide more economic impact than the enterprise zones that were the subject of numerous regression studies. As a result, it may be useful to examine the literature on the impact of taxes or tax incentives.

Numerous studies have found that reductions in taxes can stimulate the economy and increase employment and income. However, the key issue is the magnitude of the economic response to tax reductions, particularly reductions in state and local business taxes such as those offered by the JOBZ program. The current consensus among economists is that:

- **Reductions of state and local business taxes have a positive, but relatively modest, impact on employment when applied to interstate or intermetropolitan business location decisions.**

In particular, studies suggest that, for every 10 percent reduction in state and local business taxes, employment or economic activity in an area will increase 2 to 4 percent.¹² If we use the midpoint of this range (3 percent), this means a 30 percent reduction in state and local business taxes would increase employment or business activity by about 9 percent.

Some economists have argued that these results which apply to overall employment changes can also be used to estimate the percentage of new jobs

¹¹ The exceptions are the Michigan Renaissance Zones, Pennsylvania Keystone Opportunity Zones, and the New York Empire State Zones, which provided some of the inspiration for Minnesota's JOBZ zones. Hirasuna and Michael point out that there have been no peer-reviewed published empirical studies of any of these three programs. See Hirasuna and Michael, *Enterprise Zones*, 14.

¹² Economists use the term "elasticity" to describe the responsiveness of economic activity to tax changes. If the elasticity of business activity to state and local business taxes is -0.3, it means that a 10 percent reduction in state and local business taxes will result in a 3 percent increase in employment or general business activity. In the early 1990s, economists thought the elasticity with respect to state and local business taxes was between -0.1 and -0.6. For a review of the literature prior to 1991, see Timothy J. Bartik, *Who Benefits from State and Local Economic Development Policies?* (Kalamazoo: W.E. Upjohn Institute for Employment Research, 1991), 43. However, the consensus view has changed. In their 1995 review of the literature, Joseph Phillips and Ernest Goss conclude that the average tax elasticity found by other studies was -0.4. See Joseph M. Phillips and Ernest P. Goss, "The Effect of State and Local Taxes on Economic Development: A Meta-Analysis," *Southern Economic Journal* 62, no. 2 (October 1995): 320-333. In a subsequent article, Michael Wasylenko shows that the median interregional tax elasticity of employment found by other studies has been about -0.2 or less. See Michael Wasylenko, "Taxation and Economic Development: The State of the Economic Literature," *New England Economic Review* (March-April 1997): 49. Bartik now says that literature reviews suggest that the elasticity is between -0.2 and -0.3. See Bartik, "Solving the Problems of Economic Development Incentives," *Growth and Change* 36, no. 2 (Spring 2005): 142.

induced by the tax cuts.¹³ In other words, if an enterprise zone program offers a 30 percent reduction in state and local business taxes, then about 9 percent of the new jobs at businesses in the zones have been induced by the program. This is roughly equivalent to assuming that for every ten businesses participating in the program, the tax breaks are the decisive factor in the location or expansion decisions of only one business. For the other nine businesses, the tax incentives have no effects on their location or employment growth.

This modest response to tax incentives means that businesses are generally reluctant to move long distances in response to state and local tax breaks. State and local business taxes are a relatively small share of business activity—comprising about 5.1 percent of private sector gross state product in 2006, both in Minnesota and, on average, throughout the nation.¹⁴ Even substantial reductions in these taxes may not be enough to cause businesses to move great distances. A business may already be strategically located with respect to its suppliers and customers. In addition, the business may be satisfied with its existing employees and labor costs and may not want to disrupt that arrangement for tax reductions that are a relatively small share of their revenues.

Business tax incentives have more influence on location decisions within a metropolitan area.

Research also suggests that:

- **Tax incentives are most powerful in influencing business location decisions within a metropolitan or regional area, but this is precisely where tax incentives are often least justified.**

Economists have shown that business activity and business location decisions are far more responsive to tax reductions within a metropolitan or regional area. For example, one review of the literature concluded that, for every 10 percent reduction in taxes in one community in a metropolitan area, the community could expect a 10 to 30 percent increase in business activity assuming taxes in other local communities remain the same.¹⁵ This means that tax incentives may be very successful in getting businesses to move from one part of a city to another part of the same city or to a nearby city in the same general region if tax incentives are only available in a certain part of the city.

¹³ For example, see Alan H. Peters and Peter S. Fisher, *State Enterprise Zone Programs: Have They Worked?* (Kalamazoo: W.E. Upjohn Institute for Employment Research, 2002), 104-105 and 265-269. See also Bartik, "Solving the Problems of Economic Development Incentives," 143.

¹⁴ See Robert Cline, Thomas Neubig, and Andrew Phillips, *Total State and Local Business Taxes: 50-State Estimates for Fiscal Year 2006* (Washington, DC: Ernst and Young, February 2007), 9. State and local business taxes include property taxes, sales taxes, excise and gross receipts, corporate income taxes, unemployment insurance taxes, individual income taxes on business income, and licenses and other taxes. Compared with Minnesota (5.1 percent), state and local business taxes in 2006 were a lower share of private sector gross state product in Iowa (4.6 percent) and Wisconsin (5.0 percent) but were higher in North Dakota (7.3 percent) and South Dakota (5.4 percent).

¹⁵ Bartik, *Who Benefits from State and Local Economic Development Policies?*, 43. In technical terms, this means that the intrametropolitan elasticity of business activity with respect to state and local business taxes is between -1.0 and -3.0.

Where tax incentives work best, they are least justified.

While tax incentives are powerful in this instance, they work best precisely where they are least justified.¹⁶ The program could be used by businesses that are expanding anyway and willing to move but only a short distance. If a business moves to a nearby community to obtain tax incentives, the local government providing the subsidy gains at the expense of its neighbor. The public incurs the cost of the subsidies without any net employment benefit for the area. If a business chooses to locate in a different location in the same city because of the availability of tax subsidies, the subsidies are unnecessary because the business was planning to expand anyway.

However, this responsiveness could be useful if an enterprise zone or tax incentive program is used along a state's border. For example, a program could be successful in getting businesses to locate in Minnesota if they are deciding between locating on either side of the border between Minnesota and a neighboring state.

ESTIMATES OF THE IMPACT OF JOBZ

The literature on enterprise zones does not provide a clear indication of the likely impact of the JOBZ program. Most of the evidence from sophisticated studies of enterprise zones suggests that they have little permanent impact on an area's employment. JOBZ, however, is somewhat different from some enterprise zone programs. Although it has been used in some economically distressed areas, it is not exclusively targeted to those areas like some enterprise zones. As a result, it may avoid the problems that some enterprise zone programs encounter in trying to attract businesses to areas with significant economic barriers. In addition, JOBZ offers substantial reductions in state and local business taxes. These reductions are larger than those offered by the enterprise zone studies that have been studied extensively. Although most research on enterprise zone programs does not find that they affect employment, JOBZ may have a larger impact on employment due to its different characteristics.

Research on the impact of tax incentives on employment and business location decisions may be more relevant to the JOBZ program. Studies of tax incentives suggest that they have a relatively modest impact on business location decisions across states or regions. However, it is unclear whether those results can be directly applied to any particular program. Programs may vary significantly in how they are designed and implemented. A program that does a good job of screening out businesses that would have expanded without tax incentives would likely be better at increasing employment than a program with little screening.

In this section, we examine the economic impact of JOBZ. We first focus on how DEED has measured the impact of JOBZ and discuss the shortcomings of that approach. We then discuss the difficulties of providing a precise estimate of the program's impact. In the following section, we examine how JOBZ has been designed and implemented. In particular, we consider whether JOBZ has

¹⁶ Peter Fisher, "The Fiscal Consequences of Competition for Capital," in Ann Markusen, ed., *Reining in the Competition for Capital* (Kalamazoo: W.E. Upjohn Institute, 2007), 70.

adequate mechanisms for screening out businesses that are unlikely to produce net growth in employment for Greater Minnesota.

DEED Reports

For each year of the program's operation, DEED has issued an annual report summarizing the accomplishments of JOBZ. DEED's latest annual report for 2006 told the stories of several successful JOBZ businesses and provided information on the program's impact. That information came primarily from the progress reports submitted to DEED by local governments, which were based on employment, wage, and capital investment information supplied by JOBZ businesses to local governments. In addition, the 2006 annual report provided information from surveys conducted by DEED of JOBZ businesses.

Employment, Wage, and Investment Numbers

In its 2006 annual report on JOBZ, DEED reported that JOBZ businesses had created 3,669 new full-time jobs and retained more than 2,000 jobs as of the end of 2005.¹⁷ According to DEED, the 3,669 new jobs were about 10 percent higher than the 3,328 jobs promised by JOBZ businesses in their business subsidy agreements. As Table 4.1 shows, DEED reported that these newly created jobs were paying an average wage of \$14.99 per hour. DEED also stated that about two-thirds of the new jobs (68 percent) were at businesses in manufacturing industries.

Table 4.1: JOBZ Impact Reported by DEED, End of 2005

Type of Impact	Amount
New jobs created	3,669
Jobs retained	2,000+
Average wage for new jobs	\$14.99
Estimated annual payroll of JOBZ businesses	\$200,000,000
Estimated wages including spin-off jobs	\$284,000,000
Capital Investment	\$600,000,000

SOURCE: Department of Employment and Economic Development, *Minnesota's Job Opportunity Building Zone Initiative: 2006 Annual Report* (St. Paul, 2007).

¹⁷ For the most part, the job, wage, and capital investment figures in DEED's 2006 annual report are based on the progress reports that were supposed to be submitted during the spring of 2006. These progress reports were intended to reflect the impact of JOBZ as of the end of 2005, although some may instead be based on information from 2006. Department of Employment and Economic Development, *Minnesota's Job Opportunity Building Zone Initiative: 2006 Annual Report* (St. Paul, 2007), 2.

DEED's web site indicates that JOBZ has resulted in close to 5,500 new full-time jobs through 2006.

The 2006 annual report said that the total annual payroll at JOBZ businesses was more than \$200 million including both wages and benefits. DEED estimated that the annual wage impact of JOBZ, including spin-off jobs, was \$284 million.¹⁸ DEED compared these apparent benefits of the program to the \$13 million in costs for the program in 2005. Finally, DEED reported that there had been about \$600 million in "confirmed" capital investment at JOBZ businesses as of the end of 2005.¹⁹

At the time we prepared our evaluation report, DEED had not yet released its 2007 annual report. However, its web site provides much of the information that DEED will be using in preparing that report. Statistics on the web site indicated that JOBZ businesses had created 5,459 new full-time jobs by the end of 2006, or close to 20 percent more than the 4,568 promised in business subsidy agreements.²⁰ In addition, as Table 4.2 indicates, JOBZ businesses reported the retention of 4,507 existing jobs and the creation of 228 part-time jobs.²¹ The new

Table 4.2: JOBZ Impact Reported by DEED, End of 2006

Type of Impact	Number	Average Hourly Wage Rate	Average Hourly Benefit Rate
New full-time jobs created	5,459	\$14.78	\$2.52
New part-time jobs created	228	11.91	1.12
Jobs retained	4,507	14.95	2.99
Wages and Benefits at JOBZ Businesses	\$367,700,000		
Investment in Land and Buildings	\$626,600,000		
Investment in Equipment	<u>655,800,000</u>		
Total Capital Investment	\$1,282,400,000		

NOTE: We estimated the wages and benefits at JOBZ businesses using DEED's data. In those estimates, we assumed that, on average, two part-time jobs were the equivalent of one full-time job.

SOURCE: Department of Employment and Economic Development web site on Business Subsidy Reporting, www.deed.state.mn.us/Community/subsidies/mbaf/fetchrollup_all.asp, accessed January 11, 2008.

¹⁸ Spin-off jobs are jobs created at non-JOBZ businesses due to spending by JOBZ businesses and employees.

¹⁹ *Ibid.*, 2. Capital investment reported to DEED included \$325.8 million in real investment (land and buildings) and \$264.5 million in personal investment (equipment) for a total of \$590.4 million.

²⁰ Department of Employment and Economic Development web site on Business Subsidy Reporting, www.deed.state.mn.us/Community/subsidies/mbaf/fetchrollup_all.asp, accessed January 11, 2008.

²¹ Elsewhere, DEED has reported significantly higher numbers of retained jobs. For example, in its list of completed JOBZ deals, DEED reported 11,712 retained jobs as of December 21, 2007. These numbers come from a document filed by local governments with DEED when reporting a new business subsidy agreement. We have found that these numbers often do not accurately reflect the number of jobs that businesses promise to retain in their business subsidy agreements.

full-time jobs paid an average wage of \$14.78 per hour and an average hourly benefit rate of \$2.52. From the numbers provided on the web site, the wages and benefits paid to workers at JOBZ businesses appeared to be in excess of \$360 million per year. Capital investment figures on the web site indicated that investment by JOBZ businesses had doubled in the last year, growing to \$1.28 billion by the end of 2006. That figure included \$0.63 billion in real estate investment and \$0.66 billion in equipment.

Business Survey Results

In its 2006 annual report, DEED also reported on some of the key results from surveys it conducts of JOBZ businesses following their admission into the program.²² For example, DEED said that 88 percent of the participants reported that JOBZ tax breaks were “very important to their decision.”²³ In addition, DEED reported that about 90 percent of the responding businesses said they would not have made the same investment in the same location without the tax incentives. Finally, DEED said that more than 25 percent of the respondents said they likely would have invested in locations outside Minnesota without JOBZ assistance. According to DEED, states bordering Minnesota were most frequently mentioned as possible locations.

Program Costs per New Job

DEED staff have estimated the cost per new job to be \$5,000, but they suggest that half of this cost is nonrecurring.

Although DEED has not published estimates of the cost per new job created by JOBZ in its annual reports, DEED has calculated the average cost for 2004 and 2005 to be about \$5,000. This number is based on the cost of state subsidies provided in 2004 and 2005 (not including property tax breaks) and the number of new jobs reported at JOBZ businesses in progress reports submitted in the spring of 2006. According to DEED, this average is less than both the guideline amounts for federal business finance programs and the incentive packages offered by other states across the nation for certain large development projects. Furthermore, DEED indirectly suggests that future annual costs per job may be less because a little more than half of the costs for 2004 and 2005 were for nonrecurring costs—namely sales tax exemptions for construction materials and supplies. DEED calculated the average recurring cost per new job to be less than \$2,400.

Shortcomings

The employment, wages, and capital investment data provided in DEED’s annual JOBZ report and on its web site have a number of significant shortcomings. First:

²² The survey is provided to a JOBZ business by the appropriate local government, which then submits the completed survey along with other documents to DEED. A summary of some of the results of the surveys is available on DEED’s web site. See the Department of Employment and Economic Development web site on Business Subsidy Reporting, www.deed.state.mn.us/bizdev/PDFs/business_survey_2004_2006.pdf.

²³ DEED, *2006 Annual Report*, 2.

**DEED's figures
overstate the
economic impact
of JOBZ.**

- **DEED's reports on JOBZ overstate the number of new jobs at JOBZ businesses.**

This problem occurs because some businesses are reporting retained jobs twice—once as retained jobs and again as full-time jobs. DEED assumes the full-time job category represents the number of newly created full-time jobs at JOBZ businesses. However, the instructions for the reporting form do not make this clear.²⁴ In addition, businesses may be overstating their employment levels. In their reports to local governments, businesses are not required to certify the numbers submitted as accurate, and DEED does not generally check the accuracy of the numbers. Using unemployment insurance records, we estimate that the actual increase in employment at JOBZ businesses was at least 20 percent less than the number of new jobs reported by DEED.²⁵

We suspect that there may be similar problems with the capital investment numbers. There is no clear definition of capital investment, and the numbers are based on a poorly worded question.²⁶ More importantly, the numbers reported by businesses are, for the most part, not verified by local governments or DEED.²⁷ We prefer to call these reported figures “unconfirmed” or “unverified” capital investment, while DEED called them “confirmed” investment in its 2006 report.

²⁴ Another reporting problem is that DEED has sometimes incorrectly entered jobs or capital investment data involving decimal places. For example, a local government may submit a report indicating that the number of jobs at a particular wage level is 7.48, but DEED staff enter the number as 748. Alternatively, a local government reports that a business has made a capital investment of \$200,000.00, but DEED enters the data as \$20,000,000. While this type of error may be infrequent, it can sometimes have a significant impact on the numbers reported. During the fall of 2007, DEED's web site listed one company as having created 978 jobs although it only promised 10 new jobs. When we contacted the local officials who submitted the progress report, we found that they had reported the creation of only 24.6 jobs. Shortly thereafter, the local officials reported an updated new job total of 36 to DEED, and DEED revised the totals on its web site.

²⁵ Using unemployment insurance records, we compared DEED's numbers to the increase in full-time equivalent employees at JOBZ businesses from the quarter before their business subsidy agreement to either the last quarter of 2006 or the first quarter of 2007. Our analysis included business subsidy agreements signed in 2004 or 2005. Because of limitations with the unemployment insurance data, our analysis did not include about one-fourth of the deals made in those years and about one-fourth of the new jobs reported to DEED for businesses signing agreements in those years. In addition, we did not include businesses with 2006 agreements since their agreements were relatively recent and they accounted for only about 8 percent of all new jobs reported to DEED in progress reports submitted in the spring of 2007. JOBZ businesses included in our analysis had about 30 percent fewer new jobs in Minnesota than indicated by DEED's numbers. That result would mean that the increase in employment at all JOBZ businesses for which progress reports were submitted to DEED in the spring of 2007 was about 20 percent less than indicated by DEED's reports. The increase could be as much as 30 percent if one is willing to extrapolate the results for the businesses we examined to all JOBZ businesses for which progress reports were submitted in the spring of 2007.

²⁶ The capital investment question on the progress report asks a business to report how much capital investment was made in the zone prior to the end of the year. Because some investment may have been made prior to zone creation, the question should ask how much capital investment occurred in the zone after the signing of a business subsidy agreement and prior to the end of the current year.

²⁷ Local governments sometimes ask JOBZ businesses for a list of their capital investments when a specific level of capital investment is required in a business subsidy agreement.

Some business expansions attributed to JOBZ would have occurred without any tax breaks.

Second, even if DEED's job numbers were adjusted to reflect the actual increase in employment, they would likely overstate the net impact of the JOBZ program on employment in Greater Minnesota. In particular:

- **DEED's reports on the impact of JOBZ do not take into account the fact that some JOBZ businesses would have expanded in Greater Minnesota even without JOBZ tax breaks.**

Slightly more than two-thirds of JOBZ businesses would have expanded to some extent in Greater Minnesota in the absence of the JOBZ program. About 11 percent of the respondents to DEED's business survey said they would have made the same investment in the same location without tax breaks.

Approximately 8 percent said they would have made the same investment in another Greater Minnesota location without JOBZ assistance. Another 50 percent said they would have expanded at a reduced level in Greater Minnesota without tax breaks, with most of this group expanding in the same location as they did with JOBZ. Only 27 percent said they would have invested in a location outside of Minnesota if not for JOBZ.

There is also reason to suspect that these business surveys understate the chances that businesses would have expanded in Greater Minnesota without tax subsidies. As stated earlier, studies using survey data may not be reliable because they rely on statements from businesses or other respondents.²⁸ We suspect that some businesses responding to DEED's survey may have been reluctant to indicate that they would have expanded by the same, or even a reduced amount, without JOBZ. The survey response from each business is seen by both the appropriate local government and DEED.

JOBZ tax breaks have been provided to some businesses that compete directly with other Greater Minnesota businesses.

Third:

- **DEED's reports on the impact of JOBZ do not consider the fact that subsidizing some JOBZ businesses may reduce employment at competing businesses in Greater Minnesota.**

JOBZ subsidies have been provided to a number of types of businesses that likely compete with other Greater Minnesota companies for the same local or regional Minnesota customers. These businesses include, but are not limited to: (1) construction companies; (2) firms providing architectural, engineering, or construction management services; (3) aggregate products suppliers and haulers; (4) farm implement dealers; (5) wholesale distributors of various products including plumbing, heating, and air conditioning parts; (6) an installer of security systems; (7) a community animal hospital, (8) a garbage hauler, and (9) a motorcycle dealer. Some manufacturers, welders, and machine shops may also serve a local or regional Minnesota market and may compete largely with unsubsidized Greater Minnesota businesses. The job growth at these types of JOBZ businesses may be offset partially or completely by job losses at competing businesses in Minnesota.

²⁸ Hirasuna and Michael, *Enterprise Zones*, 10.

Fourth:

- **DEED's use of spin-off jobs to add to its calculation of the impact of JOBZ also tends to overstate the program's benefits.**

To the extent that JOBZ businesses would have expanded their employment and operations without JOBZ assistance, there are no benefits and thus no spin-off benefits. Instead, there are only the costs of providing the subsidies and potential spin-off costs when state and local governments have less to spend on education or other public services or property taxpayers have to pay more to unnecessarily subsidize a business.

Most of our criticisms in this section have focused on the number of new jobs that DEED claims are the result of the JOBZ program. Similar criticisms are warranted for DEED's estimates of retained jobs and capital investment. To the extent that expansions would have occurred in whole or in part without JOBZ, existing jobs were not at risk and were not retained by JOBZ. In those same cases, some or all of the reported capital investment would have occurred anyway. Furthermore, some businesses that would not have expanded at all without JOBZ were existing Minnesota businesses and would not have reduced their existing employment in Greater Minnesota. The jobs retained at these firms cannot be attributed to JOBZ. For these reasons, the retained jobs and capital investment numbers reported by DEED overstate the impact of JOBZ.

Finally:

- **DEED's estimate of the average cost per new job created by JOBZ understates the real costs per job.**

DEED's estimate may greatly understate the real cost per new job created by JOBZ.

DEED estimated the annual cost of each new job created by JOBZ to be approximately \$5,000, with only \$2,400 of this amount representing recurring costs. This estimate is inadequate for two reasons. First, the increase in employment at JOBZ businesses is probably much less than that assumed in DEED's analysis. As we pointed out above, DEED's numbers on new jobs overstate the actual increase in employment at JOBZ businesses and do not account for the fact that some expansion in these businesses would have occurred in the absence of JOBZ. Second, DEED did not include the amount of property tax reductions in their estimates and did not examine the trend in future property tax reductions as we did in Chapter 1. We think that the increase in property tax breaks will offset any future reduction in sales tax exemptions on construction materials and supplies. As a result, we think the average annual tax reduction per JOBZ business may continue to be about \$75,000.

We estimated the potential annual cost per new job created by JOBZ using reasonable assumptions from the literature on tax incentives on the responsiveness of employment to tax incentives. Under these assumptions, we estimate that 21 percent of the new jobs at JOBZ businesses were the result of the program. In that case, the average annual cost per new job created by JOBZ

There is no readily apparent statistical link between JOBZ and private sector job growth in Greater Minnesota.

would be about \$26,900 to \$30,800.²⁹ For comparison purposes, we used an assumption that was well outside the range of responsiveness indicated by tax studies. Under that assumption, about 50 percent of the new jobs were due to the JOBZ program, and the average annual cost per job would be about \$11,300 to \$12,900.³⁰ In either case, these estimates greatly exceed DEED's estimate of \$5,000, or about \$2,400 in recurring annual costs. The estimates we present above are also significant relative to the average annual wage paid to JOBZ employees (\$30,700). Furthermore, these estimates and the results from JOBZ business surveys suggest that there is room for improving the program and eliminating unnecessary subsidies.

Measuring the Impact of JOBZ

Although it is clear that DEED's estimates overstate the impact of JOBZ, it was not possible for us to develop a precise estimate of the impact of JOBZ on employment. We know that only a relatively modest share of the growth in private employment in Greater Minnesota could be due to the JOBZ program. The 5,459 jobs that DEED claims are new jobs caused by JOBZ represent about 16 percent of the private sector employment growth in Greater Minnesota between 2003 and 2006.³¹ In addition, there does not seem to be any readily apparent statistical relationship between the counties in which JOBZ businesses added jobs and counties that experienced private sector job growth between 2003 and 2006.³²

²⁹ In making these estimates, we calculated the tax reductions per new job created by JOBZ businesses for each year during the 2004-06 period and then calculated an average for the period by weighting the results for each year by the number of jobs created. For each year, we used the total tax reductions reported by the Department of Revenue, including property tax reductions. We also used the new job numbers reported to DEED by local governments. We adjusted the new job totals downward by 20 to 30 percent to reflect the results of our analysis of unemployment insurance records. The assumption that 21 percent of new jobs were induced by JOBZ is consistent with the midpoint of the range of tax elasticities reported by researchers and with the assumption that JOBZ reduces state and local business taxes by about 70 percent. There are insufficient data to provide a good estimate of the magnitude of the reduction in taxes. However, a 70 percent reduction seems consistent with what we know about the exemptions and credits provided by JOBZ and the amount of state and local business taxes in various categories paid by Minnesota businesses in 2006 according to estimates from Ernst and Young.

³⁰ The idea that 50 percent of new jobs were induced by JOBZ subsidies results from assuming that JOBZ reduces state and local business taxes by 70 percent and that each 10 percent reduction in taxes increases employment by a little more than 7 percent. The latter assumption that each 10 percent reduction in taxes increases employment by 7 percent reflects a higher responsiveness of employment to state and local business tax reductions than is supported by most tax research.

³¹ These figures exclude Sherburne and Wright counties, which have not participated in the JOBZ program.

³² We examined the statistical correlation at the county level between: (1) the number of reported new jobs at JOBZ businesses at the end of 2006 as a percentage of 2003 private employment, and (2) the increase in private employment between 2003 and 2006. The statistical correlation between these two variables is -.08. This result means that there was only a very weak relationship between where private sector job growth occurred and where JOBZ businesses hired employees. In addition, to the extent there was a relationship, higher rates of private employment growth occurred in counties that were less active in the JOBZ program.

However, the lack of any overall correlation does not mean that the JOBZ program has failed to have an impact on private sector employment in Greater Minnesota. Although other factors may explain most of the growth in private sector employment, JOBZ could potentially have a relatively minor, but important, role as well. Unfortunately:

- **While only regression analysis would help sort out all the factors that have affected employment growth in Greater Minnesota, it would be very difficult to develop a precise estimate of the impact of JOBZ using regression analysis.**

It would be very difficult to isolate the economic impact of JOBZ from the influence of other economic factors.

Conducting a regression analysis for JOBZ would be very difficult for several reasons. First, regression analysis requires the use of comparison groups—areas with enterprise zones and areas without zones. Because JOBZ zones have been established throughout most of Greater Minnesota, there is little opportunity to compare the economic activity in areas with zones to that in areas without zones. Second, one of the criteria in selecting the original subzones was that the property was ready for development. Regression analysis might show a statistical link between the zones and economic activity but would not be able to determine whether the link was caused by the available tax breaks or was due to the selection of property that was ripe for development. Third, many of the original subzones were moved to locations on which companies wanted to build. Regression analysis would not have been able to determine whether the increased employment was due to tax breaks or other business reasons that were causing business owners to want to expand or relocate. Fourth, the zones in the JOBZ program often consist of many relatively small, noncontiguous parcels of land rather than entire cities or counties. It would have been extremely challenging, or perhaps impossible, to obtain data on economic activity by parcel. Any regression analysis would probably have to be conducted on county-level data. Using county-level data would limit the number of data observations and limit the ability of the analysis to determine the impact of JOBZ.

Finally, even if these other problems could be addressed, there were insufficient data available on the jobs created by JOBZ until late in this study. At the time we began this study, we had data from DEED on the jobs created by JOBZ businesses by the end of 2005. This information would have been very preliminary because the JOBZ program did not begin until January 2004 and many of the JOBZ businesses did not begin operations until some time after they signed business subsidy agreements.

It is possible that the impact of the program could be more closely studied in the near future because more data are now available on the new jobs added by JOBZ firms. However, as we pointed out earlier, those data are suspect. Furthermore, it is not possible to use unemployment insurance records to correct those data because some JOBZ firms have multiple Minnesota locations and do not report separately on those locations when providing information for unemployment insurance purposes.

PROGRAM DESIGN AND OPERATION

As the previous section demonstrated, it is very difficult to provide a precise estimate of the employment impact of the JOBZ program. However, even the results from DEED's business surveys suggest that unnecessary subsidies are being provided to some businesses.

As a result, we examined how the JOBZ program is designed and operated to gain some insights as to how to improve the program and minimize unnecessary subsidies. Our review included an examination of program requirements and documents, as well as extensive interviews with city officials about their procedures and the businesses that they had approved for participation in the program.

Overall Program Design

Based on our interviews and review of files, we think that:

- **The JOBZ program has value as an economic development tool for Greater Minnesota.**

The program has been used to attract some businesses or business expansions that probably would not have occurred in Minnesota without substantial financial assistance. However:

- **The effectiveness of the JOBZ program is reduced by the lack of a statewide perspective in the approval of JOBZ subsidy agreements and the absence of any significant budgetary constraint on JOBZ tax breaks.**

Local governments consider the local benefits of a JOBZ agreement, not its broader regional implications.

Local governments make the key decisions on business participation in the program with little or no input from state officials. However, each local government views the program's benefits and costs from a local perspective. On the benefit side, most local governments are focused on attracting jobs to their communities and are not generally concerned about whether a JOBZ business would have expanded elsewhere in Greater Minnesota or would be competing with other businesses in Greater Minnesota. As a result, a local government views employment growth in its community as a benefit but is less concerned about whether a business's participation in the program represents a net employment increase for the region or Greater Minnesota.

In addition, some local governments have found it difficult to disapprove a local business's request for JOBZ tax breaks. Because the program is available throughout much of the state, local governments may risk the loss of the business to a nearby community if they fail to approve a business for JOBZ. Some cities have even viewed JOBZ as an entitlement for local businesses. They have aggressively sought out some local employers to see if they would like to participate in JOBZ.

Local governments are responsible for only a small share of the cost of JOBZ tax breaks.

On the cost side, cities and townships are responsible for paying only a small share of the program's costs. As a result, they have very weak incentives to either set priorities or target subsidies only to those businesses that are likely to produce net employment growth for Greater Minnesota as a whole.

Furthermore, the program lacks any effective constraint on the overall amount of subsidies provided or the number of businesses allowed to participate. The only constraint placed on the program has been a 5,000 acre limit in each zone. That limit has not been effective in forcing state and local officials to set priorities and make better economic decisions about the program.

One key to improving the decisions made about business participation in the JOBZ program is to require state approval of JOBZ agreements. As we saw in Chapter 3, there have been problems with the business subsidy agreements written by local governments. Requiring state approval of business subsidy agreements would serve two purposes. First, state review of proposed projects could focus the program on those businesses that are likely to produce net employment growth for Greater Minnesota. Second, state review would help ensure that business subsidy agreements have clear and meaningful requirements, particularly for employment, wages, and capital investment.

Because local governments lack a statewide perspective on the program's benefits and costs, DEED should be required to review all business subsidy agreements.

RECOMMENDATION

The Legislature should require that the Department of Employment and Economic Development approve a business subsidy agreement before a business may participate in the JOBZ program.

A second key to improving the JOBZ program is for the Legislature to set a meaningful limit on either the number of businesses allowed to enter the program each year or the expected cost of the JOBZ subsidies they will receive over the period they will participate in the program. It would be preferable to limit the amount of subsidies, but it may be difficult to enforce such a limitation. While DEED has a tax subsidy estimator, it is not always accurate for individual businesses and sometimes needs to be adjusted to allow for the specific circumstances of individual businesses. However, by allowing some deviation from the estimator, the results could be manipulated to show lower state and local tax costs. A cap on the number of businesses allowed to enter the program each year would not specifically limit overall costs but would force state and local officials to set priorities for the program.

RECOMMENDATION

The Legislature should set a cap on either the number of businesses allowed to enter the JOBZ program each year or the estimated cost of JOBZ subsidies that entering businesses are expected to receive during their participation in the program.

A cap on program activity is needed to encourage DEED and local governments to set priorities for the JOBZ program.

We think a cap on the number of businesses is the better of these two options. It is the easiest to understand and administer. One potential drawback is that it may work against smaller businesses.

The other option would be to place a cap on the estimated future cost of the subsidies given to new entrants and require DEED to stop approving any more business subsidy agreements during the year once that cap is reached. This approach is much more difficult to administer and could be manipulated by using unrealistically low estimates of the subsidies being approved.

With this second option, we are not suggesting that the cap be enforced by tracking the actual amount of subsidies received by a business. We do not think that tracking of actual subsidies can be effectively used to provide a limit on the activity approved in any year. In addition, businesses will receive higher subsidies if they create more jobs in the future. Caps based on actual subsidies could end up penalizing the program for being successful.

Specific Policies and Procedures

We think the most important ways to regulate the JOBZ program are to require state approval of business subsidy agreements and to effectively limit future participation in the program. However, the JOBZ program also lacks specific policies and procedures that might enable the program to more selectively determine which businesses should be allowed to participate. For example:

- **The JOBZ program does not require businesses to demonstrate that they would have located elsewhere or not expanded without the JOBZ tax breaks.**
- **The program does not require any consideration of whether a business requesting JOBZ assistance is competing with other Greater Minnesota companies for the same customers.**
- **The program does not require state or local officials to undertake any rigorous analysis of the benefits and costs of allowing a particular business to participate in the program.**
- **The program does not require state or local officials to consider other types of financial assistance or provide advice on when other types of assistance should be used in lieu of JOBZ assistance.**

One way to help ensure that JOBZ assistance is needed for a particular business would be to require DEED and local governments to review whether the business would have located outside of Minnesota or not expanded in Greater Minnesota without JOBZ assistance. In addition, the business could be required to provide evidence using official financial figures that, without the assistance, the business would have located outside Greater Minnesota or not expanded in Greater Minnesota. On occasion, a city has included a clause in a business subsidy agreement that says that the business certifies that the expansion would not have happened in that city without JOBZ. This type of clause may be useful but does

not address the possibility that the project would have occurred elsewhere in Greater Minnesota.

RECOMMENDATION

DEED should require businesses applying for JOBZ assistance to demonstrate, using financial information where necessary, that they would not have located or expanded in Greater Minnesota without JOBZ assistance.

DEED needs to develop policies aimed at eliminating unnecessary future subsidies.

This requirement would not eliminate every unnecessary subsidy from the program but would help eliminate some of the most obvious cases.

One of the main ways in which economies grow is by increasing exports and decreasing imports. If a business is only competing with other Greater Minnesota companies for the same Minnesota customers, then subsidizing that business may harm other Greater Minnesota companies. Earlier in this chapter, we highlighted some of the JOBZ businesses that are likely to be serving only a Minnesota market and competing largely with other Minnesota firms. In one case, a township provided a subsidy to a business that moved from a nearby city. When an existing business in the township complained that its competitor had received favorable treatment, the township approved JOBZ assistance for the existing business.

RECOMMENDATION

DEED should require businesses to provide information during the application process on the extent to which they compete with other Greater Minnesota businesses for the same Minnesota customers.

DEED should attempt to obtain useful information from businesses while also keeping the required paperwork for businesses to a minimum. The Legislature and DEED should consider whether this type of information should be given a status as nonpublic data in order to assure cooperation from businesses.

Since July 1, 2005, local governments have been required by DEED to submit the results of a “deal evaluator” analysis. As discussed in Chapter 3, this analysis has never been used to reject a project. Furthermore, the deal evaluator is not particularly useful in assessing the merits of providing a JOBZ subsidy to a business. We think DEED needs to develop a better approach to analyzing the benefits and costs of providing a subsidy. In addition, it is important to match the assumptions about employment, wages, and capital investment in an analysis with the requirements in the business subsidy agreement. In preparing deal evaluator analyses, cities have sometimes used higher levels of employment or capital investment than were required in the business subsidy agreement.

RECOMMENDATION

Prior to approving a business subsidy agreement, DEED should require a more rigorous analysis of the benefits and costs of providing a business with JOBZ tax breaks. The levels of employment and capital investment used in the analysis should be required in the business subsidy agreement.

Some city development officials told us that the JOBZ program is used at times when a lesser subsidy or loan would be more appropriate. They say that city councils often find it difficult to turn down requests for JOBZ assistance from existing businesses even though a smaller subsidy might be more appropriate. We think DEED could help local governments by providing them with some guidance on when other types of assistance are more appropriate.

RECOMMENDATION

DEED should develop policies and provide local governments with guidance on when other types of assistance should be considered in lieu of JOBZ assistance.

We think it would be best if the Department of Employment and Economic Development implemented the recommendations outlined above. It is important, however, that the Legislature first make DEED's approval of a business subsidy agreement a condition of JOBZ participation, as we recommended earlier. Without a clear mandate for DEED, the policies recommended above may not be effective. The Legislature could also help move DEED in the right direction by requiring DEED to develop criteria for determining whether a business should receive JOBZ assistance.

RECOMMENDATION

The Legislature should require DEED to develop criteria to be used in deciding which businesses should receive JOBZ assistance.

Those criteria could include the items we have outlined above such as: (1) a clear demonstration that the development would not have occurred in Greater Minnesota without JOBZ; (2) a demonstration that other financial assistance is not sufficient to cause the development to occur; (3) a demonstration that the business does not compete with other Minnesota businesses for the same local or regional customers; (4) an analysis of the employment benefits to Greater Minnesota relative to the costs of providing the tax subsidies, including property tax breaks; and (5) the extent to which the proposed development is in an economically distressed part of Greater Minnesota.

All of the above recommendations, as well as some recommendations in Chapter 3, may have some staffing implications for DEED. In order to effectively implement the recommendations, DEED may need additional staff to administer the JOBZ

program. We suggest the Legislature discuss with DEED what resources are needed to implement our recommendations.

JOBZ Tax Breaks

The Legislature should also reassess the purpose of JOBZ and the desirability of targeting incentives more to blighted or economically distressed areas. Other issues that should also be considered include an extension of the JOBZ term for new projects and modifications to the jobs credits. In addition, some technical changes appear to be needed in both the jobs credits and the capital gains exemptions on real property. These issues are discussed below.

Targeting to Distressed Areas

In Chapter 2, we found that the JOBZ program has not been targeted to blighted or distressed areas within Greater Minnesota. The lack of targeting enables the program to attract some development that would have located outside Minnesota and would probably not have located in a distressed part of the state. However, the lack of targeting has meant that some more distressed regions of the state have experienced only small benefits from the JOBZ program. Economists suggest that projects that reduce unemployment rates have significant social and economic benefits.

The Legislature should consider changes in the focus and duration of the JOBZ program.

RECOMMENDATION

The Legislature should consider targeting the JOBZ program to economically distressed areas.

Extension of JOBZ Period

Currently, JOBZ benefits, except for certain ethanol plants, end on December 31, 2015. Each year, new entrants to the program are receiving fewer years of benefits than previous participants. Some local economic development officials told us that JOBZ is losing significant value as an economic development tool and may be surpassed by tax increment financing in the near future as the most valuable tool. We think that the Legislature should consider lengthening the JOBZ term for new entrants to a minimum of ten full years of benefits.

RECOMMENDATION

The Legislature should consider extending the period of benefits for new entrants in the JOBZ program to at least ten years provided that other restrictions are placed on the program.

In our view, the Legislature should not approve an extension of the JOBZ period for new entrants unless it also places a cap on future participation and requires DEED's approval of business subsidy agreements. In addition, the Legislature

should seek assurance from DEED that it will implement the policies recommended in this report before approving an extension for new entrants.

Jobs Credit

The JOBZ jobs credit provides a refundable tax credit for JOBZ businesses or their owners on income and corporate franchise taxes. For 2007, the credit is only available when a business pays its employees more than an average of \$32,880 in annual wages. The credit is limited for a company with other Minnesota operations if the company has not increased its overall payroll in the state by as much as it has increased its payroll in the JOBZ zone. However, regardless of this limitation, the jobs credit can be lower for existing Minnesota businesses than for businesses moving into the state even when both have increased employment by the same amount.

The Legislature should review the method used to calculate the jobs credits available to JOBZ businesses.

Table 4.3 shows the jobs credit calculations for two businesses. One is an existing Minnesota business that relocated to a zone and added 50 employees to its previously existing workforce of 20. The other business could either be a new business or a business that relocated from another state. Like the first business, this second business added 50 employees in a JOBZ zone. However, the second business is entitled to a larger jobs credit than the first business.

This difference occurs because, in calculating the jobs credit, the first business had a higher number of zone employees in 2007 than the second business—70 versus 50. In calculating the jobs credit, each business must multiply its total zone employment in 2007 times \$32,880 and subtract the result from \$2,500,000—its annual payroll for the 500 additional employees. Even though the two businesses have added the same number of employees in Minnesota, the existing Minnesota business is treated less favorably than the business that is new to the state.

RECOMMENDATION

The Legislature, along with the Department of Revenue and the Department of Employment and Economic Development, should consider ways of improving the jobs credit so that it is fairer in how it treats existing Minnesota businesses.

One possible solution may be to adjust the number of employees that is multiplied times the minimum qualifying salary of \$32,880. However, tax experts at the Department of Revenue and legislative staff need to examine this issue more thoroughly.

Table 4.3: Sample Jobs Credit Calculation for Two Companies with the Same Employment Increase, 2007

Existing Minnesota Business		New Business or Move-In from Out of State	
Item	Amount	Item	Amount
2007 zone payroll	\$3,500,000	2007 zone payroll	\$2,500,000
2003 zone payroll	0	2003 zone payroll	0
Amount #1: Change in zone payroll	\$3,500,000	Amount #1: Change in zone payroll	\$2,500,000
2007 Minnesota payroll	\$3,500,000	2007 Minnesota payroll	\$2,500,000
2003 Minnesota payroll	860,000	2003 Minnesota payroll	0
Amount #2: Change in Minnesota payroll	\$2,640,000	Amount #2: Change in Minnesota payroll	\$2,500,000
Amount #3: Lesser of Amount #1 and Amount #2	\$2,640,000	Amount #3: Lesser of Amount #1 and Amount #2	\$2,500,000
2007 number of FTE employees in the zone	70	2007 number of FTE employees in the zone	50
2003 number of FTE employees in the zone	0	2003 number of FTE employees in the zone	0
Amount #4: Change in FTE employees	70	Amount #4: Change in FTE employees	50
Amount #5: Amount #4 multiplied by \$32,880	\$2,301,600	Amount #5: Amount #4 multiplied by \$32,880	\$1,644,000
Amount #6: Amount #3 less Amount #5	\$338,400	Amount #6: Amount #3 less Amount #5	\$856,000
Jobs Credit: 7% times Amount #6	\$23,688	Jobs Credit: 7% times Amount #6	\$59,920
Jobs Credit per Job Added in Greater Minnesota	\$474	Jobs Credit per Job Added in Greater Minnesota	\$1,198
Assumptions for Existing Minnesota Business		Assumptions for New Business	
<ul style="list-style-type: none"> Had 20 jobs in Minnesota prior to moving to a zone in 2004 Added 50 jobs and now has 70 full-time employees Pays an average annual salary of \$50,000 to its new employees and to the employees that moved to the zone; paid an average salary of \$43,000 in 2003 No employees are paid more than \$109,600 annually Has no other Minnesota operations 		<ul style="list-style-type: none"> Had no operations in Minnesota prior to moving to a zone in 2004 Has 50 full-time employees Pays an average annual salary of \$50,000 to its employees No employees are paid more than \$109,600 annually Has no other Minnesota operations 	

SOURCE: Office of the Legislative Auditor analysis.

Technical Changes

We also think that technical changes are needed in the laws governing the jobs credit and the capital gains exemption on real property.³³ The provisions of these

³³ See *Minnesota Statutes* 2007, 469.318 for the jobs credit provisions and *Minnesota Statutes* 2007, 469.316, subd. 4a, for the capital gains provisions.

laws seem to be based on the initial bills introduced during the 2003 legislative session that called for tax-free zones.

For the jobs credit, the credit is based on the increase in zone payroll between the base year and the current tax year.³⁴ The base year is defined as the “taxable year beginning during the calendar year prior to the calendar year in which zone designation took effect.”³⁵ The Department of Revenue has interpreted the base year to always be 2003 since zone designations took effect in 2004.

However, as we have seen, the zones are very flexible and the subzones have moved considerably over the last four years. It makes little sense to use 2003 as the base year if a JOBZ business first enters the program in 2008. We think that the base year for purposes of calculating the jobs credit should then be 2007.

Technical changes should be made in the laws affecting certain JOBZ tax breaks.

RECOMMENDATION

The Legislature should revise the language governing the jobs credit so that the base period is the year prior to the year a JOBZ business begins operating in a subzone.

We have similar concerns about the capital gains exemption for real property. An exemption for capital gains on the sale or exchange of real property is allowed if the property is located in a zone and is used by a JOBZ business.³⁶ The amount of the gain must be prorated based on the percentage of time the property was held during the period of zone designation relative to the total period of time the property was held. The term “zone designation” refers to the period of time starting on January 1, 2004, since all zones became effective on that date. However, since then, new subzones have been added and initial subzones removed. It does not seem appropriate to provide a capital gains exemption dating back to January 2004, particularly when a subzone was not created until 2007. We suggest the period for which the capital gains exemption is allowed should begin with the date that a JOBZ business signs its business subsidy agreement or the date the business begins operating in a subzone.

RECOMMENDATION

The Legislature should revise the language governing the capital gains exemption for real property so that the gain is prorated based on the percentage of time the property was held since it was first used by a JOBZ business relative to the total period of time the property was held.

³⁴ In addition, the limitation that applies if a business has increased its overall payroll in the state by less than the increase in zone payroll is also based on a comparison to the “base year.”

³⁵ [Minnesota Statutes](#) 2007, 469.318, subd. 2b.

³⁶ [Minnesota Statutes](#) 2007, 469.316, subd. 4.

The statutory language on capital gains exemptions for tangible personal property is similar to that for real property and should also be reviewed by the Legislature.³⁷

³⁷ *Ibid.*

List of Recommendations

- The Legislature should require that DEED review and approve all JOBZ business subsidy agreements before they can take effect. The separate relocation agreements could be discontinued if DEED makes sure that business subsidy agreements for relocating businesses include the statutory requirements (p. 59).
- DEED should ensure that business subsidy agreements contain meaningful but realistic requirements for businesses (p. 60)
- DEED should rewrite the sample business subsidy agreement to define key terms and correct grammatical errors. DEED should have revisions to the agreement reviewed by an attorney (p. 61).
- DEED should discontinue use of the deal evaluator (p. 61).
- DEED should streamline its compliance review process to produce more timely information about the progress of JOBZ businesses. DEED should move promptly to either remove noncompliant businesses from the program or provide an extension if warranted (p. 70).
- The Legislature should enact a stronger penalty for local governments that do not file required reports on time (p. 71).
- DEED should develop a compliance review process triggered by the deadlines listed in business subsidy agreements (p. 71).
- DEED should revamp the business subsidy reporting form (p. 71).
- The Legislature should require businesses to attest to the accuracy of their business subsidy reports (p. 72).
- DEED should use information from unemployment insurance filings to periodically check the performance of JOBZ businesses. DEED should require participating businesses to file their unemployment insurance data in a manner that would simplify compliance checking (p. 73).
- The Legislature should authorize the State Auditor to use state tax data and unemployment insurance data in ongoing audits of JOBZ compliance (p. 73).

- The Legislature should modify the JOBZ law to:
 - Require all JOBZ businesses to annually submit the M500 tax form in order to remain in the program;
 - Require that noncompliant businesses repay any property tax benefits they may receive after the date they cease to meet their obligations;
 - Clarify that businesses are subject to the repayment provisions of the statute if they remain in the zone but do not fulfill their obligations; and
 - Clarify that the provision protecting businesses from having a zone moved out from underneath them does not protect businesses that are out of compliance with their agreements (p. 79).
- DEED should stop using the “inactive” classification and treat all businesses as either active JOBZ participants or out of compliance (p. 79).
- DEED should provide more complete information to DOR, county tax officials, and the public about businesses entering and leaving the JOBZ program (p. 80).
- DOR should revise the M500 tax form to make it more easily usable by individuals and entities that receive JOBZ benefits but are not themselves participating businesses (p. 80).
- DOR should correct the calculation error on the Schedule JOBZ tax form (p. 81).
- DOR should review the calculation of the JOBZ jobs credit on the Schedule JOBZ forms filed by participating businesses and consider further clarification of the instructions (p. 81).
- DOR should increase its outreach to county property tax officials to improve their understanding of how to pursue repayment of JOBZ tax benefits from noncompliant businesses (p. 81).
- The Legislature should require that the Department of Employment and Economic Development approve a business subsidy agreement before a business may participate in the JOBZ program (p. 98).
- The Legislature should set a cap on either the number of businesses allowed to enter the JOBZ program each year or the estimated cost of JOBZ subsidies that entering businesses are expected to receive during their participation in the program (p. 98).
- DEED should require businesses applying for JOBZ assistance to demonstrate, using financial information where necessary, that they would not have located or expanded in Greater Minnesota without JOBZ assistance (p. 100).

- DEED should require businesses to provide information during the application process on the extent to which they compete with other Greater Minnesota businesses for the same Minnesota customers (p. 100).
- Prior to approving a business subsidy agreement, DEED should require a more rigorous analysis of the benefits and costs of providing a business with JOBZ tax breaks. The levels of employment and capital investment used in the analysis should be required in the business subsidy agreement (p. 101).
- DEED should develop policies and provide local governments with guidance on when other types of assistance should be considered in lieu of JOBZ assistance (p. 101).
- The Legislature should require DEED to develop criteria to be used in deciding which businesses should receive JOBZ assistance (p. 101).
- The Legislature should consider targeting the JOBZ program to economically distressed areas (p. 102).
- The Legislature should consider extending the period of benefits for new entrants in the JOBZ program to at least ten years provided that other restrictions are placed on the program (p. 102).
- The Legislature, along with the Department of Revenue and the Department of Employment and Economic Development, should consider ways of improving the jobs credit so that it is fairer in how it treats existing Minnesota businesses (p. 103).
- The Legislature should revise the language governing the jobs credit so that the base period is the year prior to the year a JOBZ business begins operating in a subzone (p. 105).
- The Legislature should revise the language governing the capital gains exemption for real property so that the gain is prorated based on the percentage of time the property was held since it was first used by a JOBZ business relative to the total period of time the property was held (p. 105).

February 4, 2008

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
140 Centennial Office Building
St. Paul, MN 55155-1603

Dear Mr. Nobles:

This letter is a response from the Department of Employment and Economic Development to your final report on Minnesota's Job Opportunity Building Zone (JOBZ) Program.

Thank you for the professionalism, thoughtfulness and courtesy of the team that worked on this important analysis. The report speaks to both policy and administrative aspects underlying this important economic development program's implementation. We appreciate the report's conclusions that JOBZ has value as an economic development tool and should be continued, and we agree with the findings that significant changes need to be made to increase state oversight and accountability for program performance. The report will serve as a useful basis for what those changes should be and we are committed to their implementation.

This response is organized to follow the four main recommendations contained in the report.

Recommendations:

(1) The Legislature should require DEED to review and approve all business subsidy agreements before they can become effective. DEED should also be required to implement meaningful criteria for determining whether a business should receive JOBZ assistance.

Response:

We agree that more meaningful state-level review is required. At its inception, JOBZ was formed as a state program with decisions largely driven by local judgment on selection of specific businesses for inclusion in the program. While we believed that was the legislative intent, four years of experience with the program give us sufficient reason to strongly agree that a new direction that meets statewide goals while respecting local decision making is needed.

DEED will work with cities and economic development leaders to design a new process and criteria to guide local decision-making. Because this represents a significant new direction, we believe legislation will be required to implement it. Under such a process, local governments proposing JOBZ projects would be required to submit preliminary

applications - prior to holding a business subsidy hearing - explaining the proposed project. Included will be substantive elements that DEED could evaluate: whether the proposed project represents competition with other local or regional businesses, whether the JOBZ subsidy is required for the project to move forward, whether the investment and job creation or retention is sufficient to warrant the subsidy, and other factors that will support the state and local tax subsidy afforded by JOBZ. DEED would then act upon this application prior to local approval of business subsidy agreements. That process would match that of other DEED programs, principally the Minnesota Investment Fund, in which projects are evaluated and approved or rejected by the department before they can proceed.

(2) The Legislature should either limit the number of businesses allowed to enter the JOBZ program each year or limit the estimated cost of future subsidies for new entrants each year.

We do not think it feasible or reasonable, as the audit report recommends, to place a cap on the level of subsidies or number of new businesses entering the program. The new state oversight proposed above is likely to reduce the number of businesses entering the program, and we recommend the Legislature monitor the overall program cost over time to evaluate whether a cap needs to be imposed. Also, as the report observes, implementation of a cap on either the number of new entry businesses or the amount of subsidies in a given time period would be unwieldy or create the potential that the necessary projects would not be served. However, if the Legislature believes a cap of either kind is necessary DEED will work diligently to develop the means to implement it.

(3) DEED should revamp the reporting forms used to monitor compliance and measure the overall effectiveness of the program.

We agree with the report's recommendations that the Business Subsidy Agreement template provided to subzone administrators needs to be reviewed by the Attorney General and then used consistently for all future agreements. We also agree that a new Minnesota Business Assistance Form needs to be created to clarify terminology related to job creation and investment requirements.

(4) DEED should streamline its compliance process to more rapidly identify and remove from the program businesses that are clearly not meeting their obligations.

DEED agrees it is necessary to tighten the process of monitoring JOBZ business subsidy agreements. DEED will require that the new Minnesota Business Assistance Form be submitted in a more timely manner following the period for which the commitment was made. This will shorten by months the current process of receiving them on an annual basis along with the required reports for all other business subsidies. We expect this

process alone, followed by closer communication and more systematic reporting with the Department of Revenue on compliance questions, will significantly tighten the monitoring of actual business performance relative to commitments. We will also establish a process by which the subzone administrator and the business certify that the job, wage, and investment commitments are accurate.

We also believe that management and staff assignment changes DEED has made in the past six months will have great benefit for improving the compliance process. DEED has never had substantial funding for the program, so limited internal capacity led decisions to attach its administration to other community economic development programs. In 2007 DEED reorganized its business and community development staff so that JOBZ is now part of the business financing group, whose work load and job and wage monitoring responsibilities are more closely aligned with heightened oversight of JOBZ. We believe this will address many of the audit report's findings and make a significant difference.

The report states that the program has not been sufficiently focused on economically distressed areas in greater Minnesota. With the Strategic Entrepreneurial Economic Development (SEED) initiatives that Governor Pawlenty will introduce in the 2008 session, DEED will propose that those greater Minnesota areas of greatest distress (measured by either long-term population loss or unemployment in excess of the statewide average) be permitted to enter into business subsidy agreements for a full twelve years of JOBZ, compared to ten years in greater Minnesota areas without those economic circumstances. Other programs in SEED will either be targeted exclusively or as a preference to those more distressed areas.

We look forward to working with the Legislature as we implement these suggested changes.

Sincerely,

A handwritten signature in cursive script that reads "Dan McElroy".

Dan McElroy
Commissioner

MINNESOTA • REVENUE

February 4, 2008

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
140 Centennial Office Building
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

We thank the Office of Legislative Auditor for its thoughtful review and analysis of the Job Opportunity Building Zone (JOBZ) Program. We agree with the findings and recommendations specifically directed at the department.

We believe the JOBZ program is a valuable economic development tool. However, because it is a comprehensive and complex program it is appropriate that it be evaluated from time to time to ensure that it is being appropriately administered.

We agree with your recommendation that all JOBZ businesses should be required to submit the M500 tax form. This will enable us to get a complete set of information from all recipients on the tax benefits received during the tax year.

You have identified an error in the JOBZ tax form involving the order of application of the relocation percentage and the 20% benefit limitation. We agree with that finding and are in the process of correcting that form and the instructions.

You point out several modifications that should be addressed by the Legislature to clarify and amend statutes to improve the clawback provisions aimed at noncompliant businesses. We agree that some changes to these provisions are necessary. We have been working on proposed law changes since the last legislative session and we will be coming forward with a comprehensive proposal as part of our department tax bill. This will address both businesses that cease to operate in the zone and those that continue to operate in the zone but have not met their obligations under the business subsidy agreement.

You mention in the report a need for a greater coordination of effort and more timely communication between the Department of Employment and Economic Development (DEED), the counties and this department. This is especially true as it relates to businesses that are no longer operating as a qualified business in the zone. We agree with this recommendation as well. We will be seeking legislation requiring businesses to

annually certify that they are still operating in the zone and are in compliance with the requirements of its business subsidy agreement. This will also be part of our department tax bill. We are committed to working with DEED and the counties to improve communications and make them more meaningful and timely.

Your recommendations and analysis will help us to improve the administration of the JOBZ program and hopefully provide the foundation that enables us to work successfully with the Legislature to get the necessary law changes enacted.

Again, we want to thank the OLA for their review and analysis of the Job Opportunity Building Zone Programs and we look forward to working with the Legislature, the Department of Employment and Economic Development and county tax officials in addressing the recommendations of the report.

Sincerely,

A handwritten signature in cursive script, appearing to read "Ward Einess".

Ward Einess
Commissioner

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