

A Golden Opportunity: Making Gulf Opportunity Zone Bonds Work for Those Most in Need

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Executive Summary

The Gulf Opportunity Zone law passed by Congress in December 2005 to assist the recovery from Hurricane Katrina gives the states of Louisiana, Mississippi and Alabama control over the allocation of more than \$14 billion in low-interest loans (in the form of tax-exempt bonds) that can be used by businesses to build or repair a wide range of facilities. The three states are now in the process of developing standards for determining which projects should benefit from what are known as GO Zone bonds.

In this report Good Jobs First, Interfaith Worker Justice and the Gulf Coast Commission on Reconstruction Equity offer the three states policy options for allocating the bonds in ways that promote efficiency, equity, transparency and accountability. Specifically, these options are:

- Reserve at least half the dollar value of the GO Zone bond allocations for projects in areas that sustained substantial damage from Hurricane Katrina or the subsequent flooding.
- Give priority to proposals from those industries that suffered the most physical or economic damage as a result of the storm and its aftermath.
- Cap allocations at \$100 million per firm per year.
- Give special consideration to proposals from certified minority-owned and women-owned businesses, both those based in the hurricane-affected region and those from outside.
- Deny bond allocations to companies that are already recipients of federal contracts worth \$10 million or more for Katrina-related work, so that the economic benefits of hurricane reconstruction are widely distributed.
- Give preference to projects that will create the largest number of high-quality jobs.
- Give preference to applicants that commit to paying wages that are at least as high as existing market averages and commit to providing adequate and affordable family medical coverage. These provisions can apply both to temporary construction jobs and permanent positions at the facility.
- Require that employers give displaced workers access to decent temporary housing.
- Give preference to projects that commit to hiring a majority of workers from those areas most heavily damaged by the storm and subsequent flooding.
- Disclose GO Zone bond applications and make them immediately available on a state website.

- Hold public hearings on all applications and actively solicit public comments.
- Monitor the performance of GO Zone bond recipients in complying with job-creation and other criteria. Promptly publish the results of that monitoring on a state website.
- Impose financial penalties on companies that fail to live up to their obligations on job-creation and other standards.

Protections like these are the best way to ensure that the GO Zone bond program does not exhibit the same kinds of performance problems that have afflicted a large portion of the federal contracts awarded for Katrina cleanup and reconstruction. They would also guard against some of the inequitable results seen in the use of Liberty Bonds, the post-9/11 program for New York City that served as the model for GO Zone bonds. Adopting these policies would, instead, go a long way toward guaranteeing that the benefits of the bonds accrue to those who need them the most—workers and small/medium-sized businesses in the hardest hit areas of the Gulf Coast region.

Introduction

Even before the waters had receded in New Orleans, conservative organizations were urging the Bush Administration to respond to Hurricane Katrina in a business-friendly way. The Heritage Foundation took the lead, encouraging the use of tax incentives and regulatory relief in rebuilding the Gulf Coast region. On September 15, President Bush picked up on this theme in a speech in New Orleans in which he vowed to help rebuild the affected communities. He called for turning areas of Louisiana, Mississippi and Alabama hit by the hurricane into a Gulf Opportunity Zone:

Within this zone, we should provide immediate incentives for job-creating investments, tax relief for small businesses, incentives to companies that create jobs, and loans and loan guarantees for small businesses, including minority-owned enterprises, to get them up and running again. It is entrepreneurship that creates jobs and opportunity. It is entrepreneurship that helps break the cycle of poverty, and we will take the side of entrepreneurs as they lead the economic revival of the gulf region.

It was not feasible to base the recovery effort entirely on a resurgence of entrepreneurship, so the federal government ended up providing a substantial amount of traditional aid. Yet the notion of redevelopment incentives remained alive, leading to the passage by Congress of the Gulf Opportunity Zone Act, which Bush signed into law on December 21.

At the heart of the legislation is a set of tax incentives for business activity in designated counties of Louisiana, Mississippi and Alabama (called the GO Zone), including the following¹:

Bonus depreciation. This provision, modeled after a feature of the September 11 tax relief package, creates a sweetener for businesses in the recovery of the cost of GO Zone property put into effect following Hurricane Katrina (through the end of next year). The special deduction is equal to 50 percent of the property's cost during the first year.

Double small business expensing. Certain small businesses affected by Hurricane Katrina can annually deduct up to \$200,000 in qualifying property expenditures made in the disaster area. This is double the maximum amount otherwise allowed for small business.

Deductions for demolition and cleanup costs. Businesses are allowed to take a deduction for 50 percent of GO Zone cleanup costs (through the end of next year) that would otherwise have to be capitalized.

Net operating loss carryback extended. The period for carrybacks (applying an operating loss to a preceding year's income) is extended from two to five years for net operating losses attributable to Hurricane Katrina. This provision will allow some businesses affected by the hurricane to obtain a refund of taxes paid in earlier tax years.

What characterizes these provisions is that they are available to *all* qualified businesses in the GO Zone areas of the three states, making them a kind of entitlement.² Companies don't have to apply and receive individual approval, thus denying the affected states and the public the ability to question the award of these benefits to certain companies or to attach safeguards. Instead,

firms simply claim the benefits on their federal corporate income tax returns. Those returns, of course, are not public documents, so the public will never know which companies have taken advantage of these incentives and to what extent.

GO Zone Bonds

The GO Zone law has additional provisions that create business benefits over which public officials in the three states do have direct control. The most important of these is the power given to the three affected states to issue a large quantity of GO Zone bonds: tax-exempt private-activity bonds to help finance recovery by giving businesses access to low-cost capital. The new bonding authority is set at the equivalent of \$2,500 per resident in the affected areas, which works out to \$7.9 billion for Louisiana, \$4.8 billion for Mississippi and \$2.1 billion for Alabama.

Private-activity bonds—which are distinct from bonds that governments issue for their own public purposes—are not a new tool for economic development. In fact, they have been used by state and local governments for more than half a century. A particular form of these securities, known as industrial revenue bonds, played a major role in the effort by Southern states to lure Northern manufacturers.

These bonds are a way for government to give companies access to capital at a lower rate of interest than what is available in the commercial lending marketplace. This is done by issuing the bonds through a public entity, which makes the interest received by investors exempt from federal (and often state) income tax. Because of the tax advantage, investors are willing to accept a lower interest rate, thus saving money for the borrowing company. Despite the government's role in issuing the securities, it is the company that is responsible for repaying the principal and the debt service on the bonds. That is why these are often called pass-through or conduit bonds.

The difference between the interest rate on tax-exempt private-activity bonds and the interest rate on commercial corporate bonds constitutes the subsidy to the business. That difference is usually at least a couple of percentage points.

All this is seen as a win-win-win for the companies (which get cheaper financing), state and local governments (which take credit for promoting economic growth and job-creation) and investors (who get a tax break and a reasonable rate of return for a highly secure investment). The party paying the bill is the federal government, which loses revenue on the tax-exempt interest. (Those states with an income tax that exempt the interest on the bonds lose revenue as well, though to a much smaller degree).

To limit its losses from private-activity bonds, Congress began placing limitations on their use in the late 1960s. Today, there are two remaining permissible types of tax-exempt bonds used as corporate subsidies:

- **Small Issue Industrial Revenue Bonds (IRBs)** are restricted to the construction, expansion, or renovation of manufacturing facilities. They are generally limited to \$1 million, but under certain circumstances that amount can go up to \$10 million.

- **Exempt Facility IRBs** have no size limits, but they can be used only for specific types of projects, such as water and sewer facilities, electricity and natural gas facilities, and certain types of rental housing. Certain facilities such as stadiums, convention centers, and parking garages that used to be allowed are now excluded.

There is a \$40 million aggregate limit (nationwide) on the total amount of IRBs that can be outstanding for the same company. There are also limits on the volume of certain categories of private-activity bonds that can be issued by each state. In 2001 those state ceilings were set at the greater of \$75 per capita or \$225 million, with those amounts indexed to inflation in subsequent years. Typically, half of the state ceiling is allotted to state agencies and the other half is allotted to local government entities within the state according to relative population. As a result, each issuing entity ends up with what is known as a *volume cap*.

The GO Zone law provides the three affected states a temporary relaxation of : the volume cap, the limits on the value of bonds that can be issued for a single company and the restrictions on what kinds of projects are eligible (allowing, for example, office buildings, shopping centers and hotels). Interest on the bonds is also exempt from the alternative minimum tax.

The total of \$14.8 billion in new bonding authority, which lasts until the end of 2010, can be used to give companies access to capital to finance the acquisition, construction and renovation of non-residential real property, qualified low-income residential rental housing, single-family residential housing and public utility property in designated areas.³ Individual projects must be approved by the state’s governor or bond commission.

Progress by the States on Setting Standards

Since the passage of the GO Zone law, Louisiana, Mississippi and Alabama have been proceeding, each in its own way, to make the new private-activity bond financing available to companies. The following is a summary of where things stood in each state as of late March 2006:

Louisiana. The Pelican State has by far the biggest pool of bond financing to play with. One newspaper in the state said that the funding “puts Louisiana on the brink of the largest construction boom in state history.”⁴

Almost as soon as the bond approval process began, it became embroiled in controversy. The first step was taken by the Louisiana Public Facilities Authority, which on February 14 announced its preliminary approval of projects involving a total of \$406 million.⁵ The largest of the projects was \$200 million for Cleco Power LLC, the electric utility in central Louisiana. Three of the projects involved the construction of buildings in Baton Rouge by developer Mike Wampold. One of those was a \$40 million office building and parking garage to be occupied by The Shaw Group, an engineering company that was the recipient of more than \$200 million in Gulf Coast reconstruction contracts. Another of Wampold’s projects was a \$50 million hotel to

be built through the conversion of a partially constructed dormitory on the campus of Jimmy Swaggert Ministries.

Rather than rubber stamping the proposals from the Public Facilities Authority at their meeting on February 16, members of the State Bond Commission questioned whether it was appropriate to allocate GO Zone bonds to projects located in areas that were not hard hit by Katrina, especially in the first round of approvals. The Wampold project for The Shaw Group was singled out for scrutiny. According to the account in the Baton Rouge *Advocate*, “Sen. Francis Heitmeier, D-New Orleans, questioned why a Fortune 500 company like Shaw should qualify for the special borrowing program. He is a member of the Bond Commission. ‘Is this one of those small companies we’re talking about that’s a little shaky?’ he said sarcastically.”⁶

The Commission ended up deferring action on all the projects under consideration. Another factor in the decision appeared to be a desire to examine an executive order that had been issued the same day by Gov. Kathleen Blanco to provide allocation procedures.⁷ The executive order requires bond applications to be submitted to both the Department of Economic Development and the State Bond Commission, and they must be approved by the Governor’s office and the Commission, both of which may set criteria for making allocations. Among other things, applications must indicate the number of jobs to be created during the construction and the number of permanent jobs, with data on wage levels and the provision of healthcare benefits.⁸

State Treasurer John Kennedy, chair of the Bond Commission, seemed concerned that the Governor was trying to restrict the role of the commission in the bond approval process. In a newspaper interview, he warned that the procedures in Blanco’s executive order means “at least negative decisions on these much-coveted applications can be made behind closed doors. I don’t think that’s right.”⁹

Undeterred by the tabling of its proposals by the Bond Commission, the Public Facilities Authority met on March 6 and gave preliminary approval to two projects involving a total of \$45 million in financing: \$20 million for a Hilton Homewood Suites hotel in downtown Lafayette and \$25 million for the repair of industrial facilities in New Orleans and St. Bernard Parish owned by Air Products and Chemicals Inc. that were damaged by Hurricane Katrina.¹⁰

When the Bond Commission met again on March 16, it approved only one proposal: \$150 million to finance the construction of the Film Factory, a digital film studio and school that will train people to work in the film industry. Backers claimed that the project, which will need additional levels of approval, would create more than 2,000 jobs in the city.

Meanwhile, the state economic development agency is still working on guidelines for allocating the state’s pool of money. Richard House, general counsel for the agency, told a reporter in mid March that a possible arrangement would be to dedicate half of the \$7.9 billion for projects in the ten parishes most damaged by Hurricane Katrina and the three most damaged by Hurricane Rita.¹¹

Mississippi. There has been less public controversy over the bond criteria in Mississippi. There was, however, some disappointment when Kia Motors decided to build a \$1.2 billion auto

assembly plant in Georgia, snubbing incentive offers from officials in Mississippi that included GO Zone sweeteners.

The designated issuer, the Mississippi Business Finance Corporation, has given tentative approval to about 40 industrial revenue bond projects involving a total of about \$1.4 billion in financing.¹² They range in size from \$2.5 million for a shopping center to \$160 million for a lumber mill and \$400 million for a defense contractor. Cindy Carter of the agency says that at this point the plan is to put all proposed projects in the pipeline, on the assumption that those that are not approved for tax-exempt bond financing will receive other forms of assistance such as taxable bond financing.¹³ Carter said that applications are about evenly distributed between in-state and out-of-state companies. Very small firms do not appear among the applicants, Carter said, because the fixed costs associated with the bonds mean that the program is not economical for those trying to borrow less than a few million dollars.

Carter's agency cannot formally issue any bonds until the state completes the process of drawing up allocation procedures. That process is being handled by the Mississippi Development Authority, which will report to the Governor. Jay McCarthy, Director of the authority's Financial Resources Division, expects the standards to be issued sometime in April.¹⁴

Alabama. Alabama, with the smallest pool of GO Zone bond funding to allocate, has made the least progress among the three states. Pat Haigler of the Division of Debt Management says that the state is close to completing an application form that can be used by companies to apply for the financing.¹⁵ Haigler said that standards for evaluating applications will be devised by the Finance Department.

Policy Options

The fact that the three states have made limited progress in setting standards for the allocation of GO Zone bonds may be frustrating for those who want to see faster progress in Gulf Coast reconstruction, yet this also means that it is not too late to consider accountability safeguards.

The ability to allocate the bonds means that that the three states are in a position to shape a major portion of the reconstruction process in a way that emphasizes efficacy, equity and accountability. The following is a set of policy options that can help realize these goals.

1. Focus the Financing Where It is Needed the Most

It would seem to be a matter of common sense to direct the bond financing to those most in need of the help. Under the GO Zone law, this will not happen automatically. The new tax-exempt bonding authority applies to projects located in 31 parishes of Louisiana, 49 counties of Mississippi and 11 counties of Alabama. Many of these areas were not severely affected by the hurricane itself, and most did not experience the kind of flooding that afflicted the New Orleans area. The outer areas may have some worthy projects in need of low-cost financing, but these projects may not merit being first to receive GO Zone allocations. The Louisiana Bond

Commission has already expressed this sentiment by tabling an early spate of proposals from areas that did not suffer significant hurricane damage.

Option: Restrict at least half the dollar-value of GO Zone bond allocations to projects in areas that sustained substantial damage from Hurricane Katrina itself or the subsequent flooding.

There is also the question of differences in need by industry. Some sectors such as commercial fishing were devastated by the storm; others may have experienced only temporary dislocations. It is only fair to give preference to those sectors that were hardest hit.

Option: Give priority in GO Zone allocations to proposals from industries that suffered the most physical or economic damage as a result of the storm and its aftermath.

2. Reserve a Substantial Share of the Financing for Small and Medium Businesses

The GO Zone legislation does not put a limit on the size of individual allocations. In theory, Louisiana, for example, could devote all of its \$7.9 billion pool to a handful of mammoth construction projects in the petrochemical industry. That would freeze out the many small and medium businesses that are struggling to survive in the Gulf Coast region.

The problem of unbalanced allocations was seen with New York City's Liberty Bonds, the federal 9/11 relief program on which GO Zone bonds were modeled. As shown by Good Jobs New York, the allocation of Liberty Bonds was heavily weighted in favor of large corporations and real estate interests in the city.¹⁶ A single allocation of \$1.65 billion—one-fifth of the total available—went to investment bank Goldman Sachs to finance a new headquarters in Lower Manhattan.¹⁷

The best way to protect against this is to establish a ceiling on the size of allocations to single firm.

Option: Cap eligibility for GO Zone allocations at \$100 million per firm per year.

3. Reserve a Share of the Financing for Minority-Owned and Women-Owned Businesses

The allocation of the GO Zone bonds is an opportunity to encourage full participation by minority-owned and women-owned business in the reconstruction of the Gulf Coast region. This can be done by setting aside a portion of the bonds for such businesses.

Option: Establish a set-aside of GO Zone bond allocations for certified minority-owned and women-owned businesses, both those located in the hurricane-affected region and those from outside. Buttress that set-aside with an affirmative marketing plan to publicize the availability of the bonds through networks of minority- and women-owned businesses.

4. Prevent Egregious Double-Dipping

A small number of companies, both large and small, are enjoying the benefits of lucrative federal contracts for cleanup, reconstruction and other activities in the Gulf Coast region. These are not the companies most in need of GO Zone bond assistance.

Option: Exclude recipients of primary federal contracts worth \$10 million or more for Katrina-related from GO Zone bond allocations.

5. Encourage the Creation of Quality Jobs

The justification for the GO Zone bond program applies not only to the businesses that receive the financing but also to the workers hired for the projects, both during the construction phase and the permanent operation. The states ought to see the GO Zones as important job-creation tools; Louisiana already seems to be moving in this direction with the Governor's above-cited executive order that requires bond applicants to indicate the number of construction and permanent jobs that will be created.

There is a growing consensus on the importance of applying job-quality standards to all forms of economic development subsidies. Good Jobs First has long tracked this trend. Our last survey of the subject found that at least 43 states, 41 cities and 5 counties applied such rules to at least one subsidy program. At the local level, many standards have been enacted through living wage laws that apply to all types of economic development assistance above a certain dollar amount. At the state level, standards are more often attached to specific incentive programs. At least 116 state subsidy programs currently use job quality standards.¹⁸ Several states attach prevailing-wage requirements to private construction subsidized by programs such as industrial revenue bonds.

Job quality does not only mean a decent rate of pay. Just as important these days is providing adequate and affordable medical coverage for the worker and his or her family. This is especially true for families dislocated by the hurricane, many of whom have lost existing coverage.

When it comes to projects being planned in those areas hardest hit by Katrina, a case can be made for another kind of employee benefit: the provision of temporary housing. Given the poor performance of relief agencies in providing temporary housing and the slow pace of residential rebuilding, companies would do well to follow the lead of firms such as Domino Sugar by making sure that workers who have been displaced from their homes by the storm have access to decent temporary housing.

Option: Allocate GO Zone bonds with an eye to the creation of the largest number of high-quality jobs. This means jobs with wages at or above the existing market level as well as adequate and affordable family medical coverage; in areas still suffering from a high level of hurricane-related destruction, it also means access to decent temporary housing.

6. Give Preference to Residents of the Areas with Heaviest Hurricane Damage

Just as it makes sense to give priority to businesses in the areas hardest hit by the storm, so would it be advisable to give preference to projects that commit to hiring workers living in those same areas. There has been great concern that Katrina contractors have been bringing in cheap labor from outside the Gulf Coast region to do jobs that could be performed by jobless local residents. This problem could be avoided when it comes to projects that receive GO Zone bond financing.

Option: Give preferences in GO Zone bond allocations to projects that commit to hiring a majority of their workers from those areas most heavily damaged by the storm and subsequent flooding.

7. Transparency and Accountability

As with all economic development programs that involve the use of public funds, it would be good public policy for the states to handle GO Zone bond allocations in a way that is transparent and accountable. This would include making information about applications and approvals readily available to the public, along with holding public hearings on all applications. Such policies are in line with the trend toward disclosure in state subsidy programs in general. Today, about a dozen states have some form of company-specific disclosure for one or more programs.¹⁹

The need for transparency does not end after the bonds are allocated. States can monitor the projects to be sure that they live up to their job-creation goals and other commitments, and the results of this monitoring, whether in the form of company reporting or state reports, can also be made public.

If the results of the monitoring show that a recipient company is not living up to its obligations, the state can take steps to enforce the terms of the bond approval. At first, this might mean a warning, but states can impose financial penalties on a company that consistently fails to do what it promised. Such penalties, which are used by some 20 states and dozens of localities for various subsidy programs, are known as “clawbacks.”²⁰ A non-compliant company could, for instance, be penalized an amount equal to the savings in interest costs it enjoyed as a result of the bonds.

Option: Disclose GO Zone applications and approvals to the public and make them available on a state website. Monitor the performance of GO Zone bond recipients in complying with job-creation and other criteria and make the results of that monitoring immediately available to the public through a state website. Impose financial penalties on companies that fail to live up to their obligations on job creation, job quality, etc.

Conclusion

The \$14 billion in GO Zone bond allocations that will be made by Louisiana, Mississippi and Alabama represent an important opportunity to shape the economic future of the region that was seriously impacted by Hurricane Katrina. If the states pursue this program in a way that promotes efficiency, equity, transparency and accountability, it will have the best chance of being a true boon for the struggling people of the Gulf Coast region.

ENDNOTES

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- ¹. The bill created different tax benefits in the areas affected by Hurricanes Rita and Wilma.
 - ². The bill restricted the tax benefits from projects involving private golf courses, country clubs, massage parlors, hot tub and suntan facilities, racetrack or other gambling facilities, or liquor stores.
 - ³. The law also, among other provisions, allows the three states to do one advance refunding of certain existing private-activity bonds, allows the states to issue \$350 million of debt-service tax-credit bonds to help distressed local governments, and allows a larger portion of mortgage revenue bonds to be used to repair homes.
 - ⁴. John Hill, "Gulf Zone Bonds to Pump Cash into Louisiana," *The News-Star* (Monroe, La.), March 13, 2006.
 - ⁵. "LPFA Board of Trustees gives preliminary okay to \$406 million in financing for new construction projects," press release dated February 14, 2006; available online at http://www.lpfa.com/dynaweb/1001221/docs/lpfa_february_board_meeting_02-7-06.pdf
 - ⁶. Michelle Millhollon, "Bond Panel Questions Requests by BR Firms for Storm-Aid Funds," *The Advocate* (Baton Rouge), February 17, 2006, p.A1.
 - ⁷. Executive Order No. KBB 2006-9; online at http://www.gov.louisiana.gov/assets/docs/Executive_Orders/906execGulfOpportunityZoneBondProcedures.pdf
 - ⁸. *Ibid.*, Section 3, F.6.b.
 - ⁹. John LaPlante, "Kennedy: Blanco Took Teeth Out of Loan Watchdog Panel," *The Advocate* (Baton Rouge), February 18, 2006.
 - ¹⁰. "LFPA Board of Trustees Gives Preliminary Approval to Lafayette, New Orleans and St. Bernard Projects," press release dated March 7, 2006; online at http://www.lpfa.com/dynaweb/1001221/docs/lpfa_march_board_meeting_03-6-06.pdf
 - ¹¹. John Hill, "GO Zone Project for Digital Media Studio Approved," *The News-Star* (Monroe, La.), March 17, 2006.
 - ¹². Spreadsheet dated March 6, 2006 provided to the author by the Mississippi Business Finance Corporation.
 - ¹³. Telephone interview on March 22, 2006.
 - ¹⁴. Telephone interview on March 27, 2006.
 - ¹⁵. Telephone interviews on March 21, 2006 and April 4, 2006.

¹⁶. See Good Jobs New York, *The LMDC--They're in the Money, We're in the Dark*, August 2004; available online at http://www.goodjobsfirst.org/pdf/lmdc_report.pdf

¹⁷. Elizabeth O'Brien, "Liberty Board OKs \$1.65B for Goldman," *The Bond Buyer*, August 16, 2005.

¹⁸. See a more detailed discussion at http://www.goodjobsfirst.org/accountable_development/reform3.cfm and in the Good Jobs First report titled *The Policy Shift to Good Jobs*; available online at <http://www.goodjobsfirst.org/pdf/jobquality.pdf>

¹⁹. For more details on subsidy disclosure, see http://www.goodjobsfirst.org/accountable_development/reform1.cfm

²⁰. For more on clawbacks, see http://www.goodjobsfirst.org/accountable_development/reform1.cfm