Study of the factors that have contributed to the termination of Job Development Investment Grants

North Carolina Department of Commerce

March 1, 2016

Report Pursuant to Section 1(i) of S.L. 2015-259

Executive Summary

A 2015 session law directed the Department of Commerce to study the factors that have contributed to the terminations of grants awarded through the Job Development Investment Grant (JDIG) program.

This report provides the numbers of JDIG terminations and the reasons businesses have given for ending their incentive contracts. Our analysis finds the causes are reasonable and mostly the result of economic conditions, with 90% of terminations occurring over the last six years of the program. It's important to keep in mind that even if a company terminates its grant early, the State of North Carolina benefits from the jobs the JDIG awardee creates at least through the point of termination and North Carolina taxpayers receive a positive fiscal return from the Job Development Investment Grant program.

The Economic Investment Committee awards JDIGs to companies who contractually commit to create jobs and invest in North Carolina. Upon the award of a JDIG, grantees agree to specific job creation and investment performance requirements in order to receive payments from the state, which are in fact reimbursements of a portion of the state income taxes withheld by the company from the newly created jobs. Before any reimbursement is issued (i) Commerce verifies that the new jobs have in fact already been created and (ii) the grantee company has remitted payroll taxes for the new jobs to the state in excess of the grant amount. Where jobs are not created and payroll taxes are not made, no payment is issued.

The unpredictability of market conditions often creates challenges for companies when they attempt to accurately forecast net job creation over the life of their grant agreement, which frequently run as many as twelve years. In some cases, a pro-rata portion of the grant is reimbursed for partial performance. In other cases, if a grantee fails to comply with the JDIG requirements, the grant may be terminated. However, most companies whose JDIG grants have been terminated did engage in some level of job creation. The major findings of this report are:

1) **JDIG grant terminations have been closely linked with downturns in the overall economy.** Given the uncertainty of economic conditions and the inherent difficulties in predicting business needs over 12 years, the typical length of grant agreements, some terminations should be expected. For instance, evidence suggests that the Great Recession significantly impacted awardees' job growth projections and created a spike in grant terminations.

    - From 2003 through 2015, **79 JDIG grants were terminated** out of 211 awards (37%).[1] During this time, the reasons given for termination were:
        - Economic conditions – 33 grants (42% of all terminations)
        - Failure to meet performance requirements – 24 grants (30% of all terminations)
        - Business changes – 21 grants (27% of all terminations)
        - Workforce limitations – 1 grant (1% of all terminations)

[1] Five grant awards during this period were withdrawn prior to the execution of grant agreements, and are not reflected in this report.

- **65% of all JDIG terminations occurred between 2010 and 2013**. These terminations largely represent project activity from 2008, 2009, and 2010 – a period of poor economic activity nationwide.

2) **Most terminated grant agreements have resulted in job creation**, though at lower levels than forecast in the companies' original grant agreements.

    - Among the total of terminated grants, **companies reported creating 8,900 qualifying jobs** during the year prior to termination (which was 41% of the jobs initially projected by these grantees).

    - **57% of all JDIG terminations occurred between grant years four and six**, which means that most terminated grantees only terminated after already creating some jobs.

3) **North Carolina is a leader in discretionary incentive performance accountability.** No other state was found, through research or industry experts, to have studied its rate of incentive grant termination or to have established policies to limit or reduce grant terminations.

Introduction

Section 1(i) of S.L. 2015-259 directs the Department of Commerce (Commerce) to study the factors that have contributed to the termination of grants awarded through the Job Development Investment Grant (JDIG) program. Pursuant to the requirements of this study, Commerce also investigated the performance improvement efforts of other states with similar economic development programs to identify best practices for lowering the incidence of termination among JDIG grantees.

JDIG is a discretionary business incentive grant program that makes awards to businesses creating new jobs in North Carolina. Grant payments are only made to companies after job performance has been demonstrated. If a grantee fails to fulfill the requirements of their JDIG grant agreement, the grant may be terminated.

JDIG Terminations

From 2003 (the program's first year) through December 31, 2015, 79 grants terminated out of 211 total awards (five grant awards were withdrawn prior to the execution of grant agreements). However, grant termination does not necessarily mean that grantees achieved no job creation or investment performance after being awarded a JDIG grant. It only means that the grantees did not meet their own projected performance metrics, which are laid out in their grant agreements. Most terminated grants have, in fact, resulted in some job creation and investment in North Carolina. Looking at all the grants that have terminated, companies reported having created a total of 8,900 jobs during the year prior to termination (which was 41% of the jobs initially projected by these grantees).

Because terminated grantees failed to fulfill 100% of their performance requirements, annual payments to these grantees were reduced or eliminated. As a result, JDIG payments toward grants that eventually terminated cost $1,082 per job, while payments to non-terminated grantees cost $1,823 per job (45% less).[2]

JDIG Grantee Performance Accountability

JDIG grant agreements include company-projected job creation, wages, and construction investment, which companies must fulfill in order to receive annual grant payments. Under the agreement, each grantee is required to create a defined number of jobs during its "base period," which may extend up to five grant years. JDIG payments are only made after job creation, wage requirements, and investment performance have been verified by Commerce. If a grantee fails to maintain employment levels (or fails to comply with any other condition) stipulated in its grant award agreement, the grantee is considered to be in "performance default."

If a grantee experiences its first performance default, the JDIG statute (§143B-437.59) requires the Economic Investment Committee (EIC), the body that approves JDIG awards and annual payments, to

[2] Because some jobs exist longer than others, cost per job was calculated by dividing total JDIG payments to terminated grantees by total job years reported by terminated grantees.

reduce the amount or the term of the grant, or to terminate the grant. The result of additional consecutive years of performance default depends upon whether the grantee is still in its base period.

Grantee still in Base Period

↳ If a grantee is still in its base period and experiences a second consecutive year of performance default, the EIC may again reduce the amount or term of the grant, or terminate the grant.

If a grantee is still in its base period and experiences a third consecutive year of performance default, no grant payment is permitted for that year, or for any consecutive year of default. If the grantee is in the last year of its base period and demonstrates that it expects to achieve compliance within the following two years, the EIC may extend the grant's base period, for up to 24 months, by which time the grantee must be in compliance, or the grant is terminated.

Grantee out of Base Period

↳ If a grantee is not within its base period and experiences a second consecutive year of performance default, the EIC must terminate the grant.

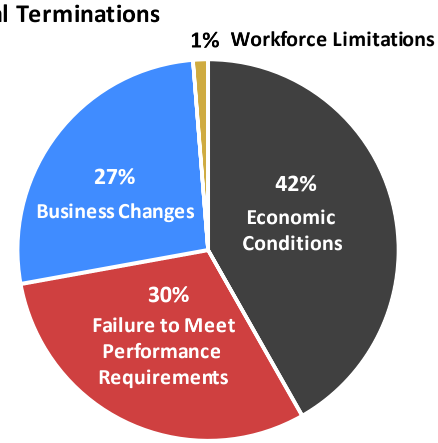
Because Commerce is in close contact with JDIG grantees about their performance, companies with grants in danger of being terminated will usually terminate voluntarily before being forced to do so by the EIC. For instance, if a company changes its business plan or suffers the results of poor economic conditions, it may determine that meeting its JDIG performance requirements is no longer feasible. The company may, under these circumstances, opt out of the program and voluntarily terminate.

Terminations Largely Resulted from Economic Conditions

As a part of the process to terminate a JDIG grant, Commerce asks the grantee for a reason for termination. This question is asked in an open-ended format and companies are free to answer as they see fit. As such, responses vary in specificity, but Commerce has grouped the responses into four categories.

Among the 79 grant terminations, the reasons given for termination have been grouped as follows.

Exhibit 1: Reasons for Terminations
79 Total Terminations



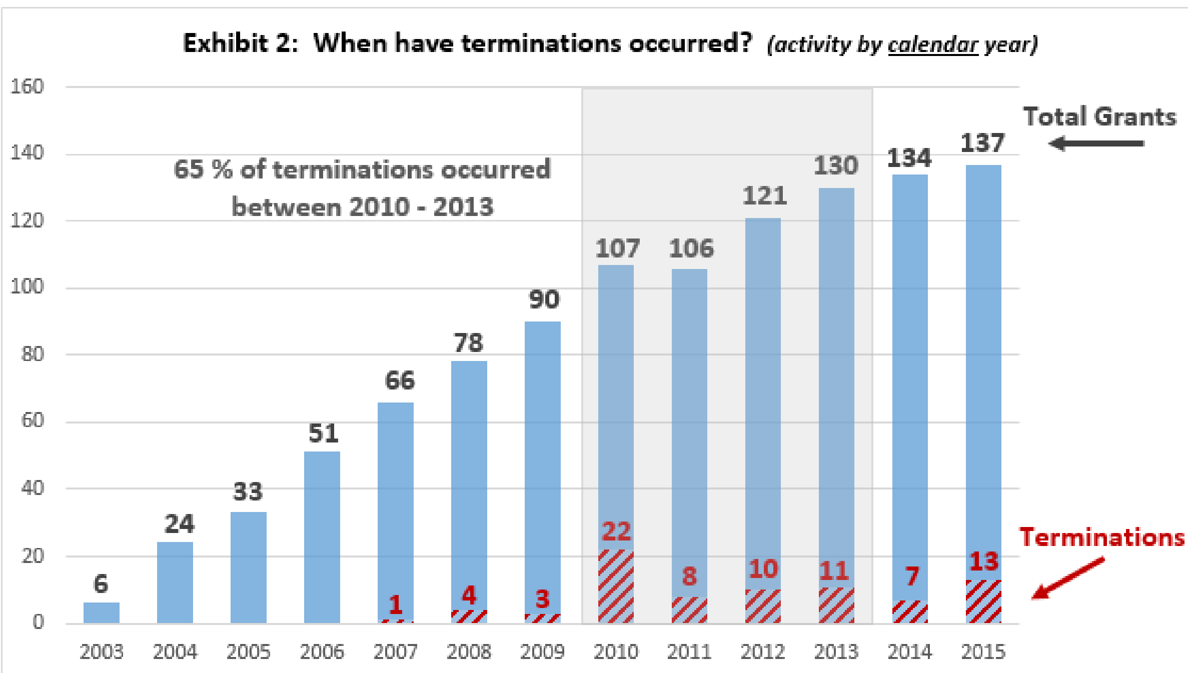
Reasons for Grant Terminations:

1. **Economic conditions**
   - 33 grants (42% of all terminations)
   - These grantees identified the economy or the recession as their reason for grant termination.

2. **Failure to meet performance requirements**
    - 24 grants (30% of all terminations)
    - These grantees identified their own failure to comply with their own projected and agreed-upon performance metrics as their reason for grant termination.
3. **Business changes**
    - 21 grants (27% of all terminations)
    - These grantees identified changes in their specific business plans or strategies as their reason for grant termination.
4. **Workforce limitations**
    - 1 grant (1% of all terminations)
    - One grantee identified a lack of stable and sustainable workers in its region as its reason for grant termination.

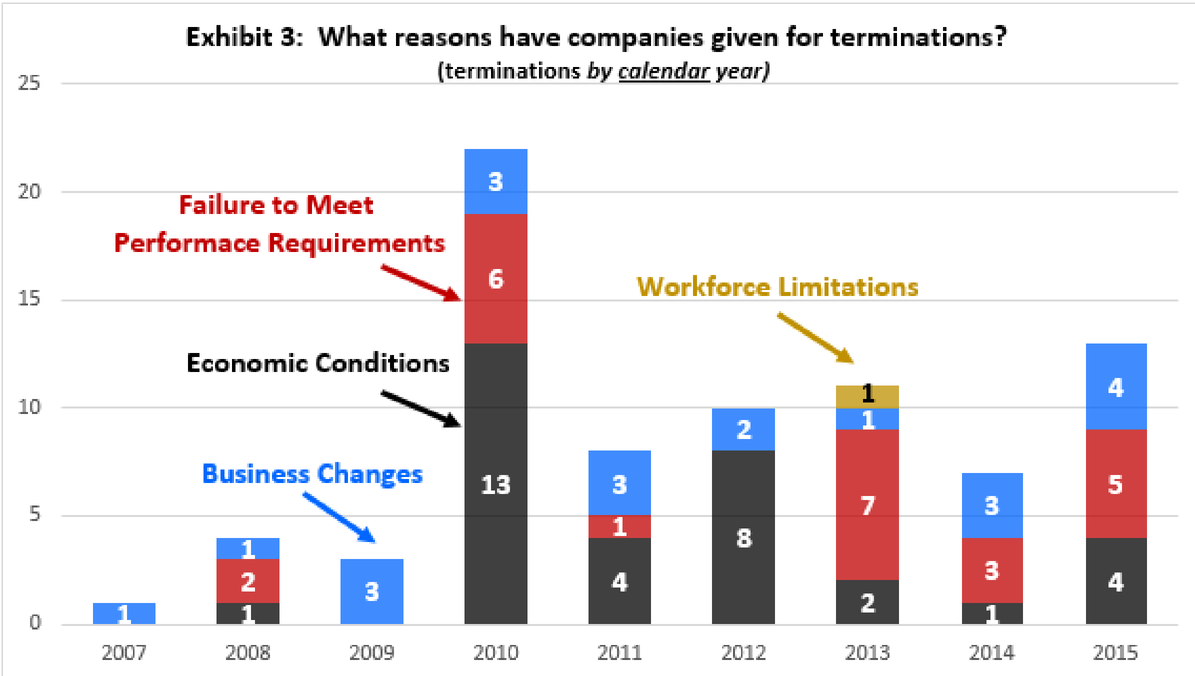
Recent Recession Greatly Impacted Terminations

Exhibit 2 provides some context for the number of grant terminations within the JDIG program for each year since 2003. The growing blue bars represent Commerce's growing JDIG portfolio of grants over the life of the program. The red stripped overlay shows the number of grant terminations that occurred during each year. As Commerce continues to make JDIG awards with multi-year grant terms, the total number of grants in the Department's portfolio has increased, despite some grant terminations.



Sixty-five percent of terminations have occurred between 2010 and 2013. Because reporting of JDIG job and investment performance lags as much as a year from actual performance, these terminations largely represent project activity from 2008, 2009, and 2010, during which time North Carolina's economy was suffering the effects of the Great Recession.

Exhibit 3 describes the reasons companies gave for their terminations by year. Overall, 42% of terminations resulted from economic conditions faced by grantees, but that response was particularly frequent during the years immediately following the economic recession.



Many Terminated JDIG Grants Resulted in Job Creation for Multiple Years

The terminations of JDIG grant agreements have also varied by the age of the grant when termination takes place. The greatest numbers of grants have terminated in grant years four, five, and six, accounting for 57% of all terminations.

Over 70% of terminated JDIG grant agreements were still active into their fourth grant year, which has meant that most terminated grantees had an incentive to create and maintain jobs for several years under the JDIG program. It is, however, worth noting that grantees in the early stages of their grant terms are less likely to have terminated due to the flexibility of the program during each grantee's base period.

JDIG Terminations by Award Year

Exhibit 5 provides the rate of grant terminations by each year in which grants were awarded. As for grants awarded in 2012 or later, it is likely too early to draw conclusions about terminations due to the program's flexibility in the early years of each grant term. Nevertheless, some reasonable level of grant agreement termination is expected, but not likely at the same level that was seen during the Great Recession.

Exhibit 5: Terminations by Grant Award Year (as of December 31, 2015)		
Award Year	Total Grant Awards	Terminated Grant Awards
2003	6	4
2004	18	10
2005	9	8
2006	18	12
2007	15	11
2008	13	11
2009	16	5
2010	20	5
2011	21	9
2012	23	1
2013	20	2
2014	16	1
2015	15	0

} Grantees still early in their grant terms

North Carolina is a Leader on Incentive Grant Performance Accountability

To better understand how competitor states attempt to limit grant terminations, Commerce contacted economic development incentives experts from the following organizations:

- the Council for Community and Economic Research and the Pew Charitable Trusts, two research-oriented nonprofits working on state incentive issues;
- Smart Incentives, a private consulting firm assisting state economic developers with business incentive design and performance evaluation; and
- the Commonwealth of Virginia, through the Virginia Economic Development Partnership, which administers an incentive grant program similar to JDIG.

Neither Commerce nor the organizations contacted were able to identify any similar efforts undertaken by other states to address, improve, or predict the performance of individual companies awarded incentive grants. Part of the explanation for this lack of evaluations in other states may be that most states using incentives for economic development purposes rely heavily on job creation tax credits. These tax credits carry no risk of termination, as they are awarded based only on a company's performance during an individual tax year. For those with performance-based grants, terminations are likely occurring due to the same economic conditions that North Carolina has faced. However, according to those we spoke to, no other state is concerned enough to be investigating this issue.

In Commerce's effort to award JDIG grants to high-performing companies, staff closely vet potential awards, analyzing financial records, employment history, industry-specific growth projections, and other factors. Following the award of a grant, JDIG is structured to pay only after job creation has been verified. Furthermore, Commerce publishes a variety of reports on the state's discretionary incentive grant program, which have led to North Carolina's reputation as a leader in incentive spending transparency.