



EMPOWERMENT ZONES AND ECONOMIC DEVELOPMENT

The following article provides information on federal Empowerment Zones (EZ) and continues the efforts of the California Debt and Investment Advisory Commission (CDIAC) to provide resources to community leaders and service providers working to develop their local economies. It expands on information presented at CDIAC's 2nd Annual Tools to Revitalize California Communities held in Los Angeles on October 17, 2003.

The federal Empowerment Zone and Enterprise Communities (EZ/EC) program was enacted into law as part of the *Omni-bus Budget Reconciliation Act of 1993*. The 1993 legislation represented a departure in federal policy towards developing low-income rural and urban communities. By combining flexible, long-term financing with strategic planning and performance benchmarking, the program was designed to help impoverished communities address structural problems comprehensively, rather than on an issue-by-issue basis.

The 1993 legislation authorized 9 EZs and 95 ECs for Round I of the program. In January 1999, the program was expanded under the *Taxpayer Relief Act of 1997* to include 20 new urban and rural EZs and 20 new rural ECs. In December 2000, the program was expanded further through the *Community Renewal Tax Relief Act of 2000*, which authorized designations for 40 Renewal Communities (RCs) and 9 more EZs. Four California communities have been designated as EZs: Los Angeles, Santa Ana, San Diego, and an unincorporated section of Riverside County. These communities received a federal designation based on their qualification as economically distressed communities and on such measures as high unemployment and poverty rates.

The EZ/EC legislation built upon earlier efforts under federal and state legislation to establish enterprise zones by including tax credits and other supply-side incentives for business investment. The EZ/EC legislation added major new features that made it a very different program. Designated EZs and ECs receive social services block grants and tax benefits. Among the tax benefits, EZs and ECs are authorized to issue tax-exempt private activity bonds and EZ businesses receive a 20 percent wage credit for the first \$15,000 of qualified wages paid to zone residents who work in the zone. Subsequent federal legislation provided tax deductions for certain brownfields cleanup expenses and Work Opportunity Tax Credits for 40 percent of the first \$6,000 of first-year wages for "high risk youth" who live in EZs or ECs.

Enterprise Zone Facility Bonds

State or local governments can issue Enterprise Zone Facility Bonds – a type of industrial development facility tax-exempt bond – to make loans to an EZ business to finance Qualified Zone Property. At least 95 percent of the net proceeds from the bond issue must be used to finance Qualified Zone Property principally used by an EZ business, and certain land used for a related purpose (for example, land used for a business parking lot). Tax-exempt bonds generally have lower interest rates than conventional financing because the purchaser of the bonds does not have to pay federal income tax on the interest income received from the bonds.

The primary benefit of tax-exempt financing is a lower interest rate than the rate on a conventional loan. Bond purchasers are willing to take a lower interest rate because they will not have to pay federal income tax on the interest income that they receive from the bond. The government issuer loans the proceeds of the bonds to a business, passing on the lower interest rate. Lower interest rates mean a better cash flow for EZ businesses. Another benefit is the time period of the debt. Tax-exempt bonds may be issued for 120 percent of the average useful life of the capital investment. It also is possible – depending on the financial circumstances – to issue tax-exempt bonds to finance 100 percent, or nearly 100 percent, of the transaction. In addition, up to 2 percent of the issuance can be used to pay for the costs of issuance, thus allowing the borrower to finance those expenses instead of paying them out of pocket.

Empowerment Bond Eligibility Requirements

This program applies to manufacturers, retailers and any service with the exception of housing that operates in an EZ. To qualify for EZ Bond financing in California, the issuer must submit a completed application and supplemental material in a manner prescribed by the California Industrial Development Financing Advisory Commission (CIDFAC) and meet the minimum requirements set forth below:

- At least 35 percent of the employees of an EZ business must be residents of the EZ.
- At least 50 percent of the total gross income of an EZ business must be derived from the active conduct of such business.

- 85 percent of the use of the tangible property of an EZ business (whether owned or leased) must be used in active conduct of such business.
- 85 percent of the intangible property of an EZ business must be used in active conduct of such business.
- 85 percent of the services performed for an EZ business by its employees must be performed in the EZ.
- Less than five percent of the aggregate unadjusted bases of the property of an EZ business must be attributable to collectibles.
- Less than five percent of the average aggregate unadjusted bases of the property of an EZ business must be attributable to debt, stock, partnership interest, options, warrants or other similar property specified in the Internal Revenue Code or the regulations.
- The EZ business must finance property that qualifies as “Qualified Zone Property”. Qualified Zone Property generally consists of a capital asset to which the straight-line depreciation method applies and to which the original use begins with the EZ business.

- The borrower must provide documentation of the applicable discretionary use permits and approvals from federal, state, or local planning agencies for the proposed project at the time of application.

Ongoing Allocation and Financing Process

Funding EZ/EC projects is contingent upon state and local government approvals. The EZ bond program will expire at the end of 2009 unless extended by the federal government. The EZ Bond approval process in California is outlined below:

- EZ bond projects in the City of Los Angeles, City of Santa Ana and the unincorporated area of Riverside County may apply directly to CIDFAC for approval. The San Diego EZ bond program must secure a California Debt Limit Allocation Committee private activity bond allocation and CIDFAC approval prior to issuance.
- EZ bond funding is contingent upon CIDFAC approval when a local agency is the issuer.

For additional information on the EZ bond program, please contact CIDFAC at (916) 653-3843 or visit its website at www.treasurer.ca.gov/cidfac.

This Offprint was previously published in DEBT LINE, a monthly publication of the California Debt and Investment Advisory Commission (CDIAC). CDIAC was created in 1981 to provide information, education, and technical assistance on public debt and investment to state and local public officials and public finance officers. DEBT LINE serves as a vehicle to reach CDIAC's constituents, providing news and information pertaining to the California municipal finance market. In addition to topical articles, DEBT LINE contains a listing of the proposed and final sales of public debt provided to CDIAC pursuant to Section 8855(g) of the California Government Code. Questions concerning the Commission should be directed to CDIAC at (916) 653-3269 or, by e-mail, at cdiac@treasurer.ca.gov. For a full listing of CDIAC publications, please visit our website at <http://www.treasurer.ca.gov/cdiac>.

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