NORTH CAROLINA GENERAL ASSEMBLY

Session 2017

Legislative Fiscal Note

Short Title: **High-Pay JDIG Job Cap Modification**
Bill Number: Senate Bill 820 (First Edition)
Sponsor(s): **Senators Tillman, Newton, and Alexander**

Requestor: **Finance Committee**
Analyst(s): **Madison Lahey**
Emma Turner

SUMMARY TABLE

FISCAL IMPACT OF S.B. 820, V.1 ($ in millions)

	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22	FY 2022-23
State Impact					
General Fund Revenue	-	-	-	-	-
Less Expenditures	-	-	-	-	-
General Fund Impact	**Likely Significant Budget Cost - Refer to Fiscal Analysis section**				
NET STATE IMPACT	**Refer to Fiscal Analysis section**				

FISCAL IMPACT SUMMARY

Changing the per-employee withholdings cap from $6,500 to $16,000 will affect projects likely to receive JDIG payments starting in calendar year 2020, with first payments made in FY 2020-21. While there will be no change to the maximum total liability from the JDIG program, it is anticipated that this change will likely affect actual JDIG expenditures. Under the current proposal, and based on previous award patterns and pending applications, Fiscal Research anticipates a total increase in State liability for JDIG projects of $7.1 million from FY 2018-19 through FY 2022-23. Though the Fiscal Research Division typically only projects impacts for five years, due to the length of JDIG grant commitments an additional five-year projection is included for informational purposes. For FY 2023-24 through FY 2027-28, the increase in State liability is estimated to be an additional $42.9 million. These estimates provide an indication of how the recurring appropriation to JDIG will likely be adjusted in future years. The Department of Commerce negotiates the terms of each JDIG award, and it is impossible to predict how award types and contract details will vary in future years. This estimate is based on recent award patterns and how raising the withholdings cap would have increased those awards. Other factors, such as the negotiated withholdings percentage and the average salary of high-earning employees, significantly impact award amounts.

FISCAL ANALYSIS

PART I: BACKGROUND

Program Description: The current Job Development Investment Grant (JDIG) program provides a discretionary incentive offering sustained annual grants directly to new and expanding businesses statewide. The amount of the grant is calculated using a percentage (between 10% and 75% for Tier 2 and 3 counties and up to 80% for Tier 1 counties) of the personal income tax withholdings generated by the new employees hired by the business. Grant payments to a business occur only after the Department of Revenue verifies that the company has created jobs and generated withholdings pursuant to the JDIG agreement. A JDIG agreement may be up to 12 years and is a binding obligation of the State; the General Assembly annually appropriates funds necessary to pay existing JDIG obligations (awards already committed); this amount is determined by Commerce's yearly April 1 funding study. A portion of JDIG payments to projects located in Tier 2 and 3 counties (15% and 25%, respectively) are redirected and allocated to the Utility Account for economic infrastructure grants to local governments in Tier 1 and 2 counties that are reasonably anticipated to create jobs.

Per-employee Withholdings Cap: G.S. 143B-437.56(f) requires that each employee's withholdings used to calculate a total JDIG award be capped at $6,500. This requirement affects companies with employees earning more than $175,000 per year ($160,000 for projects in Tier 1 counties). For example, a company with an employee earning $200,000 per year could expect to report income tax withholdings of $10,165. Though 75% of $10,165 is $7,623, under current law, only $6,500 could be used to add to the company's award. Under the proposed bill, the withholdings cap would increase to $16,000 per employee. The Department of Commerce could then use withholdings of employees earning up to approximately $410,000 per year to calculate companies' JDIG awards.

Disbursement: Before funds are disbursed to the company the Department of Revenue certifies the company's reported withholdings and the absence of overdue tax debts.

Disbursements have consistently been less than the maximum due to a two factors:

1. Commerce award practices: Given the gradual "ramp up" of new jobs by each company, the fact that most companies do not receive a full 12-year grant term, and that in several years of a grant cohort the annual maximum cap is not reached, the actual State liability is typically less than the maximum.
2. Company performance: Businesses are often not eligible for the full amount initially awarded to them due to failure to achieve 100% of the performance requirements.

Annual Appropriations: General Fund appropriations pay for existing award commitments. To determine the amount needed to pay awards under contract in the following fiscal year's budget, the Department of Commerce submits an annual funding study by April 1 to the General Assembly and the Fiscal Research Division; this study also includes the maximum liability associated with active grants through their full terms (Commerce's 2018 Funding Study indicated a maximum liability of $809 million through CY 2032).

Commerce determines the estimate for the following fiscal year's JDIG payments by accounting for metrics (job creation, average wage, and capital investment) recorded in companies' annual reports, which outline performance during the prior calendar year and are due to Commerce by March 1. Based on Commerce's estimates, the General Assembly makes reductions or increases to the recurring appropriation of $71.7 million each year. The estimated expenditure increase of $7.1 million by FY 2022-23 and an additional $42.9 million from FY 2023-2028 is based on how past project awards would have increased given the withholdings cap increase and companies' historical performance.

PART II: REVENUE AND EXPENDITURES

REVENUE:

Fiscal Research estimated the change in State liability using historical JDIG awards and detailed 2018 application data. Therefore, our estimate includes the increased amount the State would spend on projects that would have existed in the JDIG program regardless of the withholdings cap increase. Fiscal Research estimates no new revenue to the State given the assumption that projects awarded in the future would have also been awarded in previous years.

If the withholdings cap increase does yield more projects for the State, there may be a positive revenue impact to the State. This would only be the case if additional revenue exceeds the additional expenditures on projects that would have accepted a JDIG award prior to the withholdings cap increase. While the Department of Commerce models a cost-benefit analysis for each JDIG to ensure that an awarded grant will provide a positive net effect on the State's General Fund over the course of the grant's term, the exact revenue impact on an annual fiscal year basis cannot be determined.

EXPENDITURES:

Historical awards and applications: Fiscal Research calculated the expected increase in the amount awarded each calendar year using historical data showing the JDIG projects awarded in 2015, 2016 and 2017, the award amounts as a percentage of withholding, and the distribution of target average annual wages. Increasing the per-employee withholdings cap from $6,500 to $16,000 would have affected approximately 20% of historical projects. Projects with the most high-earning employees (employees earning more than $175,000 per year) experienced greater award increases. This amount was adjusted to account for the overall cap increase from $20 million to $35 million set by the General Assembly on future grant year liability in S.L. 2018-5, Appropriations Act of 2018.

Fiscal Research assumed a year similar to 2017 for each year starting with 2018 and calculated the increase that would have occurred in awards made in 2017, adjusted for pending application data in 2018. The 2017 year estimate provides the most conservative estimate of increased State liability because it was the year that would have been most affected by the withholdings cap increase. Because JDIG grants can last up to 12 years, the expected expenditure increases are cumulative. Had the 2017 projects been awarded under the $16,000 withholdings cap (adjusted for the overall cap increase), the State would have paid an additional $600,000 in the first year of grant payments and an additional $800,000 in the second year of payments to grants awarded in 2017. So, if a year of projects similar to 2017 was awarded in 2018 and again in 2019, the estimated impact in the first payment year (FY 2020-21) would be $600,000 but the estimated impact in the second payment year (FY 2021-22) would be $1.4 million ($800,000 from 2018 awards plus $600,000 from 2019 awards). This cumulative effect is illustrated below:

Example of JDIG Awards and Payments Over Time

	Payment Year 1	Payment Year 2	Payment Year 3	Payment Year 4	Payment Year 5
Award Year 1	$ 600,000	$ 800,000	$ 1,100,000	$ 1,400,000	$ 1,700,000
Award Year 2		$ 600,000	$ 800,000	$ 1,100,000	$ 1,400,000
Award Year 3			$ 600,000	$ 800,000	$ 1,100,000
Award Year 4				$ 600,000	$ 800,000
Award Year 5					$ 600,000
Total	**$ 600,000**	**$ 1,400,000**	**$ 2,500,000**	**$ 3,900,000**	**$ 5,600,000**

*Note that this table is for example purposes only and may differ from final estimate due to rounding and adjustment for 2018 application data.

Base period: Most companies that receive awards do not receive the first grant payment until one or two years after the award. So, a JDIG award made in 2018 might not start until 2020 (with the first payment in FY 2020-21). Therefore, the anticipated expenditure impacts do not start until FY 2020-21. Additionally, companies are allotted a ramp-up or a "base" period of five years starting with the initial payment year. The base period payment for this analysis is taken from a detailed company application registered with Commerce, starting at 3% of the total award amount and ending at 10% when the base period is complete and for each subsequent year. For example, using this base period adjustment, a company that received a JDIG award for $1 million would expect to receive $30,000 in the first year of grant payments, when relatively few employees have been hired. The company would then receive increased annual payments until reaching its maximum annual payment of approximately $100,000 after the base period.

Past performance/disbursement to grantees: Over the past 5 years, Commerce has disbursed approximately 40% of award amounts to companies based on year-to-year performance by those companies. It is unknown how projects with many high-earning employees perform relative to the average; therefore, Fiscal Research opted for a conservative estimate of 50% of the award amount disbursed per year.

Estimated State liability increase for JDIG projects: Based on the information and assumptions described above, the tables below estimate the year-by-year spending increases for JDIG projects.

Projected JDIG Revenue and Expenditure Change from SB 820, FY 2018-19 through FY 2022-23

	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22	FY 2022-23	Total
Expenditures	0	0	$ 1,200,000	$ 2,300,000	$ 3,600,000	**$ 7,100,000**
Revenue	0	0	0	0	0	**0**
GF Appropriation	0	0	$ 1,200,000	$ 2,300,000	$ 3,600,000	**$ 7,100,000**

Though the Fiscal Research Division typically only projects impacts for five years, an additional five-year projection is included due to the length of JDIG grant commitments.

Projected JDIG Revenue and Expenditure Change from SB 820, FY 2023-24 through FY 2027-28

	FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27	FY 2027-28	Total
Expenditures	$ 5,100,000	$ 7,000,000	$ 8,600,000	$ 10,300,000	$ 11,900,000	**$ 42,900,000**
Revenue	0	0	0	0	0	**0**
GF Appropriation	**$ 5,100,000**	**$ 7,000,000**	**$ 8,600,000**	**$ 10,300,000**	**$ 11,900,000**	**$ 42,900,000**

TECHNICAL CONSIDERATIONS

N/A.

DATA SOURCES

Department of Commerce, JDIG Annual Reports 2015-2017

LEGISLATIVE FISCAL NOTE – PURPOSE AND LIMITATIONS

This document is an official fiscal analysis prepared pursuant to Chapter 120 of the General Statutes and rules adopted by the Senate and House of Representatives. The estimates in this analysis are based on the data, assumptions, and methodology described in the Fiscal Analysis section of this document. This document only addresses sections of the bill that have projected direct fiscal impacts on State or local governments and does not address sections that have no projected fiscal impacts.

CONTACT INFORMATION

Questions on this analysis should be directed to the Fiscal Research Division at (919) 733-4910.

ESTIMATE PREPARED BY

Madison Kaye Lahey
Emma Turner

ESTIMATE APPROVED BY

Mark Trogdon
Director of Fiscal Research
Fiscal Research Division
November 28, 2018

Signed copy located in the NCGA Principal Clerk's Offices

Official Fiscal Research Division Publication