

TRANSMITTAL

To:

THE COUNCIL

Date:

MAY 08 2013

From:

THE MAYOR

TRANSMITTED FOR YOUR CONSIDERATION. PLEASE SEE ATTACHED.

*Antonio Villaraigosa by
Bar Curry*

ANTONIO R. VILLARAIGOSA
Mayor

CITY OF LOS ANGELES

CALIFORNIA



ANTONIO R. VILLARAIGOSA
MAYOR

COMMUNITY DEVELOPMENT
DEPARTMENT

1200 W. SEVENTH STREET
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GREGORY P. IRISH
INTERIM GENERAL MANAGER

April 17, 2013

Council File: New
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The Honorable Antonio R. Villaraigosa
Mayor, City of Los Angeles
Room 303, City Hall

Attention: Mandy Morales, Legislative Coordinator

COMMITTEE TRANSMITTAL: REQUEST AUTHORITY TO INCREASE THE FEE FOR PROCESSING STATE ENTERPRISE ZONE HIRING TAX CREDIT VOUCHER APPLICATIONS

RECOMMENDATIONS

The General Manager, Community Development Department (CDD), respectfully requests that the Mayor and City Council:

1. APPROVE the recommendation of CDD to increase the current voucher fee of \$40.00 to \$70.00 for the processing of individual State Enterprise Zone (SEZ) Hiring Tax Credit Voucher applications starting July 1, 2013.
2. INSTRUCT the City Attorney to prepare a draft ordinance amending Chapter II, Article 1.17 of the Los Angeles Municipal Code (LAMC) to establish the new fee rate of seventy dollars (\$70.00) and to allow the fee to offset all costs of administering the SEZ program within CDD starting July 1, 2013.

FISCAL IMPACT

There is no adverse impact to the General Fund. Voucher Fees are revenues that fund costs related to processing vouchers, as well as administration and promotion of incentives in State Enterprise Zones (SEZs) within the City of Los Angeles.

BACKGROUND

The City of Los Angeles Community Development Department administers three SEZs within the boundaries of the City: the Los Angeles-Hollywood Zone, the East Los Angeles Zone, and the Harbor Gateway Communities Zone.

The SEZs are intended to revitalize economically challenged and under-served communities in the City by enhancing business attraction, retention, expansion and job creation. This proposed \$30 increase in the City's Voucher Fee is small and it is not considered a disincentive for the businesses' decision whether to apply for the hiring tax credits or not. The voucher tax credit applications at a Voucher Fee of \$70.00 provide the businesses with more than \$12,000 in tax credit benefits for each hiring of Qualified Employees. Additionally, the recommended Voucher Fee of \$70.00 remains significantly less than the same fee charged by the cities of Long Beach, Santa Ana, Santa Clarita and Pasadena (the chart below illustrates the fees of other local jurisdictions). In summary, the benefits of the SEZ program significantly outweigh the cost of filing for the credits.

SEZ	Voucher Fee
Long Beach	\$71
Santa Ana	\$100
Santa Clarita	\$93
Pasadena	\$102
LA County	\$75

The SEZs incentives include:

- Provision of tax credits to employers for hiring new qualified employees. Qualified Employees are: employees that are residents of a primarily low-moderate income census tract known as a Targeted Employment Area, or a member of one of the following hard-to-serve groups: (a) recipients of services under the Workforce Investment Act (WIA) or CalWorks; (b) ex-offenders; (c) economically disadvantaged persons 14-years of age or older; (d) dislocated workers; (e) disabled persons enrolled in a vocational rehabilitation program; (f) veterans; (g) persons receiving Supplemental Security Income (SSI); Food Stamps; or Temporary Assistance to Needy Families (TANF); (h) members of a Federally recognized Indian tribe; or (i) persons certified under the Work Opportunity Tax Credit (WOTC) program;
- Increased business expense deductions for tax purposes;
- Sales and use tax credits;
- City incentives that augment the State program: (a) Department of Water and Power (DWP) provision of electric rate reduction for new businesses within the SEZs; (b) Department of Building & Safety (LADBS) provision of site plan review for new businesses, or expansions, at no charge; and (c) LADBS together with the City Planning Department provision of reduced parking requirements for businesses within the SEZs.

The SEZ incentive package reduces operating costs of businesses, specifically payroll costs, and frees up capital for additional new local hires and investments in machinery and equipment.

Businesses within SEZs may qualify for the hiring tax credit incentives if they:

- Hire Qualified Employees; and
- Are profitable and subject to income tax obligations to the State of California in the year when the hiring tax credit is claimed.

Currently, if in any tax-year a business is not profitable for income tax purposes, State tax laws provide that such businesses may claim the hiring tax credits in the subsequent tax-years, i.e., when they do have income tax obligations to the State. Moreover, currently, businesses may for any discretionary reason(s) choose to postpone their claim for hiring tax credits, and instead choose to apply and receive the certificates and related tax credits in subsequent years. There is pending legislation, however, that may disallow businesses to retroactively file for hiring tax credits.

Businesses within SEZs, by applying and receiving the hiring tax credits, reduce their State income tax obligations by up to \$37,440 per qualified employee over a five-year period.

For businesses to receive the hiring tax credit, the State requires a certified voucher to be issued by a pre-certified agency. In the City of Los Angeles, with respect to City based SEZs, CDD's Voucher Processing Unit (VPU) is the designated certified local agency.

The VPU reviews all voucher applications and their supporting documentation. Upon approving applications, the VPU issues a certified voucher (TCA EZ 1) to the businesses which is attached to their tax returns for submittal to the State Franchise Tax Board (FTB). The businesses and the VPU are required to retain records of the certified vouchers in the event of an audit by the FTB.

SEZ BUDGET

Pursuant to the City's original SEZ application (C.F. 81-3781-S2 dated 9-19-86, C.F. 86-1017 dated 6-20-86) and the City's Memorandum of Understanding (MOU) with the State's Housing and Community Development Department (HCD), the City has made various commitments for the purpose of meeting the goals and objectives set forth in its SEZ applications. Among these commitments, the City has committed to employ one Full-Time Equivalent (FTE) SEZ manager in each of the zones and also provide staffing for the processing of voucher applications and issuance of voucher certificates.

The VPU, as a stand-alone enterprise, requires an annual budget of about \$1,238,000. The VPU budget is as follows:

	<u>Budget</u>
1. 8 zone managers, each allocating fifty percent (50%) of their time towards administration and promotion of SEZ incentives;	\$428,500
2. 4 vouchers processing full time staff and 2 Community Administrative and Support Worker (CASW) IIs;	\$348,400
3. 1 program manager and 1 accounting staff allocating thirty percent (30%) and fifty percent (50%) of their time, respectively;	\$108,400
4. Rent and other facility costs	\$62,000
5. General Administrative Support Program (GASP); and	\$295,600
6. General VPU administrative & maintenance costs.	\$50,000
Annual VPU Budget	<hr/> \$1,292,900 <hr/>

Initially, a substantial portion of the VPU budget gap was funded by Community Development Block Grant (CDBG). In 2005, CDD recommended and received Council and Mayoral approval (Ordinance No. 176632, effective June 14, 2005) to establish a Voucher Processing Service Fee in order to reduce the burden on CDBG. The voucher fee revenues have been used to fund costs related to administration and vouchers processing, maintaining records, developing a tracking database and accounting for the fees and associated costs.

Also in 2005, the State passed CA Revenue and Taxation Codes 17053.4 and 23622.7, establishing a \$10.00 service fee to recover the State's administrative costs for overseeing the Statewide SEZ Program. The City's fee was set at \$35.00, of which \$25.00 was retained by CDD and the balance of \$10.00 was remitted to the State. Subsequently, the State increased its service fee by \$5.00 to \$15.00, and therefore, CDD administratively (per Ordinance No. 176632) increased the City's fee also by \$5.00 to the current level of \$40.00. Accordingly, the City currently retains a net of \$25.00 for each application.

The prospect of new legislation disallowing retroactive filing of voucher applications will affect the flow and volume of applications received by the VPU. Currently, more than fifty percent of applications processed by the VPU are retroactive applications. The scope of the impact of the proposed legislation cannot be determined at this time.

SEZ STAFFING AND INFRASTRUCTURE

The Program Manager coordinates Zone Managers' activities, interfaces with HCD and coordinates the City's applications, MOUs and amendments with the State.

The Zone Managers call on businesses within SEZs, provide incentive information, receive calls from businesses inquiring about applications and other program parameters, hold seminars for businesses and also process business applications for the DWP electrical rate reduction.

Presently, CDD staffing for promotion and administration of SEZs is appropriate.

The Voucher Processing Staff checks for completeness, consistency and eligibility of applications and supporting documents. This staff also enters data from applications into the voucher processing and approval system, addresses discrepancies by contacting the business or their accountants, and when all is satisfactory, produce voucher certificates. The hard copy of data is retained in the event that the FTB requests such back up information.

At the current volume, in spite of cyclical flow of application flow, CDD is understaffed in voucher processors, resulting in frequent and voluminous backlogs for staff. The VPU is short one full time staff and two active CASWs. The voucher processing task is labor intensive, so it is imperative that the current staff deficiencies be addressed either through new hires or reassignments.

The budgetary impact of one full time processing staff and two CASWs, including CDD's allocation of related rent and facilities costs and the City's GASP, is estimated at \$168,600 annually. Upon the subject adjustment, projected total budget for the VPU is \$1,461,500 annually. At an annual projected VPU budget of \$1,461,500, assuming the number of voucher applications at 30,000 per annum, the City's net share of the Voucher Fee must be at least \$48.71 per application in order for the City administered SEZ program to break-even and be self-sufficient. Adding the State portion of the projected fee at \$20.00, the total Voucher Fee to businesses will be \$68.71.

It is also important to note that the above VPU budget of nearly \$1.5 million will most likely be even higher if functions of the Community Development Department are divided into a new Economic Development Department and another entity. The reason for the increased cost is attributable to the increased percentage of GASP that must be assumed by the Enterprise Zone Tax Credit (EZTC) funding since there will be less funding and fewer funding sources in the new Economic Development Department. These factors could increase the EZTC budget costs by nearly \$0.28 million to \$1.74 million.

The computer and software used by the VPU is outdated and has reached the marginal point of utilization. As a result, periodic system break downs and lengthy repairs result in waste of staff time and additional costs and burdens. The current system must be either replaced or materially up-graded in order to handle new inputs timely and effectively. The fixed cost of this imperative expense is estimated at about \$350,000.

As of March 1, 2013, the VPU maintains a cash balance of \$1,359,628 that pays for the cost of cyclical fluctuations in the flow of revenues versus operating outlays. The cash balance may be used to pay for the projected cost of a major overhaul of equipment and software. The balance is expected to be sufficient to compensate for the cyclical impacts.

VOUCHER FEE REVENUE ESTIMATES

In the past three years, the number of voucher applications received was 30,092, 28,540 and 33,953. The trend for the flow of applications is not consistent, as indicated by the number of applications received decreasing by 5.2 percent in 2011 and increasing by 19 percent in 2012. Therefore, for VPU revenue projection purposes, the number of voucher applications received and processed is assumed to be 30,000 annually.

At the current net City retained Voucher Fee of \$25, the estimated gross revenues from the program is \$750,000 annually. Therefore, the estimated annual gap of \$487,900 (before adding the aforementioned additional staff) is met by City subsidy funded through CDBG.

As per AB28, the State is currently proposing to increase the State portion of the Voucher Fee by \$5.00 to a total of \$20.00. Unless preemptively addressed, upon passing of AB28, the additional funding gap will be \$150,000 and the total annual gap in need of subsidy will be \$637,900.

Therefore, in order for the City to compensate for the forthcoming fee hike by the State and also to manage the SEZ program as a self-sustained enterprise, it is imperative for the City to increase the Voucher Fee at this time.

At the present time, the Voucher Fee for the SEZs that are exclusively located in the County of Los Angeles is \$75.00. As a result of the State's rate hike, the County's Voucher Fee is expected to increase by \$5.00 to a total of \$80.00. For the City to compensate for the State fee hike, and, in order to ensure that the SEZs program is self-funded and self-sufficient, CDD recommends to increase the Voucher Fee from \$40.00 to \$70.00.

Currently, the City and County of Los Angeles, based on their geographic boundaries, share the East Los Angeles and Harbor Gateway Communities SEZs. However, based on the dividing lines between the two jurisdictions, businesses pay a different Voucher Fee. The recommended fee increase will reduce the gap, and yet the City's fee will remain below the County's Voucher Fee.

The recommended increase is imperative to preemptively address the widely anticipated rate hike by the State, and to place the program on a self-funded stand in order to reduce the burden on contracting the CDBG fund entitlement grant.

Therefore, the Department recommends that the City adopt a Voucher Fee that covers operational costs, and ensures that the SEZ Program will not require a subsidy of other City funds which will have financial and/or regulatory limitations.



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Interim General Manager

GPI:RS:NYB:MAA