

April 30, 2013

Extending Or Expanding Chapter 313 Without Proper Oversight Would Cost Texas Billions

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A program of school property tax abatements, known by the chapter of the Tax Code containing its provisions (Chapter 313), is due to expire at the end of 2014. Two bills to extend and expand the program – SB 1647 and HB 3390 – have been reported from committee and are heading for floor debate this week. (All references are to the substitutes that were reported out of committee.)

Chapter 313 was created in 2001 to incentivize the creation of high-paying jobs and investments by companies deciding whether or not to locate in Texas. Existing abatement agreements and pending applications will cost the state roughly \$4.2 billion in lost property taxes and tax credits over the life of these agreements.

The proposed Chapter 313 expansions would reduce property taxes paid by companies to school districts by an additional \$4.4 billion over the course of newly authorized agreements, which would increase the state cost of funding school-finance formulas by the same amount.

Problems with the program

Chapter 313 has many shortcomings which have been identified repeatedly by both the Legislative Budget Board and the Comptroller. Neither bill advancing this session constructively addresses these problems.

A 2010 analysis by the Comptroller (www.texasahead.org/reports/incentives/ch313.php) made four specific recommendations, none of which are followed in the proposed legislation.

- 1) *Eliminate supplemental payments by companies to school districts.*

Companies seeking school district approval for an abatement agreement routinely offer “supplemental payments” to the district as an incentive to grant an abatement. The payments, known as PILTs (Payments In Lieu of Taxes), were limited to \$100 per pupil per year by legislation passed in 2009 (no bill affecting Chapter 313 was passed in the 2011 legislative session). These payments are not included in school-finance formulas.

Obviously, such payments can distort district decision-making, leading districts to grant abatements that, as the Comptroller phrased it, “may not be beneficial to the state.”

But, more importantly, the willingness of companies to make these payments, which reach as high as 40 to 50 percent of the tax benefits the company could receive, is a strong warning that, in the Comptroller’s words, “incentives awarded are higher than necessary to attract these projects and represent unnecessary cost to the state.”

- 2) *Modify the requirements pertaining to renewable energy projects, with targets and benefits that more closely correlate to those projects.*

Wind farm projects account for 60 percent of all Chapter 313 agreements and 35 percent of the cost to the state, but only 9.5 percent of new job creation. In addition, wind projects have tended to pay out the highest supplement payments, indicating that they are receiving much greater tax benefits than necessary to convince them to locate in Texas.

A separate program for renewable energy, with incentives that are appropriate for the industry, would allow Chapter 313 to return to its original intent of promoting large-scale investments that create large numbers of high-paying jobs with good benefits.

- 3) *Eliminate the local school districts’ authority to waive minimum job requirements*

Since 2007, districts have been able to waive the minimum job creation requirement (25 jobs in larger school districts; 10 jobs in rural areas). Since then, the minimum requirements have been waived in most agreements.

As a result, the cost per job created by Chapter 313 is extremely high – some \$350,000 per job!

Since just two projects – Toyota in San Antonio and Caterpillar in Seguin – are responsible for more than half of all the jobs created by the program, the cost to the state of the jobs created by all of the other projects is an astounding \$700,000 per job.

HB 3390 would give the Comptroller the authority to waive the minimum job creation requirement, at the request of the district, if she determined that the standard job creation requirement exceeded the industry standard for the number of employees necessary for the operation of the facility. This cures the problem of the district waiving the requirement, but merely transfers the authority to the comptroller, while leaving unchanged the statutory standard for waiver.

4) *Evaluate the program*

Despite its enormous cost to the state (\$4.2 billion over the life of current agreements), Chapter 313 has never been audited or subject to Sunset review. SB 1391 by Sen. Davis, which would require the Comptroller to conduct a study of the program to determine if it accomplishes its intended purpose and if legislative action is necessary to increase its efficiency or effectiveness, was placed on the Senate Intent Calendar on April 30.

The Legislative Budget Board, in its 2011 *Government Effectiveness and Efficiency Report* (GEER), expressed similar concerns including that “benefits provided through the program represent a significant fiscal impact to the state that, in aggregate, is limitless.” In 2011 Senators Ogden and Hinojosa, then the chair and vice-chair of the Senate Finance Committee, filed SB 1590, which included a provision to cap the cost to the state at \$225 million per year, with the size of each abatement statewide reduced proportionately to remain under the cap. The bill was left pending in committee.

The changes proposed by HB 3390 and SB 1647 would:

Extend life of the program by an unprecedented length of time

Chapter 313 is currently scheduled to expire on Dec. 31, 2014. HB 3390 would extend the program for *ten years*, to Dec. 31, 2024, and make all changes effective on Jan. 1, 2014. SB 1647 would extend the program for only *six years*, to Dec. 31, 2020.

Since its inception in 2001, Chapter 313 been enacted for limited periods of time – *never for more than six years*. HB 1200, which created the program, expired at the end of 2007. In 2007, HB 1470 pushed expiration until 2011, and in 2009 HB 3676 set the current expiration date.

A ten-year extension is unjustifiable, particularly in light of the lack of any thorough evaluation of the purpose, effectiveness, or administration of the program.

Increase the scope of the program, inflating the cost to the state

SB 1647 would include renovations, expansions, and improvements of existing buildings. This small change is estimated to potentially double the cost to the state of new agreements authorized by this bill, compared to current law. In contrast, HB 3390 would allow abatements for expansions only.

Although SB 1647 would extend the program for six years, compared to ten years in HB 3390, the inclusion of renovations and improvements expands the scope of eligible projects sufficiently

that the total lifetime cost of both bills is similar.

Of course, many renovations, expansions, and improvements of projects already located in Texas would be likely to take place in Texas without additional abatements.

Continue Payments In Lieu of Taxes (PILTs)

As the comptroller pointed out, payments made by companies to school districts as part of a Chapter 313 agreement can encourage districts to grant abatements that are of questionable benefits to the state. In addition, the willingness of companies to give up half of their tax benefits is a clear warning sign that the incentive is far larger than necessary to lure investments to Texas.

Only a handful of Chapter 313 agreements do not include some “supplemental payment” by the company to the school district in consideration for granting the abatement.

HB 3390 would not only continue to allow companies to offer PILTs to school districts, but would raise the current cap of \$100 per student per year over the course of an agreement to the greater of \$100 per student or \$50,000, which has the effect of increasing payments to districts with fewer than 500 students. Many rural districts with wind farm projects have very low enrollment. It is a measure of the importance of these off-the-books payments that several very small school districts can afford to hire high-powered lobbyists for the session to protect their additional revenue.

Weaken the wage standards

Chapter 313 currently requires that 80 percent of all new jobs pay at least 110 percent of the average weekly wage for manufacturing in the county or region, with an exception for projects creating more than 1,000 jobs (Caterpillar).

HB 3390 would reduce this standard for all agreements to the county average wage overall, which is often only two-thirds of the wage for manufacturing jobs.

Not solve “but for” problem

A key question in economic development is whether a project would have located in Texas “but for” the offered incentive.

A 2003 study of local property tax abatements by the Comptroller (“Texas Economic Development Incentives,” March 2003, Chapter 2) concluded that in one-third of the cases studied “there was a sizeable probability that the same growth observed as the result of the tax abatement would have been seen without the abatement.” In other words, any tax revenue lost

to those abatements was an unnecessary expense with no offsetting gain.

Chapter 313 agreements have been approved despite clear evidence that the project would have located in Texas without an incentive. For instance, one application to use woody biomass fuel chips to generate electricity stated “the project can locate anywhere in East Texas.” East Texas, of course, is where the wood is that serves as fuel. An application for a project to manufacture cattle feed explained, “after an extensive review of various locations in Texas” the business selected one particular site because it “is centrally located in the heart of our customer’s feed yard businesses.” Clearly both projects had already decided to locate somewhere in Texas; the choice among particular school districts should not trigger state-financed incentives.

Similarly, the Eagle Ford Shale has attracted many new projects. These collect natural gas for local wells and process it before transport to plants located near Houston. Several such agreements were approved, even though the companies reported having already invested up to \$20 million in the chosen site before even applying for the incentive that was ostensibly required to encourage investment in Texas.

HB 3390 attempts to control for this by requiring the comptroller to balance the school property taxes lost due to the agreement against a calculation of all school property taxes, state taxes, and “any other tax revenue attributable to the effect of the project on the economy of the state” over a 25-year period. The comptroller must also conclude that the agreement is “a significant consideration” in bringing the project to Texas. In the unlikely event that an application does not meet these tests, the comptroller may also make a “qualitative determination that other considerations... result in a net positive benefit to the state.”

SB 1647 requires only that the comptroller determine that the abatement is a “significant consideration” in siting the project in Texas.

It is likely that these provisions will filter out few, if any, applications for Chapter 313 tax breaks.

Are abatements necessary because property taxes are too high?

Both bills would amend a listing of legislative findings to state that Texas’ relatively high property taxes make it difficult for the state to compete for new investments, so a program of abatements is justified.

It is true that Texas’ property taxes are higher than most other states. However, a primary reason for this is that most other states have three major sources of revenue to support public services – sales taxes, property taxes, and a state personal income tax. Since Texas lacks a personal income tax, our sales and property taxes must be relatively high to support even our

low level of public services.

When the Chapter 313 was created by HB 1200 in 2001, the statewide average school maintenance-and-operations tax (M&O, the tax reduced in a Chapter 313 agreement) was \$1.39 per \$100 of property value. But the Legislature dramatically reduced this tax rate as part of the school finance plan passed in 2006. In 2012 the statewide average M&O tax rate was only \$1.07 – nearly one-quarter lower than when the program went into effect!

Whatever justification supported the creation of Chapter 313 is thus significantly weaker now.

What should be done?

Chapter 313 should be renewed for only two years, until Dec. 31, 2016. Before the next legislative session, the program should be subjected to a complete audit by the State Auditor to determine whether job creation, wage, and benefit requirements have been fulfilled. Currently, neither the school district nor the comptroller verifies reports from companies concerning compliance with statutory mandates.

In addition, a cost-benefit analysis of the Chapter 313 abatements, compared to other uses of state revenue to promote economic development – investments in education, transportation, water, or health and human services – should be completed by an independent party. Past analyses have been carried out only by industry representatives who rarely find fault with incentive programs.

Particularly because the Legislature may have to reform Texas' school finance system to meet new court orders, the Legislature should not prolong a program that would allow reductions in school property tax revenue by over \$4 billion.

For more information or to request an interview, please contact Alexa Garcia-Ditta at garciaditta@cphp.org or 512.823.2871.

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