General Obligation Bonds as a Financing Mechanism for Regional Economic and Workforce Development Authorities:

Lessons from three states

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Submitted by:

JOBS FOR THE FUTURE

Heath Prince
Jobs for the Future
88 Broad St., 8th Floor
Boston, MA 02110

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States and municipalities have long sold bonds to finance capital improvement projects. Relatively recently, however, a handful of states have explored bonds as financing tools for human capital development. The results of this practice are examined in this report, with particular attention given to how this financing mechanism is used to finance workforce intermediaries.

Introduction and Background

Interest in and the need for strategies to align regional economic and workforce development activities have grown in parallel over the last several years. An increasingly competitive global economy has meant that workforce development practitioners, at both the state and local levels, have needed to adjust to a rising demand for their services, but within the context of diminishing federal support. Between 1985 and 2005, the federal government decreased its inflation-adjusted investments in worker training by 30 percent—declines that are at least partially reflected at the state level. One estimate of per trainee expenditure puts the figure at $2,233—an insufficient amount to fund extensive or intensive training. (Osterman). This declining investment in workforce development is occurring in an environment in which economic developers increasingly find that business decisions to locate in a region depend largely upon the strength of a region's workforce. Global economic competition requires deeper investment in, and more creative thinking about, the integration of economic and workforce development at the regional level.

Among states, there is growing recognition that regional economies are the engines of statewide economic growth. Businesses and labor operate within a regional context, and states depend upon regional planning organizations and regional economic development agencies to map out economic growth. And the federal Department of Labor has, in recent years, begun funding projects that focus on strengthening economic regions.[1] However, alignment of workforce development activities within the same regional economic development frame is rare, and, without them, comprehensive regional strategies that would foster growth and prosperity are difficult to create. Creating this sort of comprehensive regional strategy would require regional organizations that can align economic development with workforce development, ideally in common with one or more community college districts, and centered around regional labor markets.

But there are few public resources designed to support the range of functions that are required of an organization if it is to provide, in a consistent and systematic manner, a full complement of economic development and workforce development services. Federal workforce development resources rarely pay for the work involved in organizing key stakeholders around a coordinated economic and workforce development agenda. Nor do they provide funding for testing new approaches, or blending various funding streams, to meet regional economic development and workforce development needs. Yet, these services are critical to the operations of highly effective regional economic and workforce development authorities.

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[1] DOL has invested over $195 million in 13 regional economies through its Workforce Innovation in Regional Economic Development initiative.

The Issue

For organizations that would play a coordinating role in economic and workforce development, identifying alternative financing mechanisms that would provide them with a degree of financial independence is a first step. Several states have addressed this issue by providing community colleges with some level of autonomy in issuing and/or managing the sale of bonds to fund workforce development activities. The proceeds from the bond sales are used to finance training programs and, in some cases, to finance a range of economic development functions in the community college departments that administer them. In addition, there appears to be potential for regional economic development agencies and some of the more progressive Workforce Investment Boards to act in this capacity.

This report examines the relatively rare bond-financed training programs in Iowa, Missouri and Kansas in order to determine their appropriateness for financing the activities of regional economic and workforce development authorities. Case studies of these states are included in an appendix to this report.

Using Bonds to Finance Workforce Development

Bond Financing

Economic theory argues that certain essential goods and services—"public goods"—will not be provided in "optimal" amounts by the private sector because the benefits that are derived from them are consumed collectively by the public. While states and localities use traditional taxing authority to finance most public goods, large scale capital improvement projects, such as highways and sewer systems, are typically financed through long-term debt financing mechanisms such as bonds (ICMA). State and local governments issue debt in the form of bonds in exchange for the use of the savings of individuals and corporations. This debt obligates state and local governments to make interest payments for the use of these savings and to repay, some time in the future, the amount borrowed (the bond proceeds). (Maguire, 2001)

However, there is also a significant market failure in the provision of workforce development services to low-skilled workers. Job training produces large external benefits, making underinvestment and inefficient production the likely outcome without substantial government intervention. That job training programs rely on public financing is evidence of this, but the fact that they remain underfunded is also evidence of the need for innovation in the field of workforce development financing.

Bond Financing for Human Capital Development

The use of bonds to finance human capital development programs is a topic rarely found in either public finance textbooks or workforce development conference agendas. As a funding strategy, general obligation bond financing is typically used for large-scale capital improvement programs. States also use revenue bonds, such as industrial development bonds and sports complex bonds, to finance projects that are secured by the revenue projected to be generated by the investment (Maguire). In both cases, there is an expected return on the investment, either in terms of the general public good or in terms of the states' or localities' overall fiscal health.

Public workforce development, in contrast to large-scale capital improvement programs, has typically meant grant-funded public programs that are part of the "second chance" welfare system and far removed from state and municipal economic development activities. To be sure, other differences exist, not least of which is the vast difference in the funding levels between the two activities. In 2003, the federal government estimated that states and localities issued $200 billion in governmental and private activity bonds (Joint Committee on Taxation), compared to the approximately $11 billion spent on all adult workforce development programs in the same period.

Generally speaking, however, the practice of using general obligation bonds for the purpose of funding job training has been limited to only a handful of states. The reasons for this vary and are addressed below. A primary reason, however, may have more to do with the common but inaccurate perception that this financing mechanism is incompatible with

investment in human capital development. On this score, there are lessons to be learned from a few progressive economic development authorities.

Lessons from Economic Development Authorities

Workforce development and economic development activities run along sometimes intersecting, but usually parallel, tracks in the government financing arena. A typical scenario has states or municipalities financing workforce development separately from, and without coordinating with, capital improvement projects.

However, in those cases in which economic development authorities are permitted to issue debt, job creation and economic development are sometimes explicitly linked to a loan or bond issuance. For example:

- The Boston Redevelopment Authority's Tax-Exempt Industrial Development Bonds are issued for land acquisition and construction, expansion and renovation of new facilities or new equipment. The projects often have a strong job creation/retention component. For example, the Boston Local Development Corporation, a non-profit corporation administered by the staff of the BRA, provides loans of up to $150,000 for business expanding in or relocating to Boston. Since 1998, the BLDC has provided more the $4,000,000 in loans and created or retained over 1,000 jobs in Boston.

- Another example of Boston's effort to tie debt financing to job creation and training is its Backstreets initiative. Backstreets works with small and medium-sized industrial and commercial businesses to promote their growth. The initiative also seeks to support the business community with workforce training, networking, providing site finding and other assistance to new businesses, and upgrading critical infrastructure. Backstreets offers a wide array of resources for companies looking to locate in Boston's industrial zones, including low-cost, tax exempt bond financing. (www.cityofboston.gov/bra)

- The Santa Fe Small Business Loan fund makes loans and provides technical assistance to small businesses that have difficulty in securing traditional commercial credit. Loans are intended to help create or retain jobs for low- and moderate-income persons - for every $25,000 borrowed, the borrower must create or preserve at least one job.

- The state of Florida's total allocation for its Florida First Business Bond Pool was $258,854,576 in 2005. Bonds from this pool are issued by local bonding authorities, and can only fund projects that create at least 100 new jobs, or increase employment by 10% (if it is a business expansion project), and pay at least 115% of the average area wage. (www.eflorida.com)

It is in the activities of the relatively few regional economic development authorities that link debt financing to workforce development that the conceptual similarities between the use of bond financing for capital improvement programs and bond financing for human capital development begin to emerge. In both cases, a calculation is made regarding the likelihood

of a positive return on investment. In the case of traditional economic development, investments in business expansion are expected to yield returns to the state's tax base. Similarly, investments in human capital development are expected to yield economic returns to the state, to businesses and to individual workers.

> By granting their community colleges the ability to independently finance job training through bond sales, Iowa and Missouri have, in effect, begun to transform their community colleges into regional economic development authorities. In both states, community colleges are permitted to charge up to 15% in administrative fees for managing their bond issuances. In Missouri, this fee has generated between $63,000 and $103,000 in revenue per project per year, with each college potentially managing several projects per year (McCaskill). The range in administrative fees earned by Iowa's community colleges is much wider—between $25,000 and $489,000 per year. (Iowa Department of Economic Development, 2005). In addition, these states' community colleges are permitted to recruit, and enter into agreements with, employers (with some restrictions on the type of industry and wage levels paid) to fund and provide training to new hires or to workers who need new skills in order to advance into higher-paying positions

Benefits of Financing Workforce Development with Long-term Bonds

Policymakers and practitioners have considered alternative approaches to financing workforce development programs for several reasons, including: the level and availability of public funding; the need for long-term financial sustainability; and issues related to the timing of payments.

Level of Funding of Public Goods and Services—Job training for low-skilled adults is necessary for equity reasons and, increasingly, for economic competitiveness reasons. However, it is an activity in which the private sector has invested little, for various reasons, not least of which is the high mobility of the labor force, particularly at the low-end of the wage and skill scale.[2] The benefits to the public of effective job training programs are myriad, including those that result from higher family incomes, increased worker productivity, and decreased reliance on public services, to name only a few. Despite these benefits, public investment in workforce development is generally perceived to be sub-optimal.

In those states that have adopted the practice, bond financing expands the supply of capital that would not otherwise be available for workforce development and, in doing so, has contributed significantly to filling the gap between the supply of and demand for skills training. Bond financing has permitted these states to use public funds—in each case cited in this report, a diversion of the payroll tax on the workers trained—to greatly increase the amount invested in training. It has also permitted these states to target the training to the needs of high-growth, high-wage industries, and to increase the capacity of community colleges to act as regional economic and workforce development authorities.

Iowa's New Jobs Training Program has provided job-training assistance to over 140,000 Iowans in new jobs since 1983. In the last 10 years, the number of projects per year has ranged from 29 to 149, the number trained from 2,031 to 11,547 per year, and annual certificate amounts have ranged from $10,255,000 in FY 2003 (IADED 2003) to $58,379,000 in FY05, with which it trained 4,499 workers (IADED 2005). This level of investment greatly supplemented the state's investment of Workforce Investment Act funds in training adults in 2005— $5,225,646 was spent to train 2,894 adult and dislocated workers. (Iowa Department of Workforce Development)

According to a community college official who administers the program in his region, Eastman Kodak, Weyerhauser, and a Korean steel company have, in large part, based their decisions to locate in Iowa on the strength of Iowa's workforce development system and the availability of NJTP training.

Need for financial independence of regional economic and workforce development authorities—Another reason that policymakers and practitioners consider alternative approaches to financing workforce development programs is their dependence on unpredictable budget processes.

[2] With the exception of temporary help agencies, which, nonetheless, maintain thin profit margins by working primarily with the most employable of the low-skilled adult workforce.

Federal and state funding levels for workforce development programs have rarely been seen as reliable from year to year, have generally been in decline over the past twenty-five years, and, therefore, have not been conducive to long-term program planning, not to mention program survival. To the extent that they are viewed as just part of the social service system, human capital development programs are frequently the target of the state budget axe. This has created an environment in which the public workforce development system is forced to cope with inconsistent funding, creating financial instability for training providers and, ultimately, undermining the creation of a true market for job training and human capital development.

Moreover, by tying funding for human capital development to the legislative budget process, job training as an activity becomes isolated from the needs of employers—instead of funding being determined by employer demand for a skilled workforce, funding is determined by state fiscal concerns.

In those states that use them to finance workforce development, long-term bonds are generally considered to be a significant, self-sustaining source of capital for training. The amount of bonds sold is determined directly by the aggregated demand for training, as requested by employers, and, as such, is not subject to the vagaries of the legislative budgetary cycles. In addition, because they are investments in human capital that are expected to yield returns, bonds can be expected to contribute to overall economic growth in those states that use them for this purpose.

> The Missouri New Jobs Training Program is projected by the State Auditor's Office to create over 87,000 new jobs by 2010, and increase personal income by $6.6 billion and industry output growth by $15.4 billion by 2015. The State Auditor estimates that Missouri's bond financing strategy will continue to produce positive outcomes on state revenues, with the highest annual revenue increase in 2010 of $581 million. (McCaskill)

Timing of Payments—The returns to the public on its investment in skills training occurs over time, as newly employed or promoted workers pay into a state's tax base, but, typically, financing is required up front (and, typically, from public or foundation grants).

Bonds enable states and municipalities to capture the future benefits of a project to help finance it in the present. Typically, long-term bonds are used in order to match the timing of the principal and interest payments to the flow of services generated by the investment. This is particularly true for state and local governments. As residents, taxpayers lay claim to the benefits from these investments, and relinquish their claim to benefits when they move. However, geographically mobile taxpayers are reluctant to pay today for the benefits of state and local investments to be received in the future. The rational response of the state or local official concerned with satisfying the preferences of residents is to match the timing of the payments to the flow of services, precisely the function served by long-term bond financing. (Maguire)

Since public investment in workforce development can generate returns over a long period of time, it makes financial and economic sense to pay for the training over a similarly long period of time. Iowa, Missouri, and Kansas have applied this logic to a bond financing

mechanism to pay for job training. The asset stream represented by the payroll tax diversion from the newly employed worker provides a guarantee of a return to the state. Moreover, while the workforce that benefits from the states' investment in training is potentially mobile, the existence of a trained workforce, or the infrastructure with the ability to provide one on short notice, is presumed to act as an inducement for firms to locate and remain in a state.

> Iowa's community colleges have the option of taking the entire administrative allowance upon sale of the bonds or to prorate collection of the administrative allowance over a period of up to 10 years. The bonds have a 10 year retirement schedule and delivery of the training program can take two to three years necessitating a reserve to support the ongoing administrative costs of the program over time. The administrative allowance has provided essential support to a broad range of economic and workforce development activities, and special programs, in the community college regions for which other funds were not available." (Iowa Department of Economic Development)

The practice of using debt financing as an economic development tool is a longstanding one. A state or locality's willingness to take on debt is based on an expectation of positive returns on the investment that the debt finances. And, as state and municipal governments have come to recognize that workforce development is an essential component of economic development, the sale of bonds as a financing strategy for job training has received increasing consideration. However, several additional factors constrain the wider adoption of the use of bonds to finance workforce development. These factors are more procedural than conceptual, but, in combination, can serve as a deterrent for states considering this financing strategy.

Barriers to Scaling Up

There are several reasons that the practice of using bonds to finance job training is relatively rare in the workforce development field, including:

- the complex legislative process;
- the need for a high level of capacity on part of community colleges;
- the means of securing the bonds;
- their tendency to be demand-driven rather than population-focused;
- the requirement of a state income tax as a repayment mechanism; and
- equity concerns over the diversion of state taxes.

Nonetheless, a few states have made successful use of the practice and have learned lessons from which the broader field could benefit.

Complex Legislative Process. Most would agree that the process for creating a bond-financed workforce development program is complex and potentially confusing. In each of the cases highlighted in this report, legislation that clearly defined the parameters and objectives of the programs was required to authorize them. Moreover, getting the legislation passed required grassroots campaigns that mobilized the business, labor and education communities before conversations with legislators could begin.

In each of the four programs described in the appendix to this report, advocates made extensive use of research and data that could demonstrate that the potential benefits outweighed the risks (to the state's bond rating as a result of defaults, for example).

> According to one state leader involved in the process, a team of creative legislators in Iowa worked with a bond attorney and a representative of a community college, who was also a former U.S. Congressman, to design policy that would satisfy not only the state's needs for a cost neutral training program, but also worker needs for employment and advancement opportunities and employer needs for a skilled workforce. Legislation was drafted and legislative leaders moved ahead with the proposal. The business community, state agencies, and then-Governor Terry Branstad's administration were all recruited, in that order, in the process of building support for the bill in the legislature.

Need for high level of capacity on part of community college. In each of the cases in this report, community colleges are charged with some level of responsibility for operating the bond-financed programs. In Iowa and Missouri, and, to a lesser extent, Kansas, community colleges are provided with considerable license to enter into and manage relations with employers, public agencies and other training providers, as well as responsibility for managing the sale and retirement of the bonds. In this role, community colleges align the economic and workforce development needs within their districts in order to develop demand-led regional growth strategies. The extent to which the colleges manage

relationships successfully, in large part, determines the effectiveness of the bond financing mechanism. Colleges with, for example, limited ability to conduct labor market research, or limited capacity to manage the not insignificant red tape that accompanies bond sales, have been less effective as workforce intermediaries.

> State-level advocates for Missouri's Community College New Jobs Training Program have had to contend with the program's spotty reviews in a recent analysis of the state's workforce development programs. Researchers found that inconsistency in the capacity among the state's community colleges led to reports of employer dissatisfaction. (Trimerica). According to state-level representatives, some colleges lack experience with working with employers and, as a result, fail to understand the importance of handling the red tape. "They take their 15% administrative fee and leave all the paperwork on the employers."

Means of securing the bonds. The typical capital improvement bond is secured by the taxing authority of the state or municipality that issues it. This is not always the case regarding the use of bonds to finance workforce development. In Iowa, while the principal and interest payments on the bonds are paid over a ten year by diverting state income tax withholding on the newly trained workers, local property tax receipts resulting from new capital investment made to support the creation of the new jobs can also be encumbered for up to ten years through the use of tax increment financing. However, the state has rarely had to resort to TIF funding to secure repayment. In Missouri and Kansas, training bonds are treated in much the same was as capital improvement bonds in that they are secured by the taxing authority of the state legislatures.

Bond financing programs are demand-driven rather than population-focused. In each of the cases highlighted in this report, bond-financing programs are used primarily as economic development tools, and, as such, do not specify populations to be served, and this has drawn some criticism. Indeed, the absence of flexible funding for demand-driven training was a large part of the reason for the creation of these programs. Nonetheless, a significant number of the jobs created through these programs have benefited workers at the low-end of the skill spectrum.

Requirement of a state income tax as a repayment mechanism. Each state currently using bonds to finance job training uses a diversion of the state payroll tax to retire them. However, all but nine states have a state income tax. Moreover, Texas has begun experimenting with diverting sales tax to fund job training programs, and diverting future UI payments to retire bonds issued to secure current UI balances, perhaps pointing to alternative methods for retiring bonds.

Equity concerns over the diversion of state taxes. Critics of the use of bonds to finance job training have noted that the practice of diverting a portion of the payroll tax to retire bonds amounts to a transfer of public funds to employers. These critics contend that public funds are used, inappropriately, to subsidize employers to do what they would, or should, do in any event. (Oleson)

If measured strictly by the amount of redeemed bonds, bond-financed programs do reduce state income tax revenues in the short term. However, the states that have successfully

employed this mechanism view the forgone tax revenue as an investment in human capital that yields net positive returns to the state. For example, by taking into account taxes on increased wages, higher firm productivity, and the boost to local economies that result from increased employment, Missouri state auditors estimate that the approximately $90 million in bonds issued to date will increase state revenues by nearly $4 billion by 2012. (McCaskill)

Bonds as a Financing Mechanism for Regional Economic and Workforce Development Authorities

It is apparent from the experience of Iowa, Missouri and, to a lesser extent, Kansas, that the ability of community colleges to finance job-training programs through the sale of bonds has provided them with a level of financial independence needed to act as effective regional economic and workforce development authorities. In each state, community colleges have been positioned to work with city, county and regional economic developers to attract businesses. Moreover, the bond-funded programs have provided the colleges with flexible, sustainable funding that supports not only direct services, but also the range of core functions that permits them to act in a regional economic development capacity.

Iowa and Missouri's community colleges use a 15% administrative fee associated with bond sales to finance a wide range of functions that enable them to act as regional economic and workforce development authorities. Beyond managing the repayment of the bonds, these include the negotiation of training activities proposed by employers, interviewing and selecting staff for the projects, aggregating local employer demand for training, and, in most cases, providing the training, to name only a few important functions. Indeed, in its response to a 2003 performance audit, the Missouri Community Colleges Association took exception to suggestions that administrative fees might be too generous when compared to actual costs, claiming that the auditors underestimated the time required to properly administer and oversee their Community College New Jobs Training Program (McCaskill).

> In its early stages, Kansas IMPACT program permitted community colleges with which employers contracted for training to sell bonds to finance the training, and then to keep a portion of the sale for administrative costs. This procedure was changed, however, when it became evident that administrative fees were accruing disproportionately to those community colleges with the strongest relations with employers. Current practice has the state collecting a 10% administrative fee and distributing it equally across all of the state's community colleges, to be used for workforce development capacity building activities.

While bond financing for workforce development is rarely used as a financing strategy, those states that have used this strategy have greatly increased the amount of capital available for training, as well as the number of workers trained. Moreover, at least in the cases of Iowa and Missouri, community colleges, acting as regional economic and workforce development authorities, have benefited significantly from their role in managing the bond issuances and the relationships with employers. States that would consider replicating Iowa's, Missouri's or Kansas' models would benefit from the lessons these states have learned regarding regulatory and process hurdles.

Regulatory Considerations

One could argue that, by granting them a level of financial and managerial authority over their work with their local employers, these states have begun to transform their community colleges into regional economic and workforce development authorities. This is a departure

from the traditional role of economic development authorities, for which the authority to issue bonds is not uncommon, but the practice of linking their economic development activity to workforce development is. What has emerged in Iowa and Missouri, and, to a lesser extent, Kansas, is something of a hybrid model, in which community colleges have successfully combined both economic and workforce development functions—largely enabled by the level of autonomy they have over the financing of training.

However, it would be incorrect to assume that only community colleges can perform in this role. States have a great deal of leeway in determining which entities can issue bonds, and the examples of Iowa, Kansas and Missouri demonstrate that they also have some leeway in determining for what purposes they may issue bonds. States regularly establish or designate other entities to issue bonds on behalf of governmental units.[3]

For example, qualified scholarship funding bonds are bonds issued by specially constituted nonprofit corporations acting on behalf of governmental units to facilitate the making of student loans. Similarly, a nonprofit corporation might own, operate, and issue debt to finance a local airport. (Joint Committee on Taxation)

Process for Replication

Despite their differences, there are enough commonalities across the Iowa, Missouri and Kansas models to suggest that replication of the community college model is possible. Efforts to expand the model to other states would take their lead from the process followed by these states.

First, while the level of autonomy over projects varies from state to state, community colleges in each state play important roles, especially with regard to organizing employer demand for training, and contracting with them to either provide or oversee the training. For this reason, it would be essential to consider this strategy only in those states with strong community college systems, and with community colleges that have established a level of trust with employers. It would be essential to also develop an advocate within the community college system who could steer the process.

Second, advocates promoted the strategy in each state by couching it in economic development terms, and by engaging their states' economic development agents early on in the process. The use of data to demonstrate the need for, and the potential benefits of, the strategy was vital in making the case to economic developers.

Third, once the economic development community was engaged and supportive, they met with the labor and workforce development communities as an essential next step. Support

[3] "In general, an entity is a political subdivision (and thereby a qualified governmental unit) only if it has more than an insubstantial amount of one or more of the following governmental powers: the power to tax, the power of eminent domain, and the police power (in the law enforcement sense)." (Present Law and Background Relating to State and Local Government Bonds. March 14, 2006. Joint Committee on Taxation, U.S. Congress)

from these groups was obtained by demonstrating that the bond financing mechanism would be a net benefit for their constituencies.

As in any scenario involving the repayment of bonds with a diversion of the payroll tax, authorizing legislation would be required. It was only after developing grassroots support among all of the key constituencies (economic, business, workforce, and education) that legislation for the initiative was drafted and introduced in Iowa, Missouri and Kansas.

There may also be options to using a payroll tax diversion to retiring the bonds. While not directly analogous, Texas has recently passed legislation permitting the Texas Workforce Commission (the state's department of labor) to issue bonds in order to finance its current UI obligations. These bonds are retired through a diversion of future UI receipts (Texas Legislative Council). While there are legal and regulatory questions still to be addressed, one could conceive of a system in which bonds are sold to provide education and training through regional economic and workforce development authorities, and then retired through a pool of funds created by a UI diversion.

Three Approaches to Financing Regional Workforce and Economic Development Authorities

A Community College-centered Approach

The experience of Iowa, Missouri and Kansas demonstrates that states can establish bond financing mechanisms to fund the activities of regional economic and workforce development authorities. In each of these states, community colleges were a natural fit for this role. They had both the experience working with employers needed to act as effective regional economic development actors, and the capacity to perform workforce development functions. While Iowa secures its bonds through the ability to levy a local property tax, Missouri and Kansas secure the bonds with the full faith and credit of the state's taxing authority.

Investing regional organizations with bonding authority

Other regional organizations possess attributes similar to entrepreneurial community colleges, but lack a financing mechanism that would provide them with the independence needed in a regional economic and workforce development authority. Several workforce investment boards in Pennsylvania, for example, are leading sector-based Industry Partnerships in which the training demand by area employers is aggregated and met through partnerships among employers, unions, and community colleges. At present, however, funding for Industry Partnerships is provided by a combination of sources, including state Workforce Investment Act funds, state general revenue funds, and foundation funds. Legislation enabling the lead agencies in the Industry Partnerships to issue bonds and retire them with a payroll tax diversion, or some other mechanism, would provide the partnerships with long-term financial independence and "teeth" as an economic and workforce development authority.

Expanding the Authority of Regional Economic Development Agencies

Similarly, existing economic development authorities with bond issuing authority could, through legislation, have their authority extended to include authority to issue training bonds. For example, the Boston Redevelopment Authority issues an average of $15 million in bonds per year to finance capital improvement projects. The bonds are secured by the credit of the borrower, and not by the City of Boston. Legislation enabling economic development authorities, like the BRA, to issue training bonds that are secured by the anticipated payroll tax associated with the newly trained workers would significantly complement the services that they could offer.

Conclusion

Intensely competitive labor markets have become the hallmarks of the twenty-first century economy. Economic success at the national, industry and individual levels will depend on public systems that can produce highly educated, skilled and innovative workers. But unless this system is easily accessed by employers, it will fail. Improvements in the competitiveness of the national economy will build, region by region, on the work of economic, political, and education and training agents moving in concert to build upon regional strengths.

Organizations with the capacity to orchestrate this level of activity are few, however. It is the rare organization that has not only the political clout to develop and implement unified, comprehensive strategies for economic growth, but also the financial independence to act with any sort of authority. These authorities, in order to be effective, need to be able to raise and spend the money needed to grow their regions' economies over time.

As demonstrated in Iowa, Missouri and Kansas, it is possible to invest community colleges with this authority by giving them the ability to issue bonds for workforce development purposes, and, in turn, increasing their capacity to work with employers as economic development agents. It is also possible to imagine how entrepreneurial WIBs could use bonds to become self-financing, or how existing economic development agencies could extend their bond issuing authority to include workforce development. In each case, by granting these organizations the level of financial independence and flexibility afforded by bond financing, states would create regional economic and workforce development authorities, with real authority.

With this expansion in their purviews, these regional economic and workforce development authorities could be tasked with redefining regional economic and workforce development systems. Instead of a system that is driven by a "work-first" mentality under which many state workforce development systems have operated over the past eight years, this is a system driven by training and employment goals that lead to a family-supporting wage while meeting employer need for high-skills.

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Case Studies

The high demand for a skilled workforce has led to innovation in the use of bonds to finance human capital development in several states. In these states, policymakers have joined with advocates from community colleges, state agencies, and labor-management partnerships to consider how to finance the shared needs of workers and employers more creatively and efficiently.

These innovative bond financing policies share several design principles. They:

- Create new sources of funding, or leverage funding from employers and other sources, to increase support for skill development;
- Target priority industries and training for jobs that pay well;
- Make use of funding responsive to the needs of employers; and
- Create region-level decision-making authority so that funding is more responsive to regional priorities and needs.

The bond financing models in Iowa, Missouri and Kansas have dramatically changed not only the funding of services but also the working relationship between community colleges and industry. By providing their states' community colleges with the ability to finance, independently from the state budget, their job training activities, these states have, in effect, enabled their community colleges to function as regional economic and workforce development authorities.

The following are examples of bond-financing mechanisms for workforce development across the country. They have been chosen because they represent a cross section of the best of what's out there, and what's different (the permutations are finite), along with some insights into process and results. Iowa's pioneering efforts is followed by a description of Kansas' and Missouri's adaptations of the Iowa model to their unique political environments. In addition to these models, we profile the variation on the bond financing theme developed by North Dakota.

Iowa's New Jobs Training Act

In the early 1980s, faced with shrinking state budgets, a rapidly growing number of unemployed farmers, and the loss of well-paying jobs to other states and countries, Iowa policymakers succeeded in creating new legislation that enabled the nation's first customized job-training program to be funded through bond sales rather than through state appropriations.

In 1983, the legislature responded to the state's fiscal crisis with the New Jobs Training Act, which authorized the New Jobs Training Program. The NJTP was created under several constraints: no new state funds could be appropriated and no state agencies could be created; the program would need to be free to participating businesses and workers; it would need to devolve decision-making authority down to local levels; and it would need to stipulate that no funds could be expended unless jobs were created. But, the NJTP's primary objective was to reverse the flow of business out of the state by sufficiently funding the creation of a competitive workforce.

From the beginning, policymakers were motivated to address the outflow of jobs from Iowa and the rapidly expanding numbers of unemployed farmers, making relatively easy work of rallying support for the legislation. According to one state leader involved in the process, a team of creative legislators worked with a bond attorney and a representative of a community college who was also a former U.S. Congressman, to design policy that would satisfy not only the state's needs for a cost neutral training program, but also worker needs for employment and advancement opportunities and employer needs for a skilled workforce.

Legislation was drafted and legislative leaders moved ahead with the proposal. The business community, state agencies, and then-Governor Terry Branstad's administration were all recruited in the process of building support for the bill in the legislature.

Program Summary

The Iowa NJTP assists businesses that create new positions or new jobs. If a company is expanding its operations or locating a new facility in Iowa, the NJTP provides flexible funding to meet a variety of training and development needs. The assistance ranges from highly specialized educational programs, to basic skill training for new jobs.

The program is demand driven and self-funded. Each community college sells both taxable and tax-exempt bonds to fund projects, which are solely the obligations of the community colleges.

The bonds are repaid over a maximum of 10 years through the diversion of 1.5 percent of gross payroll, which is 50 percent of Iowa withholding tax revenue (3.0 percent of gross payroll for jobs with wages exceeding the county or regional average) generated by the business' newly hired employees or, rarely, through the diversion of incremental property taxes generated by business' new construction. Because bonds are repaid using tax revenues, the amount of training funds available to a business is determined by the business' tax-generating capability. Taxable bond financing is unlimited, but there is a $100 million

statewide cap on outstanding *tax-exempt* debt at any time. Iowa's community colleges also have the authority to levy stand-by property tax throughout their taxing area as a method for securing against default, although they have rarely taken this step.

The Iowa Department of Economic Development maintains overall responsibility for the program, but agreements with employers are approved by the community colleges' boards of trustees. The department makes certain that all new jobs meet wage requirements when applicable and that the jobs are in industries that provide Iowa with a comparative advantage. The DED is also responsible for keeping track of projects and the uses of funds, and generating an annual report of the results.

Results

The NJTP has proven to be a significant boon to the Iowa economy, both by helping new and expanding businesses to compete in the national and international marketplace, and by helping Iowans to gain employment and advance. It has remained relatively unchanged since its inception, a testament to its ongoing success. The NJTP has provided job-training assistance to over 140,000 Iowans in new jobs since 1983. In the last 10 years, the number of projects per year has ranged from 29 to 149, the number trained from 2,031 to 11,547 per year, and annual certificate amounts have ranged from $10,255,000 to $58,379,000 in FY05. The program continues to contribute to the dynamism of the Iowa economy.

The actions of employers are evidence that the New Jobs Training Program has been a determining factor in their decisions to locate in Iowa. According to a community college official who administers the program in his region, Eastman Kodak, Weyerhauser, and a Korean steel company have all based their location decisions on the strength of Iowa's workforce development system and the availability of NJTP training.

In the 1986 tax reform, Iowa Senator Chuck Grassley asked Congress for and got an exemption allowing Iowa's community colleges to continue issuing tax-exempt bonds in support of the NJTP. This makes Iowa's community colleges somewhat unique. However, in most states community colleges can issue taxable bonds. While interest is not tax deductible, taxable bonds carry higher interest rates and are easier to obtain and administer.

NJTP as a Financing Strategy for Regional Economic and Workforce Development Authorities

As workforce intermediaries, Iowa's community colleges have found that the New Job Training Program provides a steady stream of operational resources. The NJTP provides that administrative expenses are an allowable program service and program cost. The Iowa Department of Education (DE) calculates the administrative allowance rate annually and bases it on the collective percentage of a specific set of non-instructional cost centers in the community college general fund budgets. It has generally ranged between 14 and 17 percent annually. (IDED 2005 Annual Report)

Prior to 1987, neither statute nor the NJTP rules provided specific guidelines as to how the administrative fees associated with the community colleges' sale of bonds were to be used.

At the prompting of the state legislature, the community college presidents, the DED and the DE agreed upon and presented to legislative leaders the following guidelines guidelines by which the community colleges report their expenses from the administrative allowance to the DE. Eligible expenditures include the following:

Support for economic development staff and associated office expenditures;

Support for monitoring and accounting staff and associated expenditures for economic development activities and projects under Code of Iowa, Chapter 260E;

Professional contract services relating to Code of Iowa, Chapter 260E. May include but not limited to Legal, Bank Agency, Bond Registrar, Transfer Agent, and Bond Rating fees;

Economic development activities directly related to the needs of the community;

Special programs, including several other training programs, relating to the needs of the community that will promote economic development; and

In the event of a default in a Chapter 260E training project, and the area school so deems appropriate, the administrative allowance may be used to help offset the default.

The NJTP is the cornerstone of Iowa's workforce and economic development efforts. The state's 15 community colleges serve as regional economic and workforce development intermediaries for the program, and each college is authorized to sell bonds based on regional demand. In addition, the colleges work with employers to develop training programs and monitor training activities. Using bond proceeds, colleges reimburse the companies for approved training courses. By granting its community colleges this level of control over workforce development financing, Iowa has created regional authorities with the responsibility for developing and implementing unified, comprehensive economic development strategies for regional growth.

Missouri: Redesigning Financing for Workforce Development

In the late 1980s, Mike Crawford, a key player in establishing Iowa's New Job Training Program, became Chancellor of the Missouri Community College System and began the process of adapting the Iowa's bond financing model for job training to Missouri's workforce and economic development system. The result was the Missouri Community College New Jobs Training Program, enacted in 1991 though HB 1364 and enhanced in 2004 through JOBS NOW.

Program Summary

As in Iowa's New Jobs Training Program, Missouri community colleges have financed training through the sale of bonds. Since the program's implementation in 1992, Missouri employers who received training assistance were the primary purchasers of the bonds. However, as a result of a rule change in the 2005 legislative session, bonds are now sold to the public as well. The bonds are repaid by using tax credits from the employer's regular payroll tax withholdings, which are based on a percentage of the gross wages paid to workers in the new jobs. The tax withholding is equal to 2.5 percent of gross wages for the first 100 new jobs and 1.5 percent for the remaining new jobs. To repay the training and bond costs, the tax withholding for projects in excess of $500,000 may be claimed up to eight years, and those under $500,000 may be claimed up to ten years. The amount of bond principal outstanding at any one time is not to exceed $55 million.

The Missouri model differs from Iowa in that the state does not guarantee repayment by imposing additional property taxes. Another difference between the Iowa and Missouri models is the role of lead agencies. While the role of the Iowa Department of Economic Development is limited largely to program oversight, the Missouri Department of Economic Development's Division of Workforce Development determines company eligibility and monitors the program for training duplication. The DED also sets specific wage levels that must be met by participating employers, as well as identifies target industries in which to invest. The community college system serves as the program intermediary, administering the program and delivering training. Upon approval of the application by DWD, the community college may enter into a formal contract agreement with the company applying for training. However, the community college board of trustees must approve all final project agreements.

Eligible companies apply for training funds for training based on a projected number of new hires at a projected wage. The state forecasts the amount of income tax it will collect based on the number of jobs and wages and considers a six or eight year time frame. The state and company agree an amount and bonds are issued. The employer buys the bonds. The state uses the proceeds from the sale (basically, the employers own money) to fund the training for the company. The training takes place at a community college, which is also responsible for administering the sale and repayment. The company is repaid plus interest over the life of the issue (usually 6-8 years).

The JOBS NOW Program

In July 2004, Governor Bob Holden signed SB 1155, modifying various laws regarding economic development. JOBS NOW, the Job Training portion of the legislation, complements and enhances the existing Community College New Jobs Training Program in three significant ways:

Pooled Bond Structure. Community colleges had been authorized to issue revenue bonds and use the proceeds to reimburse companies for their training costs. JOBS NOW expands this, allowing two or more community colleges to arrange pooled bond issuance using the capacity of either the Missouri Higher Education Loan Authority or the Missouri Health and Education Facilities Authority. This pooled bond issuance could lower the cost to each community college and generate a better bond rate due to the increased offering. This in turn may lower the overall cost, making training more attractive to employers.

Flexibility in Appropriation Limits. The Community College New Jobs Training Program was originally limited to an aggregate amount of outstanding bonds of $55 million, with the amount of funds available each year further controlled by appropriation. JOBS NOW makes the yearly appropriation limit flexible so that maximum job training and new job creation may occur.

Results

In April 2003, the Office of the State Auditor concluded that the Community College New Jobs Training Program had a "positive economic impact" for Missouri, projecting 87,000 new jobs to be created between the program's inception in 1991 and fiscal year 2010, along with a projected increase in state revenues associated with the program by over $4 billion by 2012. These same projections put growth in real disposable income increasing by $2.9 billion in 2015. As of September 2004, the MNJTP had provided training for workers in 29,421 newly created jobs paying approximately $19 per hour on average.

The Missouri bond-financing program has also enjoyed bipartisan support through successive administrations and legislatures. The Missouri model, however, represents an important variation on the bond-financing theme: encouraging employers to purchase the bonds. This decision resulted, in part, from a deep aversion among state policymakers to relying on property taxes to secure the bonds. Program administrators note that the default rate on the bonds issued through the Missouri program is less than 1 percent.

Missouri's NJTP as a financing strategy for regional economic and workforce development authorities

The community college administering the NJTP program collects a fee (about 15%) from the sale of the bonds to expand its capacity to manage such programs and market to more companies. As of 2003, this fee had generated approximately $10.6 million from $85 million in bonds issued since 1992 to cover community college administrative costs. The average administrative fee received by a community college is approximately $80,000 per bond issuance.

Allowable administrative costs for community colleges administering the NJTP include:

Time and travel related to marketing and discussing the program;

Time related to college executive oversight of the program; and

Monitoring of projects.

As in Iowa, Missouri's community colleges exercise a significant degree of financial independence over the NJTP. Given the state-defined parameters relating to wage levels and types of industry in which they can invest, community colleges' ability to enter into contracts with local employers for training, as well as raise funding to provide it, enable them to act as regional economic and workforce development authorities that promote regional growth and prosperity.

Kansas' IMPACT Program (Investment in Major Projects and Comprehensive Training)

In 1991, Kansas was at risk of losing a major employer in the state. Sprint Corporation was making plans to embark on a major expansion, and was being courted by Missouri with an offer of millions of dollars in training funds for new employees, financed through the sale of bonds. Rather than take the offer, however, Sprint convinced then-Kansas Governor Hayden to match Missouri's offer through a bond sale in Kansas, launching the state's first foray into bond financed training programs. The early program has since evolved into the Investment in Major Projects and Comprehensive Training (IMPACT) program.

Program Summary

In the early 2000s, state policymakers realized that approximately 95% of training funds paid to companies expanding within the state or relocating to it was used by the company directly, or spent on outside contractors, and did nothing to help support the growth and capacity building of the state's educational institutions. The Economic Growth Act, which authorized the IMPACT program, was passed in 2004 to address this. The key objective of the Economic Growth Act was to redirect public funding for training to the state's educational institutions in order to strengthen the state's workforce development system.

IMPACT differs from Iowa and Missouri's programs in several important ways. Kansas' bond sales are issued by the Kansas Development Finance Authority, and administered by the state's Department of Commerce under the state taxing authority, unlike Iowa and Missouri in which community colleges administer the sale of bonds locally and operate under the limits set by the local taxing authorities. Also, the Kansas training bonds are tax exempt, whereas the bonds sold in Missouri are taxable, and in Iowa they are both tax-exempt and taxable.

As in Iowa and Missouri, the Kansas bonds are retired from a diversion of state income tax. However, in Kansas two percent (2%) of the total amount of all state payroll tax withholding is earmarked for debt service, unlike Iowa and Missouri that tie the withholding tax diversion directly to the new jobs being created by a specific project. Individual project size may not exceed ninety percent of the withholding taxes received from the new jobs over a ten-year period.

In the early years of the Kansas program, bonds were sold for each new project, as in Missouri. Later the state changed the practice to sell bonds annually in anticipation of new projects. Each year the legislature reviews current obligations and forecasted future projects and will issue bonds to cover the anticipated training costs. For example, Kansas' 2006 issuance for the IMPACT program was for $25 million. The revenue is invested in government securities and drawn down as needed throughout the year to finance training and capital investment projects under the IMPACT program.

Company Eligibility

New and expanding basic enterprises (individual firms or consortiums of businesses) that are creating new jobs are eligible to apply for IMPACT funding. Funding is typically reserved

for projects involving at least 100 new jobs at a higher-than-average wage. The IMPACT program may also be used for job retention projects that have compelling economic benefit for Kansas. Projects in metropolitan areas are required to train a minimum of 250 workers.

All IMPACT projects are tracked on a project by project basis, so if any company is unable to create jobs in sufficient numbers to generate withholding tax revenue according to its annual projections, the business may be required to repay a portion of the funds on a shared basis with the state. If the company leaves the state before the bonds are retired, the full cost must be repaid, less any withholding tax contributions collected prior to the company's departure.

Results

There was approximately $11 million used in 2005 to train over 12000 workers. The Secretary of the State Department of Commerce may invest an additional 10% in any project, provided the investment is made directly into an educational or other workforce development institution.

Kansas has made a significant change in the administration of the IMPACT program in 2005. The state concluded the original IMPACT program design was flawed. Originally, the partnering/local educational institution administered its own program and collected a 10% administrative fee. Therefore, money flowed only to the institutions that were delivering training for one of the major projects, resulting in an uneven distribution of capital and undermining its original intent to use public training dollars to build the capacity of the state's educational institutions to deliver workforce services. In areas where there were no IMPACT projects, by definition, there were no funds for capacity development for the schools.

As a result, the legislature voted to distribute the training funds across the entire educational system. In order to do this, the Department of Commerce became the administrator with the Secretary having the discretion to make direct investments in order to develop industry/training expertise and infrastructure. Now, twenty percent of the total workforce training funds committed to each project is set-aside in the Workforce Solutions Trust Fund to increase the capacity of all workforce intermediaries throughout the state to respond more effectively to business needs.

IMPACT as a Financing Strategy for Regional Economic and Workforce Development Authorities

The critical difference between Kansas and other states with respect to its capacity to create independent regional economic and workforce development authorities is that IMPACT's current operating structure puts capacity building investment decisions in the hands of the bureaucracy and legislature, rather than the more organic approach in Iowa in which investments are governed by those institutions that collect the fees. Unlike Iowa and Missouri, colleges do not benefit directly from the administrative fees associated with the bond issuances. Instead, the 10% fee charged by the state is distributed equally across all of the states community colleges for the purposes of increasing workforce development capacity. In Iowa and, to a lesser degree, Missouri, the financial independence of the

community colleges, and their capacity to act as regional economic development agents, enables them to serve in an economic and workforce development role.

Kansas' model, while perhaps more equitable in terms of revenue generation for colleges, seems to undermine the level of financial independence needed in an autonomous regional actor.

North Dakota: A Variation on the Payroll Tax Diversion Theme

Common to the bond financing models in Iowa, Kansas and Missouri is the repayment mechanism: payroll tax diversion associated with the newly-trained worker's income. In the early 1990s, North Dakota considered adopting a bond-financed program based largely on Iowa's experience. However, the result was a program that appears to skip a step (the sale of bonds), but in fact relies on commercial loans to businesses from banks, while retaining the payroll tax diversion as the repayment mechanism.

In the early nineties, the North Dakota State Job Service, along with Economic Development entities in major cities across the state, recognized that the service gaps in the state's workforce development system diminished its effectiveness in the private sector; they restrained the state's competitiveness and ability to attract new businesses from outside the state, and hampered the development and expansion of local firms.

The Job Service began to look at what other states were doing in an effort to find a program that they could adapt to fit their needs. They studied Iowa's bond financing model and concluded that the tax diversion method for repayment was the most interesting component of that model. However, bond sales, as designed in the Iowa model, would not work in North Dakota, and neither would reliance on the state's community colleges for program delivery.

The decision not to sell bonds was based primarily on the fact that North Dakota does not have a state property tax (such tax is imposed and controlled by the cities and counties) so they had no comparable way to "guarantee" repayment of the bonds. In addition, approximately seventy-five percent of the training for entry level and incumbent workers was done outside the community college and state university system, so it was felt that those institutions did not have the experience or inclination, at the time, to administer such a program.

This left state officials with the need to develop a new method for creating the cash to finance new worker training, and a new method for delivering services.

However, state officials also recognized that there was a low likelihood for success if they were to promote the idea as coming from within government. Fortunately, the president of the Local Economic Development Association in Fargo was interested in incentives to expand primary sector business and recognized the limitations of the state's current publicly-funded workforce development system. He took the role of "champion" and approached the Greater North Dakota Association (State Chamber) of Economic Developers in the other key cities, including Bismarck, Grand Forks, and Minot, to gain support.

It was agreed that since the Job Service was doing a good job administering the incumbent worker and other publicly-funded training programs, and therefore had good relationships with the Economic Development community, it would spearhead an initiative to develop a job creation program financed outside the public system, without bond sales and

administered by the Job Service. The result of these efforts was the creation of the New Jobs Training Program, which was passed into law in 1993.

Program Summary

The North Dakota New Jobs Training Program, administered by the Job Service of North Dakota, provides incentives to primary-sector businesses and industries that are creating new employment opportunities through business expansion or relocation to North Dakota. The program provides a mechanism for businesses to secure funding for training new employees in business expansion and/or startup.

Under the New Jobs Training Program, the business obtains funds in the form of a loan, grant (repayable), or self-financing option. The loan may be obtained from a commercial lender, a local development corporation, the Bank of North Dakota, or other qualified lender. A grant may be obtained from the state, a city, or a local economic development corporation.

Although the state plays the key role in helping the company establish the loan amount and effectively "endorses" the loan by making a contract with the employer that allows repayment of a commercial loan with public tax dollars, the state also maintains an arms length relationship with the lender. The state does not enter into any negotiations with the lender, other than agreeing to make the loan repayments on behalf of the borrower.

Funds from the New Jobs Training Program are made available through the capture of the state income tax withholding generated from the permanent, full-time new positions that are created. Reimbursements to repay the loan (plus interest) are made by the state directly to the lender. Reimbursements for a grant are made directly to the granting community or local economic development corporation. Under the self-financing option, 60 percent of the allowable state income tax withholding can be reimbursed directly to the participating business. State income tax withholding can be captured for up to a ten year period or until the loan is repaid, or the self-financing or grant obligations have been met, whichever comes first.

For a company with a qualifying project that needs cash upfront for training, the state makes a calculation of what the expected withholding tax will be for the new jobs over a ten year period and the company is able to use that figure to negotiate a loan with a local economic development agency, commercial lender, or the bank of North Dakota.

A five percent administration fee is due Job Service North Dakota after the final agreement is in place, due and payable when the final agreement has been signed. This is a one time fee, based on the projected amount of the agreement over the ten year period. Community lenders and banks can also charge administrative fees.

Results

In comparison to the bond-financed programs, North Dakota's NJTP is small, both in terms of expenditures and numbers trained. In 2006, the NJTP had provided approximately $4 million to create 1,100 new jobs

Payroll tax diversion as a financing strategy for regional economic and workforce development authorities

The advantages of the program seem to be that it offers both a simple way to put a cash incentive in the hands of companies that create new jobs and to provide cash up front for training if that's needed but with very little financial risk to the state and with the funding and repayment mechanism being the same.

North Dakota's New Jobs Training Program model allows local economic development authorities to charge administrative fees when they issue loans. And, according to state officials, most of the NJTP loans originate from local economic development authorities since they tend to offer better terms than commercial banks. Fees charged by EDAs are used to finance their operations and to re-invest in local economic development.