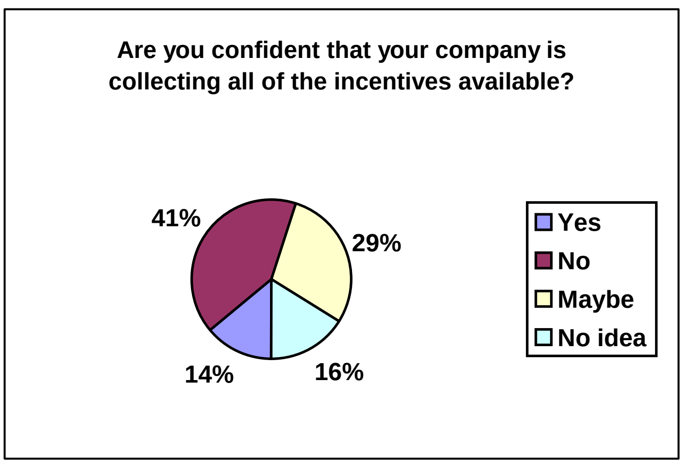
Site Selection Incentives for Medical Device Manufacturers

By:

James H. Renzas
President
Location Management Services, LLC
Mission Viejo, California

According to studies done by Professors Alan Peters and Peter Fischer, a total of $48.8 billion dollars is spent annually on state and local incentives to attract new investment, jobs and taxes. Yet many companies do not feel as if they are maximizing the utilization of these benefits. A recent survey of over 300 large companies in the United States shows only 14 % of all CFOs are confident that their companies area collecting all available incentives and credits. One third of these CFOs think that other companies in their industry are getting more incentives than their company. When asked why this is the case, respondents said that the reason they are not taking advantage of all available credits and incentives is not because they do a poor job of negotiating them – only 4 percent felt that this was the cause of the disconnect. Over 81 percent of the respondents attributed the lack of efficiency in this area to be due to: (1) the lack of a formalized process for identifying and securing incentives and credits, and; (2) poor tracking of incentives compliance requirements once the incentive program has been negotiated. This shows up in a study by Georgia State University where it was found that only about 50 % of all negotiated incentives are ever collected.



Types of Incentives

There are a variety of tax credits and incentives available for the Medical Device Manufacturing industry depending on the geographic location, type of operation, investment, employment and tax impact of the proposed facility. These include tax rebates, exemptions, moratoriums, reductions, credits, deduction, infrastructure improvements, relocation and cash grants which can be used to offset both start-up cost as well as the cost of on-going operations. Total benefits can range from a low of several thousands per employee to recent cases where employers were offered incentives packages in the millions of dollars per employee range. Whether or not your company will be on the lower or higher side of this range, or whether or not incentives are actually collected at all, will depend to a larger extent on what knowledge and skill you bring to the negotiating table.

The Incentives Management Process

An important component of the ultimate outcome is the information and approach that you bring to the negotiating table. The best incentives negotiations start with a full understanding of what tools are available in the geographic area in which you are interested in. While incentives cannot and should not be used to determine the best initial areas to look at when planning an expansion or relocation, it is important to introduce incentives discussions early on in the evaluation of finalist communities.

The finalist communities should be informed that your company is looking into how incentives can impact the final location decision and that your company will be looking at how incentives and available credits can be used to separate one finalist location from another. Often companies do not have the background or objectivity necessary to maximize the use of available incentives and credits because they simply do not do these negotiations on a regular basis. Frequently, companies will have revealed too much about their plans to state and local officials prior to making a final selection decision and will have lost some or all of their leverage in final incentives negotiations.

We recently had one client whose Senior Vice President decided to circumvent the incentives negotiation process and negotiate on his own with state and local officials. While he did end up with almost $5,000 per employee in incentives benefits, he didn't know that his biggest competitor actually negotiated a deal worth almost $15,000 per employee. With over 500 employees scheduled to be hired at the new facility, this cost the company, and its shareholders, over $5 million. By the time we were notified that the Senior VP had taken it on himself to conduct the negotiations without our help, it was too late to salvage the incentives package – he had used up all of the company's leverage in negotiations. Of course, he did save a consulting fee, which was a fraction of the $5 million he lost – and his company will have to constantly monitor the incentive package in order to make sure that they meet all compliance deadlines and requirements in order to collect the incentive package he negotiated on his own.

Types of State, Local and Federal Incentives and Credits

Building Permit Fee Waivers	Job Creation Tax Credits
Building Rent Subsidies	Loan Guarantee Program
Cash Grants Towards Working Capital	Low Cost Financing of Equipment
Child and Dependent Care Credits	Low-Interest Building Loans
Community Development Block Grants	Motor Vehicle Investment Credits
Computer and Software Investment Credits	Payment of Moving Costs
Construction of Access Roads	Payroll Tax Credits
Direct Loans	Preferential Mortgage Pool
Discretionary Grants	Pollution Control Credits
Empowerment Zone	Empire Zone
Gulf Opportunity Zone	Renewal Zone
Employee Benefits Credits	Pre-Employment Training
Empowerment Zone Hiring Credits (Federal)	Property Tax Abatement
Energy Conservation Credits	Property Tax Moratoriums/Reductions
Enterprise Zone Hiring Credits	Recycling Credits
Enterprise Zone Sales Tax Credits	Rent Free Use of Temporary Structures
Environmental Remediation Credits	Research and Development Credits
Forgivable Loans	Sales and Use Credits
Free Site Preparation	Sales Tax Sharing
General Obligation Bonds	Subordinated Loans
Healthcare Credits	Subsidized Land Prices
Historic Preservation Tax Credits	Target Industry Tax Refunds
Impact Fee Reductions	Tax Increment Financing

Income Tax Credits	Tax Moratoriums or "In-Lieu" contracts
Industrial Revenue Bond Financing	Telecommunications Tax Credits
Infrastructure Improvements	Undervalued Assessments
Investment Funds	Utility Rate Reductions
Investment Tax Credits	

It's not what you get – it's what you can use

As the accompanying chart of available incentives and credits shows, there are a broad variety of programs which may or may not apply to your company's specific situation. The key to maximizing the use of these programs is knowing how these programs work and how they will impact your operating and start-up costs. For example, many state programs offer job creation tax credits programs which provide a certain level of state tax credits ranging from $500 to $31,500 per employee, based on the hiring of new personnel. Many of these programs have specific wage and/or benefits requirements which can preclude the use of these incentives without adequate knowledge of how these apply to your company's specific situation. Moreover, if your company does not currently have a tax liability in the state your company is considering locating in and it is unlikely that your company will be generating liability in the near future, these job creation tax credits programs have little or no impact on your company's financials. Too often, operations personnel get involved in negotiating incentives with little understanding of how the value of tax credits can impact various operating scenarios. By the time corporate tax gets involved in the analysis, there is little that can be done to salvage the incentives negotiations. States and areas seeking to attract the Medical Device Manufacturing industry should carefully review their incentives programs to determine if they fit the tax situation of most of the companies they are trying to recruit.

State's Are Competing for Your Business

Many states and areas have identified the Medical Device Manufacturing industry as a high priority target for recruitment. Incentives in these states can be quite lucrative. When Scripps Research Industries was looking for an East Coast home for its new research center, the state of Florida, lead by Governor Bush, kicked in over $450 million in incentives, including over $300 million in grant funding and a free $140 million facility. According to Scripps, the facility will employ 545 workers by its seventh year of operation – an incentives/employment ratio of $826,000 per job. Most incentive deals are not quite that lucrative, but still worth pursuing. For example, when the orthopedic device manufacturer Zimmer announced its desire to expand its facilities in Warsaw, Indiana, state and local governments obliged with more than $6 million of incentives - an incentives/employment ratio of $24,000 per employee. MedVenture Technology Corporation, a designer and manufacturers of minimally invasive surgical products and other devices moved its facilities from Louisville, Kentucky across the river to Jeffersonville, Indiana in order to expand its operations and avail itself of the special tax incentives offered to Medical Device Manufacturing companies by the state of Indiana. The 85,000 square foot facility will create about 170 jobs by 2007 with the help of $4 million in state and local incentives, an incentives/employment ratio of $23,530 per employee.

Some states provide free training services to companies as a non-cash incentive that improves the quality of the local labor force. The Gambro Group worked with the Alabama Industrial Development Training Institute (AIDT) to provide training to the 150 new employees that the company expects to hire in Opelika, where 10 million Polyflux dialyzers will be produced annually in a new 100,000 square foot manufacturing facility. AIDT assisted with the hiring of Gambro's first 13 employees in Opelika – who were sent to Hechingen, Germany in February to begin 18 months of training.

State by state incentives vary greatly from one region or state to another, depending on the types of incentives programs which have been approved by state legislatures, but total state and local assistance generally falls in the $10,000 to $40,000 per job range. For capital intensive facilities, incentives can range from 10 to 30 % of capital investment costs. Of course the actual final incentive can vary markedly, depending upon the types and proposed payroll of the jobs being created, the capital investment, the tax generating potential of the project and the level of competition for the new facility.

Selecting the Right Location

Too many sophisticated managers do not evaluate all of their options prior to committing their companies to a long-term location by thoroughly exploring labor market, real estate, utilities and incentives programs which can make the difference between enterprise success and failure. Others allow one factor, such as incentives, to drive the entire location decision. Neither of these approaches are correct.

The best approach for Medical Device Manufacturers is to first identify what key criteria are necessary for the success of the proposed facility and what the "location drivers" are in the project. Some examples of location drivers include:

- Proximity to commercial air service
- Sophisticated metalworking skills
- Available workforce for expansion
- Area university and post-graduate training facilities
- Quality of life for leadership employees

Once these key drivers are identified, the company is in a better position to conduct a through analysis of potential site locations. Often times the area of search can be multiple states or countries. Each of these states, areas and countries has thousands of elements of information which could be important in the site selection process. The sheer volume of this information could be overwhelming to the site seeking executive. By knowing the key requirements up front, it is possible to focus due diligence efforts on those factors that are most important to the success of the proposed project.

Site selection is a process of elimination. Starting with a limited number of critical "fatal flaw" elements, we sift through hundreds of locations to find those that best fit the profile of the ideal location as defined in the initial phase of the project. Once a short list of locations has been identified, we conduct telephone interviews with area development executives in order to gather more detailed facts about the area and to help spot problems which would preclude the establishment of the new facility at that location. An obvious example of this would be the lack of a suitable site or building, if required since you can't locate a facility in a community with no suitable facilities. Generally incentives are not part of the analysis at this stage of the process.

The next phase of the process is to rank the short list of candidate locations based on how well they satisfy all of the defined requirements for the new facility. At Location Management Services, we use a decision-matrix approach which factors in both cost and non-cost factors in order to evaluate semi-finalist locations. A series of interviews with area employers in similar industries is then scheduled to evaluate labor market, business climate and other critical criteria. Meetings are held with area development officials, state and local training officials, school administrators, college and university research coordinators, area real estate professionals, and others to give us a complete review of what it would like to operate a facility at that location, prior to making the final site selection decision. At this point, incentives become a topic of discussion, but are not the final criteria for site selection.

The third phase of the analysis is the creation of a decision-matrix model incorporating all of the critical elements of the site location decision. This would include operating cost models for alternative locations, operating conditions factors, and living conditions for key knowledge and leadership executives. The decision-matrix includes a weighting factor which can be applied to each of the elements in the analysis, so scenario analyses can be conducted by varying the weighting applied to each element to test the voracity of the assumptions.

Based on this work, all but two of the finalist locations are eliminated from further consideration. At this time, the executive team, comprised of senior management, engineering, personnel, and finance get more deeply involved in final incentives negotiations between the remaining two locations. The decision-matrix model is modified based on how incentives affect the final operating cost and conditions criteria and incentives are focused on eliminating differences between the two finalist locations.

At the same time, the company's real estate advisor becomes more deeply involved in negotiating the real estate terms, conditions, and costs at each of the finalist locations. Once these factors have been defined, the model will be updated to include the final costs and terms and a decision will be made to rank the remaining two locations. Strategic planning meetings will be held to discuss the finalist locations and a decision will be made as to the final location. Before a decision is announced, however, it is critical that all incentives be negotiated and committed in writing. Many incentives programs become invalid if the company announces the location decision prior to documentation, so a premature announcement could end up costing the company millions of dollars.

Sophisticated companies employ professional site selection and incentives negotiations consultants to help them through the complexities of a location decision and to shield the company from unnecessary and harmful publicity during the decision-making process. Location Management Services has been selected by the Medical Device Manufacturers Association (MDMA) to work with its members to find the optimal location and incentive package for new corporate facilities. As a member service, LMS provides site selection as well as incentives negotiation and compliance services to ensure that the company chooses the best site, negotiates the most meaningful incentives package, and complies with state and local policies in order to earn those incentives dollars.

JAMES H. RENZAS

President and CEO ***Office: 949/472-4482***
Location Management Services LLC ***Fax: 949/472-5494***
Mission Viejo, CA ***jrenzas@locationmgmt.com***

Jim is the President and CEO of Location Management Services, a site selection and incentives negotiation consulting company with 37 offices nationwide. He has more than 25 years of site selection and incentives negotiation experience, providing consulting services to clients on multistate location strategies, as well as government assistance programs to aid business expansion and/or relocation.

Location Management Services is the exclusive site selection and incentives provider to the National Association of Manufacturers, Bay Bio, and the Medical Device and Manufacturers Association through the Site Selection Network which is a consortium of economic development organizations throughout the United States. Jim was Western Regional Practice Leader with a Big Five consulting firm.

RELEVANT EXPERIENCE

Jim has conducted and managed over 200 successful corporate location assignments throughout the United States, Canada, and Mexico. He has personally negotiated over $700 million in state and local tax incentives for a variety of office, manufacturing, distribution, and retail clients. Jim has served as an expert witness for several court cases involving corporate relocation and is the author of numerous articles on business location and incentives negotiations. In March 2006, Jim provided testimony to the United State Senate Finance Subcommittee on the impact of Cuno on global competitiveness.