REGIONAL DEVELOPMENT INCENTIVES 1974

Questions and Answers

Canada Dept. of

Regional Economic Expansion

Expansion Économique Régionale

REGIONAL DEVELOPMENT INCENTIVES 1974

On April 1, 1974, a number of significant changes in the Regulations, guidelines and operations of the Regional Development Incentives program come into effect. These changes are designed to improve the effectiveness of the program, to be administered by the new, decentralized organization of the Department of Regional Economic Expansion.

Standard formulae are to be used to calculate the level of assistance for most projects, thereby giving entrepreneurs a clearer indication of the probable level of incentive as well as expediting the handling of applications.

The minimum sizes of projects eligible for development incentives and loan guarantees have been lowered substantially. The kinds of incentives available have been broadened to include repayable grants for some larger projects with higher risk but with good profit potential if successful.

Details of the revised program are outlined below. In addition, a summary of the changes is attached for the convenience of those familiar with the previous program.

<u>What type of assistance is available?</u>

There are two basic types of incentives available: development incentives and loan guarantees.

Development incentives include the following:

1) Development grant (non-repayable)
2) Repayable development incentive (specifically repayable)
3) Provisional development incentive (repayable if the project achieves a certain level of profitability or other objectives specified in the offer and accepted by the applicant).

These development incentives are available individually or in combination. They also may be combined with guarantees on loans from private lenders to provide a wide variety of assistance to fit the individual needs of entrepreneurs wishing to establish or expand industrial or commercial facilities in Canada's designated regions.

Both development incentives and loan guarantees can be provided for firms which establish new manufacturing or processing facilities or expand or modernize existing plants. Assistance for eligible commercial projects is confined to loan guarantees.

In what designated regions are these benefits available?

Development incentives and loan guarantees are available in regions designated by the Governor in Council under the authority of the Regional Development Incentives Act.

The regions designated from April 1, 1974 to December 31, 1976, include all of the Provinces of Newfoundland, Nova Scotia, Prince Edward Island, New Brunswick, Manitoba and Saskatchewan, together with all of the Province of Quebec except the Montreal-Hull corridor, and the Province of Ontario, north of the southern boundaries of the Districts of Nipissing and Parry Sound.

What industries are eligible?

Most manufacturing and processing industries are eligible for development incentives and for loan guarantees.

The list of eligible manufacturing and processing industries has been enlarged to include the grinding, mixing and blending of fertilizers and feedstuffs, drying of hides, cleaning or drying of peat moss or Irish moss, some types of concrete

... 3

or asphalt operations, and certain operations which involve mobile equipment, provided that the equipment remains in the area specified by the Minister for at least five years.

The major exceptions continue to be petroleum refining, certain parts of the pulp and paper industry, mining, and the growing harvesting or extracting of natural products. However, the processing of natural products in operations such as sawmills, fish plants or food processing plants continues to be eligible.

What types of commercial facilities are eligible for loan guarantees?

Loan guarantees can be provided for new commercial establishments which will make a significant impact on the economy of the area within a designated region.

These may include business offices, warehousing and freight-handling facilities, shopping centres, hotels or motels, convention facilities, recreation facilities, or research facilities. Recreation facilities may include marinas or a variety of tourist attractions such as museums or art camps. Eligible commercial projects must be new establishments; expansions and modernizations are ineligible. However, it may be possible to add a new facility such as convention accommodation to an existing facility such as a motel or hotel.

Further details are available in the questions concerning loan guarantees on pages 12-15.

What amount of development incentive may one expect?

The amount of the development incentive depends mainly upon the type of project and its size in terms of capital costs and jobs created.

Three categories have been created. The first two (Sizes A and B) have standard formulae for development incentive calculations, subject to checks for viability,

... 4

need and economic benefits. Size C projects, which do not involve a standard formula, require a complete evaluation prior to establishing the level of the incentive.

The definitions of the three categories are as follows:

a) Size A - projects with approved capital costs ACC of less than $200,000 and fewer than 40 jobs.

b) Size B - projects other than A cases with less than $1.5 million ACC and fewer than 100 jobs.

c) Size C - projects with at least $1.5 million ACC, or at least 100 jobs.

Thus a $150,000 ACC project creating 45 jobs would be Size B, while a $1,000,000 ACC project with 110 jobs would be Size C.

The standard formulae for Size A and B projects are given below. They are based on percentages of the approved capital costs (ACC) and the average of the approved annual wages and salaries (W&S) paid during the second and third years after the commencement of commercial production. Definitions of approved capital costs and approved wages and salaries are given in a later paragraph.

a) New Facility or New Product Expansions

1) Size A projects:

i) Atlantic Region - 25% ACC & 30% W&S
ii) Other Regions - 25% ACC & 15% W&S

2) Size B projects:

i) Atlantic Region - 25% ACC & 30% W&S
ii) Other Regions - 25% ACC & 15% W&S

b) Modernizations or Volume Expansions, Sizes A and B

i) Atlantic Region - 20% ACC
ii) Other Regions - 20% ACC

... 5

The full evaluation for Size C projects includes examination of the basic eligibility criteria, the financial need, the economic impact and project viability. The recommendation by departmental officials is reviewed by an Incentives Advisory Board prior to being referred to the Minister for decision.

The ceilings for development incentive offers are:

a) For new facilities and new product expansions, the lowest of

- 25% of approved capital costs and $5,000 for each direct job; (The initial 20% of capital costs may not exceed $6,000,000.)
- $30,000 for each direct job created; or
- 50% of the capital employed in the operation, or
- 80% of the approved capital costs (for incentives determined by standard formulae).

b) For modernizations and volume expansions, the lesser of

- 20% of approved capital costs;
- $6,000,000.

<u>Could you provide an example of an incentive calculation using a standard formula?</u>

Assuming the applicant meets other requirements concerning equity, need, etc., consider a new facility for the Atlantic Region with estimated approved capital costs of $100,000, employing 10 people, with forecast eligible payrolls in the second and third years of $70,000 and $93,000 respectively. The estimated development incentive based on 25% of the estimated approved capital costs plus 30% of the average estimated approved wages and salaries would be:

$$(25\% \times \$100{,}000) + (30\% \times \frac{70{,}000 + 93{,}000}{2}) = \$49{,}450$$

Since the incentive calculated according to the standard formula is less than any of the ceilings previously described, and detailed in the appendix, the offer would be $49,450. The initial payment and any interim payments would be based on this offer, provided the performance is in line with the plans outlined and all terms and conditions of the offer are met. The final payment would be adjusted to reflect the actual capital costs (approved capital costs) and the actual wage and salary bill (approved wages and salaries) defined below.

Would you define the terms used in determining the amount of a development incentive?

Approved Capital Costs (ACC) include the capital cost to the applicant of purchasing buildings, machinery and equipment plus the direct cost of designing, acquiring, constructing, transporting and installing the assets. Interest and insurance during construction, if normally capitalized by the applicant, are also included.

Leased machinery and equipment may be included under certain arrangements. Transport vehicles used exclusively between two parts of an operation are eligible.

Land and automobiles are not eligible assets, nor are delivery vehicles used primarily to transport goods to locations other than parts of the same operation.

Capital to be employed in the operation is the total of:

(a) the approved capital costs;

(b) the value of other fixed assets (such as land);

(c) an amount of working capital appropriate to the operation at intended plant capacity.

The number of jobs for development incentives purposes is based on the additional direct jobs in the manufacturing or processing operation. The approved wages and salaries paid to such persons are used to calculate most incentives, but it is necessary to calculate the number of jobs to ensure that the maxima, as specified in the Act, are not exceeded. The number used is the number of jobs created during the third year, normally on the basis of 200 man-days of plant operation.

... 7

Approved wages and salaries consist of the average eligible wages and salaries for the second and third years of commercial production. These include the wages, salaries and overtime pay of employees of the applicant, plus employees of independent contractors or persons working under a management contract performing work related to the manufacturing operation in the facility. Ineligible wages and salaries include excessive payments for overtime or to the principals of the enterprise.

A new product expansion is an expansion of a facility to produce a product that is significantly different from any product manufactured or processed in the facility during the past three years. It must also be established that the new product could not be manufactured or processed economically in that operation unless the facility is expanded and additional machinery and equipment installed.

What size of project can be eligible for a development incentive?

The approved capital costs for new facilities, for new product expansions, for volume expansions and for modernizations must be at least $25,000.

However, if a new facility or new product expansion has capital costs commensurate with the nature of the undertaking, but in no case less than $5,000, an offer can be made if at least five direct jobs are created in the operation.

How much equity capital must one invest in the project?

Normally, the applicant must provide equity equal to at least 20% of the total capital employed in the project.

For expansions and modernizations, the equity must be equal to at least 20% of the new assets and 20% of the book value of other assets of the facility at the time of application.

The amount of the equity includes share capital, surplus accounts and subordinated shareholders' loans, adjusted for such items as intangibles, appraisal increases, amounts due from shareholders, capitalized pre-operating expenses or similar items which may inflate the equity figure unreasonably.

The equity requirement may be increased for high risk or sensitive projects. In certain unusual circumstances, the Minister may approve a project where the applicant's equity is less than that specified above but never when it is below 20% of the approved capital costs.

When must one provide this equity?

The equity should be committed to the project as soon as possible in order to ensure that the entrepreneur has an early stake in the operation and is committed to achieving its success. Unless special authorization is given, the equity should be provided at the latest by the start of commercial production. In any event no incentive payment will be made until the equity is provided.

Are there any exceptions to the standard formulae for size A & B cases?

Generally, no.

Standard formulae were introduced to make approvals more systematic, to indicate the probable amount of incentive and to accelerate the decision process. However, an applicant may request an exception to the standard formula. The review sequence would require a recommendation to the Minister by the Provincial Director General, by the Regional Assistant Deputy Minister and by the Advisory Board.

Must the eligible assets be new?

No.

... 9

Used buildings, machinery and equipment may be included as eligible assets, provided they are in suitable condition and purchased in arm's length transactions. It is also possible to include certain rebuilding, transporting and installation costs for assets owned by the applicant or an associated company and moved to the facility, even though the capital costs of these assets may not be included as eligible assets.

When will the development incentive normally be paid?

The first payment, of up to 80% of the approved total incentive, can be made after the plant is in commercial production and after an inspection has revealed that the project is operating in accordance with the terms of the offer.

The remainder of the approved incentive will be paid within 30 months after the start of commercial production for an expansion or modernization or within 42 months for a new plant or new product expansion; but no sooner than 24 or 36 months respectively.

Are there payment provisions for phased projects?

Yes.

Interim payments are permitted to prevent undue hardship to an entrepreneur who must install assets over an extended period of time following commencement of production such as in a multiphase project. Interim payments less than 25% of the initial payment are not authorized.

The commencement of commercial production may be certified when the requirements in relation to the first phase have been met. However, due to legislative restraints, all phases of construction must be completed within the control period, and the eligible wage and salary bill must be calculated for years two and three following commencement of commercial production of the first phase.

What happens if the original estimates of capital costs or jobs are not met during the second and third years?

If the project is carried out substantially in accordance with the plans authorized when making the offer, adjustments will be made at the time of the final payment.

Incentives may be adjusted upwards at that time, based on increases of up to 25% above the estimated capital costs and approved new jobs. If the capital costs or jobs are less than forecast, the final payment will be based on the reduced figures.

Before making any significant change to the project, the applicant should consult with the Department because changes which alter the substance of the project may cause it to be re-evaluated.

How does the development incentive affect taxes?

Development incentive payments are exempt from income tax. However, for capital cost allowance purposes, the value of the assets of the facility must be decreased by an amount equal to the development incentive.

Are there any other conditions respecting development incentives?

Yes.

There are a number of conditions which are outlined in the Regional Development Incentives Act and Regulations. The applicant should review these in detail before submitting an application. For convenience, some of these conditions are listed below:

... 12

Applications for incentives must be received while the project is in the planning stage, before any contractual commitments are made for buildings, machinery or equipment. No incentive can be paid in respect of a project committed before an application is received.

The applicant must certify that a development incentive is a significant factor in his decision to proceed with the project.

The applicant and firms subject to control in common with the applicant must normally continue to operate other Canadian facilities manufacturing similar products at the same level or a higher level than at the time of applying for the incentive.

The applicant must co-operate with Canada Manpower Centres in the recruitment and training of personnel, and must undertake to employ, to the maximum extent practicable, residents of the region in which the facility is located.

There must be satisfactory control of pollution.

The applicant must give manufacturers in Canada a reasonable opportunity to supply, competitively, the machinery and equipment for the project and give consultants in Canada a reasonable opportunity to bid on contracts relating to the project.

Are there any deadlines?

Applicants have ninety days from the date of an offer of a development incentive to accept it.

The offer will state a mutually acceptable time by which construction and commercial production must commence. If these deadlines cannot be met, an extension may be given upon a request in advance.

Incentives can be provided only for facilities that will be brought into commercial production before December 31, 1976.

Can one get a loan guarantee to cover the balance of a project's cost in addition to the development incentive?

No.

Loan guarantees are not intended to cover the entire cost of the project. They are provided to help the applicant secure the debt financing he requires from private lenders on normal terms and conditions to finance the project, over and above what he provides through his own equity, unguaranteed loans and grants from government agencies.

Must a manufacturing or processing project be eligible for development incentive assistance in order to qualify for a loan guarantee?

In most cases, yes.

However, if a project has been ruled ineligible for a development incentive because, in the opinion of the Minister, it is probable that the facility would be established, expanded or modernized without the provision of a development incentive, the department may confine its offer to a loan guarantee in order to ensure the provision of adequate debt financing.

Does the rule concerning prior commitments apply for loan guarantees?

Manufacturing or processing projects that have been ruled ineligible for development incentive support due to a prior commitment are also ineligible for loan guarantee assistance. However, for commercial facilities a prior commitment in the development stage of the project would not prevent the Department from offering a loan guarantee.

What is the maximum guarantee?

By regulation, the guarantee cannot exceed 90% of the total amount of the advances made by the lender. In addition, the Act precludes a loan guarantee if the loan exceeds 80% of the estimated total capital costs, after deducting the DREE development incentive or assistance from other government agencies.

How small can the project be to obtain a loan guarantee?

Projects with total capital costs of $100,000 or over may qualify for loan guarantee assistance.

Thus a project with $90,000 ACC, $5,000 land and $5,000 capitalized expenses would qualify, whereas one with $50,000 ACC, $5,000 land, no capitalized expenses and $45,000 working capital would not.

Is there any fee to obtain this guarantee?

Yes.

Lenders are required to pay the Department a fee of one per cent per annum, which is ordinarily collected from the applicant and is calculated on the declining monthly balance of the portion of the loan which is guaranteed.

Can anyone provide the loan?

Any lending institution which is active in the Canadian financial community and has a demonstrated capacity to service the loan would be acceptable.

Exceptions would be lenders with questionable sources of funds, companies which are directly related to the applicant, and government bodies or agencies unless such government assistance is essential and the loan guarantee is accepted by the Minister of DREE and the Minister of Finance. The guarantee is made to a specific lender regarding a specific loan. It is not transferable or negotiable without prior approval from DREE.

Who locates the lender?

It is the applicant's responsibility to find an appropriate lender, although guidance may be provided by the DREE provincial office for applicants requiring such assistance.

How does the loan guarantee work?

There are two basic types of guarantee.

In a shared-risk guarantee, DREE shares with the lender any and all losses ultimately sustained after liquidation and realization of security held to support the loan. The share percentage is agreed in each case (e.g. 80%:20%, or 90%:10%). This type of guarantee is particularly attractive when the security has uncertain value and judgemental factors such as markets, management capacity and overall viability are of prime importance.

An incremental guarantee insures the incremental portion of a loan over and above the amount which the lender would advance with no guarantee. The guarantee covers 100% of the loss on that portion but no more. Normally, the incremental portion must not exceed:

(a) the applicant's equity;

(b) one-third of the total loan amount if the loan term is five years or less;

(c) one-quarter of the total loan amount if the loan term is more than five years.

Incremental guarantees are most useful in mortgage-type lending circumstances when primary security consists of real property or other assets with an easily identifiable liquidation value.

Do the conditions concerning Canadian machinery and equipment, Canadian consultants, control of pollution and the use of Canada Manpower Centres apply for loan guarantees?

Yes.

How may one apply for a development incentive or loan guarantee?

Most applications will be evaluated in the province in which the project is to be located. The principal DREE processing offices are as follows:

St. John's, Nfld.	Charlottetown, P.E.I.
Halifax, N.S.	Fredericton, N.B.
Montreal, Que.	Thunder Bay, Ont.
Winnipeg, Man.	Regina, Sask.

While a prospective applicant may wish to obtain application forms or other material from the closest DREE office, he will receive more expeditious service if he deals directly with the appropriate DREE office in the province where the facility will be located.

ILLUSTRATION OF THE CALCULATION OF A DEVELOPMENT INCENTIVE USING STANDARD FORMULA

(as estimated at time of offer)

Case Data

Approved capital costs					\$100,000
Approved wage and salary bill	- year 2				\$70,000
	- year 3				\$93,000
Estimated working capital at full capacity					\$85,000
Incentive formula	- Atlantic	-	25% ACC	30% W&S	
	- Other	-	25% ACC	15% W&S	
Actual number of jobs in year 3, tabulated on basis of man-days divided by number of days plant operated					10

Incentive Calculation - if project is in Atlantic Region.

25% x \$100,000 ACC	=	\$25,000
30% x salary & wage bill		
$.3\frac{(70,000 + 93,000)}{2}$	=	\$24,450
		\$49,450

Incentive Calculation - if project is not in Atlantic Region.

25% x \$100,000	=	\$25,000
$.15\frac{(70,000 + 93,000)}{2}$	=	\$12,225
		\$37,225

Cross-check to ensure that incentive is within the maxima established by legislation and guidelines.

1. One half of capital employed

.5(100,000 + 85,000)	=	\$92,500

2. Maximum formula established by legislation

25% of 100,000 ACC	=	\$25,000
\$5,000 x 10 jobs		\$50,000
		\$75,000

3.	$30,000 per job 30,000 x 10 jobs	=	$300,000
4.	80% of $100,000 ACC	=	$80,000

Since the incentive does not exceed any of the four ceilings, the offer is $49,450.

SUMMARY OF CHANGES TO THE

REGIONAL DEVELOPMENT INCENTIVES PROGRAM

A number of significant changes in the RDIA program will come into effect on April 1, 1974. For the benefit of those already familiar with the program, a list of these changes follows:

- Some new regions have been designated, some have had designation extended and others have ceased to be designated.
- Standard formulae are to be used to calculate the level of incentive for most projects. This will give entrepreneurs a clearer indication of the probable incentive, and will expedite the handling of operations.
- Large projects may be offered a wider range of development incentives, including some which are repaid specifically or provisionally, in whole or in part. These can be used in combination with non-repayable incentives (grants) or with loan guarantees.
- Smaller projects are now eligible for development incentives. The minimum capital cost for new facilities, new product expansions, expansions to produce similar products, and modernizations, is reduced to $25,000. If five or more direct jobs are created, a new facility or new product expansion may have lower capital costs, but in no case may these costs be less than $5,000.
- The list of eligible industries has been enlarged to include the grinding, mixing and blending of fertilizers and feedstuffs, drying of hides, cleaning or drying of peat moss or Irish moss, some types of concrete or asphalt operations, and certain operations involving

... 2

mobile equipment, provided that the equipment remains in the area specified by the Minister for at least five years.

- Eligible assets may now include certain off-site assets used exclusively for the operation, such as transportation vehicles (other than passenger motor vehicles) used between separate sections of a facility.

- Under special circumstances, leased machinery and equipment may be considered as eligible assets for incentive purposes.

- Increases over the original estimates of approved capital costs and new jobs may be accepted up to an additional 25 per cent instead of the previous 15 per cent.

- An incentive for a new facility is contingent upon the continued operation, at the same level or at a higher level than at the time of applying for the incentive, of all other Canadian plants of the applicant, or firms subject to the control of the applicant, which manufacture similar products.

- Fees for loan guarantees have been reduced to 1 per cent per annum calculated on the declining monthly balance of the portion of the loan which is guaranteed.

- The minimum total capital cost for manufacturing or processing facilities or for commercial facilities receiving loan guarantees has been reduced to $100,000.

- Research facilities have been added to the list of establishments eligible for loan guarantees.