# Strategic Investment Program

## Policy Update Needed

November 2003

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MEMORANDUM

Date: October 28, 2003

To: Diane Linn, Multnomah County Chair
Maria Rojo de Steffey, Commissioner, District 1
Serena Cruz, Commissioner, District 2
Lisa Naito, Commissioner, District 3
Lonnie Roberts, Commissioner, District 4

From: Suzanne Flynn, Multnomah County Audit

Subject: Strategic Investment Program Audit

The attached report covers our audit of the Strategic Investment Program. This audit was included in our FY02-03 Audit Schedule.

Recent changes in the organization of the SIP program and a decision to administer it internally have improved the quality of management and appear to have reduced the costs. However, the program is operating without adequate policy guidance. We are also concerned about the County's general lack of capacity to monitor contractor performance and the impact of this shortcoming on contracts receiving SIP funds.

We have discussed our findings and recommendations with the Chair's Office. A formal follow-up to this audit will be scheduled within 1-2 years.

We appreciate the cooperation and assistance extended to us by the management and staff in the Chair's Office and the Departments of Community and Business Services and Community and School Partnerships.

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# Background

The County's Strategic Investment Program (SIP) started in 1995. The program is based on Oregon State law and allows the County to grant property tax abatements as an incentive for business investment within Multnomah County. The goal of the program is to attract new, capital-intensive manufacturing facilities and their associated new jobs. The justification for the tax abatement program is that some industries, like high technology, require very expensive, capital intensive manufacturing facilities and that these companies pay a disproportionately high rate of property tax, compared to companies that have similar numbers of employees. The law specifies that the abatements are limited to the portion of the real property value over $100 million. In return for the tax abatement, state law allows the County to collect a Community Service Fee (CSF) of 25 percent of the property tax abated, not to exceed $2 million. The law also allows counties and municipalities to include other reasonable fees and conditions in the agreement.

Multnomah County joined the City of Gresham in signing its first two SIP contracts in 1995. The contracts, with Fujitsu and LSI Logic, involved 15-year performance-based public/private partnership agreements. Fujitsu, Gresham, and the County terminated their contract before any tax abatement took effect. Deteriorating market conditions caused Fujitsu to halt investment and sell its facilities before reaching the $100 million tax assessed value threshold. The County and Gresham signed a third agreement with Microchip – this one a 7-year contract – to facilitate the purchase of the Fujitsu plant.

The Strategic Investment Program involves several activities, some that are unique to the program and others that fit the mold of traditional County programs. The unique aspects of the program are in the development and negotiation of the contracts with private companies. The more traditional activities involve the contracting for services paid for out of the proceeds of the SIP agreements.

## Scope and Methodology

The Auditor's Office initiated an audit of the SIP Program in March 2003. In August 2003 after completing the initial phases of the audit, we concluded that further audit work would not yield any more information than the work already completed. The objectives of the audit were (1) to determine the costs and benefits of the program and (2) to determine whether adequate policies and controls were in place to safeguard the proceeds received from the SIP agreements.

We determined that the first audit objective could not be met because it would not be feasible to accurately estimate the likelihood that the business would have located in the County without tax abatement. Further, we completed the work needed to meet the second audit objective during the initial phase of the audit. We decided to issue a report outlining our findings in the areas of SIP management, the manner in which it implements SIP contracts with private companies, the policies in place to guide the use of SIP proceeds, and the units of County government that have been charged with overseeing the distribution of the proceeds.

During our review, we completed the following tasks:

- Interviewed past and current SIP managers
- Interviewed County Finance Unit staff
- Reviewed program materials and Board of County Commissioners (BOCC) resolutions
- Performed a literature search for similar programs at other jurisdictions
- Reviewed budget documents
- Analyzed program financial data
- Interviewed department staff responsible for managing grants and contracts funded by SIP

This audit was conducted according to generally accepted government auditing standards.

# Results

As we reviewed SIP, we found improvements in several areas had already been made. Specifically, County management reduced costs for SIP administration by bringing SIP management into the County and directly contracting for job training services. However, we found other areas of concern. SIP has been operating without a guiding policy since 1997. A policy is needed to guide future uses of Community Service Fee revenue. Establishing a new SIP policy would also facilitate discussion of whether to continue to aggressively seek new agreements and how the County will approach the existing agreements when they expire.

Secondly, SIP money is being dispensed via a contracting system that has been weakened by reorganization and budget reductions. SIP program management and the SIP community housing resources are being managed out of the Chair's Office, an organization with a limited contract administration function. Other funds are managed out of the Office of Schools and Community Partnerships (OSCP), a unit with limited capacity for fiscal contract monitoring and with no evaluation capacity.

## SIP policy is needed

According to the policy passed by the BOCC in 1995, SIP's goals fit within the Portland-Multnomah Benchmark framework and include:

- The creation of long-term jobs with family wages, benefits, and working conditions for current residents of Multnomah County
- Providing assistance for residents to secure, affordable housing and dedicating a portion of any CSF to help with this effort
- Encouraging employees to use transit, van/car pooling, and alternative modes of transportation
- Assuring that no unmitigated adverse impacts on County infrastructure or public services will result from SIP
- Only granting abatements to firms that demonstrate a commitment to environmental protection
- Encouraging the purchase of goods and services produced or sold by businesses in Multnomah County and the region

This policy expired after two years and the BOCC has not approved a replacement. While the LSI contract has become the defacto policy in terms of program goals and how the contracts would advance these goals, there has been little done regarding how the CSF should be spent. The CSF has essentially been used to supplement the General Fund. Having a SIP policy in place is important because: 1) it provides a framework with which decisions can be made regarding the use of CSF revenue and 2) provides a point of reference for the discussion of the merits of future SIP agreements.

## Policy needed to guide use of SIP revenue

The SIP law allows the jurisdictions granting tax abatements to collect revenue from the company receiving the abatement. The CSF revenue is the largest revenue stream coming into SIP. The CSF is required by state law and equals 25 percent of the abated property taxes up to $2 million. In Multnomah County, the CSF is divided between the County (53 percent) and the City of Gresham (47 percent), according to an intergovernmental agreement. The administrative cost of overseeing the program is paid to the County before the CSF is divided.

While the law allows jurisdictions to collect other fees or contributions, the County has no policy requiring contracts to include other payments and has not applied this authority universally. The LSI and Fujitsu contracts included requirements that the companies contribute money to the County to address specific needs, such as affordable housing. The most recent contract with Microchip did not include any such requirements.

Some of the revenue associated with the contracts is obligated for a specific purpose, such as an agreement to hire through a local nonprofit agency, while the other revenue is more flexible. The use of the community housing, education and training, and community resource money is governed by relatively broad parameters in the individual SIP agreements. The CSF revenue is the most flexible in that it can be (and has been) used in the same way as money in the General Fund. The fees collected from the SIP agreements are shown in Table 1.

Table 1

| | FY 1996 | FY 1997 | FY 1998 | FY 1999 | FY 2000 | FY2001 | FY2002 | FY2003 | FY2004 |
|---|---|---|---|---|---|---|---|---|---|
| LSI CSF | | | | $348,341 | $425,494 | $427,584 | $624,880 | $609,377 | $402,363 |
| Microchip CSF | | | | | | | | | $216,956 |
| LSI Comm. Housing | $500,000 | $100,000 | $100,000 | $100,000 | $100,000 | $125,000 | $125,000 | $125,000 | $125,000 |
| Fujitsu Comm. Housing | $500,000 | | | | | | | | |
| LSI First Source | $30,000 | $60,000 | $60,000 | | $50,400 | $67,600 | | | |
| Fujitsu First Source | | $60,000 | $25,000 | | | | | | |
| LSI Education & Training | | $100,000 | $100,000 | $100,000 | $100,000 | $100,000 | $100,000 | $11,586 | |
| LSI Community Resources | $150,000 | $150,000 | $150,000 | | | | | | |
| **Total** | **$1,180,000** | **$470,000** | **$435,000** | **$548,341** | **$675,984** | **$720,184** | **$849,880** | **$745,963** | **$744,319** |

The original SIP policy stated that the "County Board will agree to establish criteria and a process for allocating the Community Service Fee after consultation with elected officials from all cities within the County. The fee may be used for:

- Mitigating potential impacts of the project.
- Collaborative efforts among City agencies, County agencies, school districts, and community groups to achieve progress as measured by Portland-Multnomah Benchmarks.
- Other uses in the interest of the community."

While the BOCC did pass a resolution in 1998 establishing a multi-year plan for spending a portion of the CSF, this plan has expired and the Board has not established additional criteria for allocating the CSF. In the absence of a policy, the CSF has been used essentially as General Fund money. In the most recent budget cycle (FY2004), the BOCC transferred the majority of that year's CSF, $676,294, to fund General Fund contingency. The General Fund contingency was used to restore cuts to various County programs and contracts.

## Policy needed to guide future SIP agreements

The County established SIP with the idea that such a program was necessary to compete with other jurisdictions for new capital intensive manufacturing facilities and the new, relatively high-paying jobs that come with the facilities. Whether or not programs like SIP are cost effective in the long-run is very difficult to prove.

It is logical to argue that offering abatements once creates the expectation that abatements will be offered again in the future. So, the County should develop a policy now, with clear criteria for granting abatements and that involves participation by all the affected organizations and jurisdictions. This way, the County avoids a pressured decision if a new opportunity becomes available. The SIP statute prohibits jurisdictions from extending the tax abatements granted. However, we believe it is reasonable to assume that companies will attempt to work around this prohibition as the expiration of their current agreements near. While it is not a perfect example, Washington County was obliged to alter its SIP agreement with Intel when the company threatened to expand at another location unless financial penalties for bringing on additional workers were removed from the original agreement.

Critics of these programs argue that companies make decisions regarding where to locate and where to expand based on reasons other than taxes. These critics say that granting tax abatements is simply giving money to companies to do what they would have done anyway and that it is not fair to other companies that do not receive abatements. While it is difficult to prove what a company would do in the absence of tax abatement, it is true that these agreements treat various businesses differently, with businesses established prior to the program's implementation operating without any tax breaks.

Developing and adopting a new policy should also take into consideration other jurisdictions and organizations affected by the granting of property tax abatements. Property tax revenue is distributed among a number of organizations and jurisdictions, but only Multnomah County and Gresham collect fees in lieu of tax revenue. When taking into account the fees levied and when they were paid, Multnomah County collected about 74 percent of the money it would have collected from LSI Logic without the abatement. Table 2 shows those involved in property tax collection, the proportion of property tax revenue they receive, and the revenue forgone as the result of the LSI agreement.

Table 2

| Taxing District | Tax Rates (per $1000 AV) | % Distribution of Tax Payments | Revenue Forgone as a result of LSI Agreement[1] |
|---|---|---|---|
| **City of Gresham** | 3.6129 | 20.8% | $1,064,758 |
| **Bonds** | 0.3084 | 1.8% | $90,889 |
| **Multnomah County** | 4.9381 | 28.4% | $1,455,308 |
| **Bonds** | 0.2361 | 1.4% | $69,581 |
| **Metro** | 0.0966 | 0.6% | $28,469 |
| **Bonds** | 0.1869 | 1.1% | $55,081 |
| **TriMet Bonds** | 0.1239 | 0.7% | $36,515 |
| **Port of Portland** | 0.0701 | 0.4% | $20,659 |
| **Gresham School District** | 4.5268 | 26.0% | $1,334,094 |
| **Bonds** | 2.3166 | 13.3% | $682,726 |
| **Mt. Hood Community College** | 0.4917 | 2.8% | $144,909 |
| **Bonds** | 0.0247 | 0.1% | $7,279 |
| **Multnomah Co. ESD** | 0.4576 | 2.6% | $134,859 |
| **Totals** | 17.3904 | 100.0% | $5,125,128 |

## Contracting controls needed

The majority of the revenue generated by SIP is spent on contracts with various service providers rather than used to fund County programs. This Office has commented in several previous reports on the weaknesses of departments in monitoring and evaluating the effectiveness of contracted services. [2] In the case of contracting with SIP revenues, our concern is not only the deficiencies in a contracting system, but the effect of reorganization and resource reductions on contracting controls. Recent reorganization of SIP management and other offices responsible for managing contracts let with SIP revenue have moved some contract administrative functions out of established systems. Resource reductions have further weakened the contracting controls systems that remain.

The majority of SIP revenue has been awarded or spent by SIP program management, the Office of School and Community Partnerships (OSCP) and its predecessor the Department of Community and Family Services (DCFS). Initially, SIP program contracts were channeled through the contracting process at what was then the Department of Sustainable Community Development.

[1] Because the state public school funding formula takes into account taxes collected, the taxes forgone for schools do not necessarily translate into revenue forgone.
[2] See: Contracted Human Services Audit 2000, Human Services Contracting Follow-up Audit 2003, and Homeless Youth Services Follow-up 2003

The first lump sum of Community Housing funding was distributed out of what was then the Department of Community and Family Services, using its contracting process. Since then, SIP management has been moved to the Chair's office along with the Community Housing function. DCFS was also reorganized, such that the majority of its SIP funding was channeled through the much smaller OSCP. Resource reductions at OSCP have resulted in the elimination of its contract evaluation function. The result of these changes is that the majority of SIP funded contracting is now being managed out of units with either no formal contracting apparatus or one with limited monitoring or evaluation capacity.

# Recommendations

1. The Board of County Commissioners should adopt a new policy for the Strategic Investment Program. Whether the County should or should not be in the business of granting property tax abatements is a difficult question that should be addressed. Adopting a new policy on the Strategic Investment Program will facilitate the discussion of that question and address the need for guidance on the use of current SIP resources.

2. The County should continue its efforts to improve contracting processes. Cases like SIP, that have been displaced within the organization, merit special attention.

## Responses to the Audit

# **Diane M. Linn**, Multnomah County Chair

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TO: Suzanne Flynn, County Auditor

FROM: Diane M. Linn, Chair

DATE: October 29, 2003

RE: Response to Final Draft of SIP Audit

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Thank you for your examination of the Strategic Investment Program. I appreciate your recognition of the excellent work that has been done by the program. Your findings confirm my confidence in this program, its results, and its management. Continuous improvement has been a key component of the program, and your review will contribute further to that effort.

Following are responses to each of the two recommendations listed in the report:

1. A new policy for prospective tax abatements is certainly an appropriate consideration for the Board, as is a new policy regarding use of the annual SIP Community Service Fee revenue.

2. Based upon previous County audits, attention to Multnomah County's contracting processes remains a high priority. These processes should benefit from the County's movement toward a shared services model which will provide consistency in contracting processes and operations throughout the organization.