State Grant and Loan Programs for Businesses

February 1996

Program Evaluation Division
Office of the Legislative Auditor
State of Minnesota

Program Evaluation Division

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Centennial Office Building, Saint Paul, MN 55155 • 612/296-4708

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
CENTENNIAL BUILDING, 658 CEDAR STREET • ST. PAUL, MN 55155 • 612/296-4708 • TDD RELAY 612/297-5353
JAMES R. NOBLES, LEGISLATIVE AUDITOR

February 14, 1996

Members
Legislative Audit Commission

In June 1995, the Legislative Audit Commission directed us to evaluate state grant and loan programs for businesses. The commission wanted an assessment of the programs' effectiveness in helping businesses to create jobs in Minnesota. We focused our evaluation on business assistance programs, particularly the Economic Recovery Grant Program, administered by the Department of Trade and Economic Development (DTED).

For the most part, businesses receiving assistance have created the jobs they promised. Since 1991, firms accepting grants or loans from the Economic Recovery Fund (totalling over $44 million) have created more than 8,300 jobs. But the median wage level was only $7.20 per hour and some of the jobs were not permanent. We also found that DTED has interpreted state law to allow assistance to some businesses that could carry on their projects without the state's help.

We recommend that DTED modify its method of scoring applications for assistance and give preference to businesses that promise to create higher wage jobs. We also recommend that the Legislature clarify the purposes of the program and provide guidance to the department on what kind of businesses should receive assistance.

Our report was researched and written by Tom Walstrom (project manager), Carrie Meyerhoff, and Tara Jebens-Singh, and cost approximately $50,000. We received the full cooperation of the Department of Trade and Economic Development.

Sincerely,

James Nobles
Legislative Auditor

Roger Brooks
Deputy Legislative Auditor

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MINNESOTA OFFICE OF THE LEGISLATIVE AUDITOR

State Grant and Loan Programs for Businesses

EXECUTIVE SUMMARY

State grant and loan programs for businesses are supposed to create jobs.

The Minnesota Legislature created the Economic Recovery Grant program in 1984 to stimulate economic activity and job creation by providing a source of money for businesses. Administered by the Department of Trade and Economic Development (DTED), the program provides grants, loans, and other financial awards to communities on behalf of particular businesses to help finance costs associated with the businesses' expansion, startup, or relocation. Since 1984, the Legislature has appropriated over $68 million in state funds and has used over $35 million in federal funds from a similar program, the Small Cities Community Development Block Grant program.

The Legislative Audit Commission directed our office to study the Economic Recovery Grant program and other programs providing state financial assistance to businesses in the form of grants or loans. We studied the Economic Recovery Grant program and the similar federally-funded Small Cities Community Development Block Grant program (together referred to as the Economic Recovery Fund), as well as the Challenge Grant, Capital Access, and Small Business Development Loan programs. Our study addressed the following questions:

- **What does previous research show about the effectiveness of business financial incentives?**
- **How do Minnesota's economic development tools compare with those used in other states?**
- **Are current grant criteria and proposal review procedures adequate?**
- **What is the track record of the Economic Recovery Grant program, as well as other state economic development programs, in creating and retaining jobs? What are the wage levels of the jobs that are created?**
- **Has the state received repayments from past Economic Recovery loans as required in law? How has the money retained by communities in local revolving loan funds been used?**

To answer these questions, we reviewed the literature on state economic development policies; collected information from economic development officials in neighboring states; interviewed the program administrators and loan officers at the Minnesota Department of Trade and Economic Development; reviewed the files of 176 projects that were funded by the Economic Recovery Grant or Small Cities programs between fiscal years 1991 and 1995; reviewed department records on the Challenge Grant, Capital Access, and Small Business Development Loan programs; interviewed decision makers at businesses that were beneficiaries of state loans or grants; and conducted a survey of local government revolving loan fund administrators.

STATE FINANCIAL INCENTIVES

States have offered incentives to businesses since the earliest days of this country, but the use of incentives has increased markedly over the past 15 years. The literature shows that business executives increasingly expect government assistance when they expand.

Many economists maintain that granting financial incentives to businesses to create jobs is a "zero-sum" game on a national level. In other words, they say that incentives may not actually create jobs, they may just move them from one place to another. Nevertheless, it may be rational for a state to offer financial incentives if it can entice more firms to move into or expand inside its borders rather than in other states or countries. Studies of industrial plant location decisions show that financial incentives from governments play a relatively small part in business decision making, but they can make a difference after other factors have been taken into account.

ECONOMIC RECOVERY GRANT PROGRAM

The Economic Recovery Grant program is the state's main program for job creation and retention. We examined all grants, loans, and forgivable loans made by the program between 1991 and 1995 and found that the 176 projects assisted during that period created over 8,300 jobs. Manufacturing companies received about 80 percent of the funding and created about 60 percent of the jobs.

A high proportion of businesses receiving assistance met their job creation goals.

Companies generally have two years to create the jobs they promise. Table 1 shows that a high proportion of projects met their job creation goals. Those that did not meet their goals within two years, including nine firms that went out of business during the period, fell short by a total of 1,022 jobs.

We verified companies' job claims with separate information they report to the Department of Economic Security (DES) and found that the information was consistent. But, sometimes the jobs created were not permanent. For the 112 compa-

Table 1: Economic Recovery Fund, FY 1991-95, Jobs Promised and Created by Project Status

Project Status	Number of Projects	Projects that Met Job Goals[4]	Number of Jobs Promised	Number of Jobs Created	Percent of Jobs Promised
Open < 2 years[1]	50	13	2,101	1,947	93%
Open > 2 years[2]	9	4	570	491	86
Closed[3]	96	78	5,594	5,898	105
Total	155	95	8,264	8,337	101%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

[1]Includes all projects originating in FY 1993-95 that have not been completed for which job creation information was provided.

[2]Includes all projects originating in FY 1991-92 that have not been completed for which job creation information was provided.

[3]Includes all projects that have been completed for which job creation information was provided.

[4]Includes all projects that met or exceeded job goals or were below job goals by less than 1 FTE job.

Sometimes the jobs created were not permanent.

nies for which information was available, we found 21 did not maintain employment levels at the level agreed to.

- **Three of the companies had gone out of business, five did not meet their job goal within two years as required, and thirteen met their job creation goal but employment levels fell after the project was "closed out."[1]**

Employment levels at five companies fell to levels lower than when they had applied for the loans. One company had a forgivable loan but had not met its job goals in the required two-year period.

We also examined the wage levels of the jobs created and determined whether they included benefits. As Table 2 shows, we found that:

The average wage of the jobs created was $8.64, although the median was $7.20.

- **The average wage of the jobs created with assistance from the Economic Recovery Fund was $8.64 per hour; the median wage was $7.20 per hour.**

1 Since December 1994, one additional company with 109 jobs has gone out of business.

Table 2: Economic Recovery Fund, FY 1991-95, Average and Median Wage by Region

Region	Number of Projects	Number of Jobs	Median Wage	Average Wage	1993 Region Average Wage[1]
Central	22	1,173	$7.00	$8.18	$9.54
Metro	16	1,069	9.00	10.78	13.85
Northeast	9	483	7.26	9.35	10.63
Northwest	6	600	5.95	6.73	8.88
Southeast	29	913	7.71	9.12	10.48
Southwest	13	253	6.58	7.95	8.89
West Central	10	488	5.50	6.20	8.62
Total	105	4,979	$7.20	$8.64	$12.36

Note: "Economic Recovery Fund" refers to both the state and federal funded programs. The table includes all projects for which wage information was available.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

[1]1993 Minnesota Average Covered Employment and Wages, Department of Economic Security.

Wage levels have increased slightly, but inflation probably accounts for some of the increase.

Table 3 shows the average and median wages by the year of the project's origination.[2] The table shows a slight trend of increasing wages by the year of project origination, although some of the increase may be due to inflation. Table 4 shows that state grants and loans tended to create jobs with higher wages than those from the federal program.

Table 3: Economic Recovery Fund, FY 1991-95, Average and Median Wage by Fiscal Year of Award

Fiscal Year Project Originated	Number of Projects	Number of Jobs	Median Wage	Average Wage
1991	7	205	$6.79	$7.36
1992	17	619	7.00	7.57
1993	26	1,070	7.40	9.22
1994	32	1,682	7.00	8.31
1995	23	1,404	7.50	9.26
Total	105	4,979	$7.20	$8.64

Note: "Economic Recovery Fund" refers to both state and federal funded programs.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

2 DTED has required companies to report on wages and benefits since 1993. Because of the way companies report to DTED, the jobs could have been created in any fiscal year. For example, projects originating in 1991 could have hired people and reported to the department in 1993. The department also notes that the numbers for 1994 and 1995 may change as more jobs are created.

Table 4: Economic Recovery Fund, FY 1991-95, Average and Median Wage by Source

Source	Number of Projects	Number of Jobs	Average Wage	Median Wage
State	89	4,160	$8.87	$7.50
Federal	16	819	7.51	6.00
Total	105	4,979	$8.64	$7.20

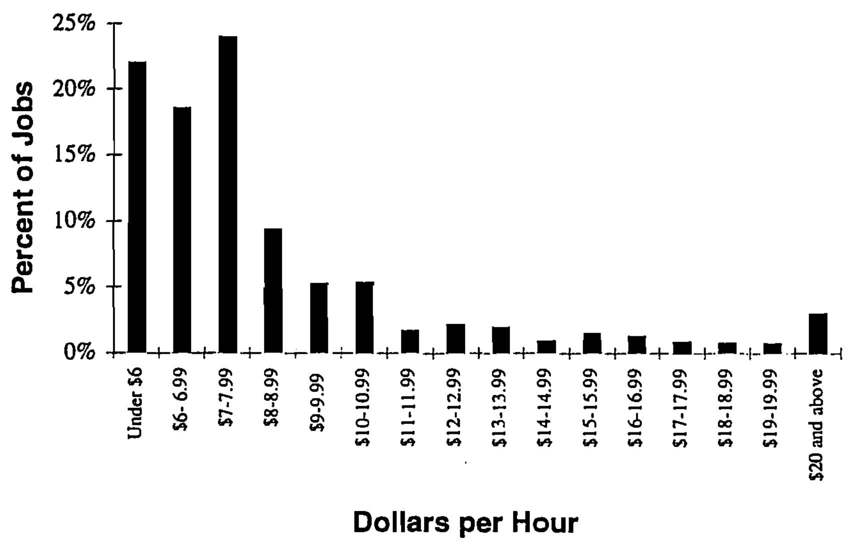
Note: The table includes all jobs for which wage information was available.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

The distribution of the jobs created is skewed towards lower wage levels.

Figure 1 shows that the distribution of jobs is skewed towards lower wage levels, with 63 percent of the jobs paying less than $8.00 per hour. One explanation for this pattern is that projects funded by the federal Community Development Block Grant (CDBG) are required to fill 51 percent of the jobs created with low and moderate income (LMI) individuals. Also, state rules have been interpreted to require the state-funded program's jobs be filled by or "made available to" LMI persons. The department has interpreted this to mean that the jobs should not require specialized training. However, in the current economic environment, when unemployment rates in many areas of the state are around 3 percent, the Legislature might want to reconsider the LMI restriction on state funds. In our opinion, the state program should have the flexibility to assist companies that create jobs that require specialized training and offer higher salaries.

Figure 1: Economic Recovery Fund, FY 1991-95, Wage Distribution



Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development reports.

We recommend:

- **DTED should separate the requirements for state Economic Recovery funds from the federal CDBG program, thus permitting assistance to companies that create high-wage jobs.**

Most jobs that were created provided employee benefits.

We also examined whether the jobs created by the grants and loans provided benefits and found that in most cases they did. For the jobs for which information was available, we found:

- **Approximately 90 percent of the jobs created provided health care, 56 percent dental benefits, 85 percent life insurance, and 62 percent retirement benefits.**

"Gap Financing" Versus "Incentive Financing"

Another important issue is whether the Economic Recovery Grant program should provide assistance only to businesses that can demonstrate financial need, or whether it can be used as an incentive for businesses to remain, relocate, or expand in Minnesota even if they could do so without financial help from the state. The former strategy is often known as "gap financing," while the latter is called "incentive financing." In our review of projects funded since 1991 we noted some projects where there was no evidence of financial need for the company assisted.

- **Even though the 1995 Legislature tried to limit "incentive financing," DTED has continued to award some "incentive" grants and loans.**

The department has given a liberal reading to the 1995 legislation, interpreting it to mean that a company being offered incentives by other states cannot otherwise secure "sufficient financing." This interpretation has allowed DTED to make awards to firms that considered relocating a portion of their business in other states but were able to fund their project internally or through market financing.

The Legislature needs to give the department clearer directions about the program's purpose.

Because of the apparent inconsistency between the statute and DTED's current practice, we recommend:

- **The Legislature should further clarify the goals and purpose of the program and provide clearer direction on whether it wants to allow "incentive financing."**

There are two aspects to this: first, deciding whether "incentive financing" should be included under the program, and, second, if "incentive financing" is permissible, under what rules it should be administered. The Legislature may 1) allow unrestricted incentive financing, 2) allow incentive financing under some circumstances, 3) prohibit incentive financing altogether (and strengthen the language in statute), or 4) provide for separate pools of money for the two types of financing, each with its own eligibility criteria.

Since there is a great deal of competition between states for expanding companies, the Legislature might consider allowing "incentive financing" in some circumstances, but restrict the funding to infrastructure or job training purposes. In that way, the funding would provide an investment in the state's physical or human capital while providing a less direct subsidy to the benefiting company.

The Legislature might consider restricting "incentive financing" to infrastructure or job training purposes.

Grant Criteria and Approval

We also evaluated DTED's current process for reviewing applications and determining eligibility for projects and found that it could be improved. The current Economic Development Score Sheet includes important elements that are subjective, measures the same criteria more than once, gives preference to projects outside the metro area, utilizes criteria that do not differentiate between projects, and does not consider the wage level and benefit availability of the jobs to be created.

We recommend that:

- **DTED should revise its scoring system for the Economic Recovery Fund.**

In our opinion, the revised scoring sheet should eliminate subjective criteria and criteria that do not differentiate projects and it should consider the job type, wage, and benefit level. The scoring sheet should also consider demographic factors on some type of relative sliding scale basis.

LOCAL ECONOMIC DEVELOPMENT

In reviewing the Economic Recovery Fund we were somewhat surprised to learn that it was only a small component of most of the projects it financed. We found:

- **Local and regional programs are very important components of economic development in Minnesota.**

Most projects had multiple financial participants.

For example, we found that most projects funded by the Economic Recovery Fund between 1991 and 1995 had local or regional financial participants such as city, county, or regional revolving loan funds, tax increment financing (TIF), Economic Development Agencies (EDAs), Regional Development Commissions, regional initiative funds, power companies, and a wide variety of other financial entities. We found that the average Economic Recovery Fund project between 1991 and 1995 had three sources of financing in addition to the state.

Public financing other than the Economic Recovery Fund was a part of 136 of the 176 funded projects: Thirty-five of the projects used local revolving loan funds, 40 used tax increment financing, and 56 used loans from the Minnesota initiative funds. These 136 projects received an average of over $586,000 in public grants or loans for about $80 million, not including $33 million from the Economic Recovery Fund. In other words, the state Economic Recovery Fund provided only slightly over 29 percent of the public financing for the projects that were funded. Claims about the numbers of jobs created need to take into account the fact that there are often multiple sources of public subsidy for the projects.

There is no comprehensive data source on local revolving loan funds. We surveyed local governments and found:

- **Over 237 local revolving loan funds exist, up from 157 in 1989. Capital has grown to over $110 million, up from $42 million in 1989.**

Local revolving loan funds had over $110 million in capital and made almost 2,300 loans in the last five years.

The 237 funds made almost 2,300 loans between 1990 and 1994. However, 27 funds made no loans, another 27 made only one, and 20 funds made only two loans during the five year period. Forty-seven percent of fund administrators told us they had more capital available than the amount of loans requested during the previous 12 months, 23.9 percent responded that the amount of capital was equal to the loans requested, and 22.9 percent said that the capital was inadequate for the loans requested. Although there was over $110 million in total capital statewide, the median fund had only $101,000 in total assets. Of the $110 million in total assets, there was over $35 million available to lend.

Based on our findings, we think that it might be advantageous to manage loan funds on a regional instead of local level. Administering loan funds regionally would allow for portfolio diversification that only the very largest funds have now. Regional funds also could avoid the problem of having to carry large balances when good lending opportunities are scarce. Regional funds could also benefit from economies of scale and could afford more professional management than individual communities. Therefore, if the Legislature wants to continue to provide loan funds to local communities, we recommend that:

- **The revolving loan funds should be administered at the regional level.**

Loan Repayments and Defaults

Loans made from the state portion of the Economic Recovery Fund are repaid by businesses to local communities and to the state. Local units of government receive and keep the first $100,000 for use in local revolving loan programs. The state receives repayment for loans greater than $100,000. Repayments are deposited in the General Fund. Funds from the federal CDBG program are all retained by the local government.

We found that:

- **Since 1984, the state has received repayment for most past loans over $100,000, although 10.4 percent of companies have gone out of business and defaulted.**

We found that 33 of 318 companies have gone out of business, and defaulted on 6.7 percent of the funds lent. For federally financed projects, 11.3 percent of the companies have gone out of business, defaulting on 8.9 percent of the funds lent. The default rate appears to have decreased in recent years. In part, this is because many of the more recent loans have not had to begin repayment yet. It is also probably partially attributable to a change of policy at DTED to not make loans for working capital. Loans for working capital tend to be riskier and have a higher default rate.

The state General Fund is scheduled to receive repayments of $1,205,000 in fiscal year 1996, $1,455,000 in fiscal year 1997, and $1,174,000 in fiscal year 1998. As of June 30, 1995, over $1.7 million had been repaid to the General Fund and an additional $19.3 million is scheduled to be repaid in the future. As of June 30, 1995 almost $3.5 million in loans had been repaid to the Economic Recovery Fund.

OTHER DTED LOAN PROGRAMS

We also examined the Rural Challenge Grant, Capital Access, and Small Business Development Loan programs.

Rural Challenge Grant Program

The 1987 Legislature created the Rural Challenge Grant program to provide job opportunities for low-income individuals, stimulate private investment, and promote economic activity in rural areas. The original appropriation included $5 million of federal funds and $1 million of state funds; in 1993, an additional $6 million was allocated. Money from the state provides up to half of the Challenge Grant dollars and a regional initiative fund provides the rest. Between fiscal years 1989 and 1994, initiative funds made 393 challenge grant loans for a total of almost $23 million. The average loan size statewide was $58,032.

Challenge grants created over 6,400 jobs at an average wage of $7.67.

We found that 369 projects receiving Challenge grants between fiscal years 1989 and 1994 created over 6,400 full-time and over 740 part-time jobs. The average wage of new full-time jobs created was approximately $7.67. Of the new full-time jobs, approximately 54 percent offered health care, 11 percent offered dental coverage, 36 percent offered life insurance, and 23 percent offered retirement benefits.

We have some concerns over the accuracy of job creation data. The initiative funds report data in different formats and do not clearly define job creation, wage, and benefit information presented in the annual reports. In addition, for over half of the companies receiving loans in 1994, some information reported by the initiative funds in their annual reports was different from the information reported for DTED's performance reports. We recommend that DTED should provide guidance and instruction to the initiative funds on collection, calculation, and reporting of data and develop a standardized reporting format.

Capital Access Program

The 1989 Legislature created the Capital Access program to encourage banks to make loans to businesses, particularly small and medium-sized businesses, that have difficulty obtaining commercial loans. DTED, the borrower and lender each contribute a percent of the loan to a reserve fund established at the lending institution. The idea is that a bank will make several Capital Access loans, creating a portfolio covered by the reserve fund containing the contributions for all of the enrolled loans. As of October 30, 1995, 17 banks had made 128 loans worth over $4.5 million in the Capital Access program. The average Capital Access loan was $36,315.

Although it is popular among bankers to whom we spoke, less than 6 percent of Minnesota banks are signed up to participate in the Capital Access program. We think that DTED should investigate why more banks do not participate in the program.

Small Business Development Loan Program

The Small Business Development Loan program provides loans to small businesses through the issuance of tax-exempt revenue bonds. The businesses must be manufacturers and have fewer than 500 employees. Between 1985 and 1995, the program issued over $50 million in bonds and made 38 loans ranging from $250,000 to over $4 million. The average Small Business Development loan is approximately $1.4 million, with a median of $1 million. Four loans have defaulted, resulting in a loss of over $2 million. DTED obtained job creation information for 23 companies. The 23 companies promised to create 642 jobs, and ended up creating 1,312. Twenty of the companies reported meeting or surpassing their job creation goals.

Introduction

In 1984, the Minnesota Legislature created the Economic Recovery Grant program in response to the economic recession of the early 1980s. The intention of the Legislature in creating the program was to stimulate economic activity and job creation by providing a source of financing for businesses. Administered by the Department of Trade and Economic Development (DTED), the program provides grants, loans, and other financial awards to communities on behalf of particular businesses to help finance costs associated with the businesses' expansion, startup, or relocation activities. The Legislature has appropriated between approximately $5 million and $6 million each fiscal year for the program. No appropriation was made for fiscal year 1997.

Following reports of financial assistance offered to businesses that may not have had a financial need for public assistance, some Legislators began to question how the Economic Recovery Grant program was being used. Legislators also raised questions about the types of jobs businesses were creating with public assistance and their wages and benefits.

In response to these questions, the Legislative Audit Commission directed our office to study the Economic Recovery Grant program and other programs providing state financial assistance to businesses in the form of grants or loans. In addition to the Economic Recovery Grant program and the similar federally-funded Small Cities Community Development Block Grant program, we looked at the Challenge Grant programs, the Capital Access program, and the Small Business Development Loan program. Our study addresses the following questions:

- **What does past research show about the effectiveness of business financial incentives?**
- **What kinds of economic development tools are used by state government agencies in Minnesota? How do they compare to those used in other states?**
- **Are current grant criteria and proposal review procedures adequate? Does department staff attempt to determine what level of financial support is necessary for the project to proceed? How does staff determine whether a project gets a grant or a loan?**

- **What is the track record of the Economic Recovery Fund in creating and retaining jobs? What wages have the jobs created paid?**

- **Has the state received repayments from past Economic Recovery loans? How many loans have been "forgiven?" What is the loan repayment schedule to the general fund for future years? How has the money retained by communities in local revolving loan funds been used?**

- **What are the job creation records of the Challenge Grant, Capital Access, and Small Business Development Loan programs?**

To answer these questions, we reviewed the literature on state economic development policies; collected information from economic development officials in neighboring states; interviewed the program administrators and loan officers at the Minnesota Department of Trade and Economic Development; reviewed the files of 176 projects that were funded by the Economic Recovery Grant or Small Cities programs between fiscal years 1991 and 1995; reviewed department records on the Challenge Grant, Capital Access, and Small Business Development Loan programs; interviewed decision-makers at businesses that were beneficiaries of state loans or grants; and conducted a survey of local government revolving loan fund administrators.

Chapter 1 reviews the literature on the effectiveness of state programs that purport to assist businesses in creating jobs. Chapter 2 reviews the state's primary program designed to assist in job creation and retention, the Economic Recovery Grant program. Chapter 3 reviews other local economic development programs, the repayment of loans made by the Economic Recovery Grant program, and the use of local economic development revolving loan funds. Chapter 4 reviews the Challenge Grant, Capital Access, and Small Business Development Loan programs.

State Economic Development Programs

CHAPTER 1

The use of business financial incentive programs has increased nationwide in the last 15 years. Minnesota has followed other states in creating a variety of programs designed to entice firms to relocate or expand in the state, as well as to help existing businesses stay in Minnesota and expand. The increased use of business incentives by states and the trend toward businesses expecting or demanding incentives has, however, raised concerns. In this chapter we address the following questions:

- **What does research show about the effectiveness of business financial incentives?**

- **What state-level programs does Minnesota use to assist business and how do they compare with those in other states?**

Some people describe the competition for businesses as "the second war between the states."

Some journalists use a battlefield metaphor to describe the competition among states for business expansions and relocations.[1] They call it the "second war between the states." In general, this chapter shows that the "war" continues and Minnesota participates in it. Minnesota's business incentive programs are comparable to those of our neighboring states, though they are far less aggressive than those of many other states. We review the business incentive programs operated by Minnesota's Department of Trade and Economic Development in detail in chapters 2 and 4.

THE HISTORY OF STATE FINANCIAL INCENTIVES

State financial incentives are not new. In 1640, Massachusetts granted the first business incentives in the U.S.[2] During the 1930s, southern states began aggressive campaigns to entice northern industrial firms to relocate, packaging tax incentives, industrial development bonds, loans, and gifts to defray moving and startup costs.

1 See for example, "The Second War Between the States: A Bitter Struggle for Jobs, Capital, and People," *Business Week*, May 17, 1976, 92 and "War Between the States," *Newsweek*, March 30, 1988, 45.

2 Sandra Kantor, "A History of State Business Subsidies," National Tax Association, Proceedings of the Seventieth Annual Conference on Taxation (Louisville, Ky., 1977), 147-155.

While business financial incentives are not new, their use increased markedly in the late 1970s and early 1980s. Many analysts mark 1976 as the beginning of the modem bidding war for business when New Stanton, Pennsylvania won a new Volkswagen auto assembly factory with a $71 million incentive package.[3] Other large incentive competitions include the following:

The use of financial incentives has increased markedly in the last 15 years.

- 1980 - Tennessee gave $33 million in incentives to Nissan to locate in Smyrna.
- 1984 - Mazda received $48.5 million to locate a manufacturing plant in Michigan.
- 1985 - Diamond-Star Motors received $83.3 million to locate an assembly plant in Illinois.
- 1985 - Tennessee gave $80 million in incentives to General Motors for its Saturn manufacturing plant in Spring Hill.
- 1985 - Toyota received $149.7 million to locate an assembly plant in Georgetown, Kentucky.
- 1986 - Fuji-Izuzu received $86 million in incentives to locate in Indiana.
- 1991 - United Airlines located an aircraft maintenance base in Indianapolis after receiving an incentive package estimated at $300 million.
- 1992 - BMW located an auto plant in South Carolina after receiving $150 million in incentives.
- 1994 - Mercedes Benz located an auto assembly plant in Alabama after receiving a $253 million incentive package.
- 1994 - Sears received $240 million from the State of Illinois to not relocate its corporate headquarters.

These are just a few of the many large business projects that have received financial assistance from a state government. It is important to keep in mind, however, that most economic development at the state and local levels is more modest and less visible. The use of business financial assistance programs by states is pervasive. In its most recent directory of business assistance programs, the National Association of State Development Agencies noted an increase in capital assistance for individual businesses through low-interest loans, guarantees, and interest subsidies over the years.[4]

3 John Hood, "Ante Freeze: Stop the State Bidding Wars for Big Business," *Policy Review* (Spring 1994), 63. Volkswagen's production at the plant never met the capacity, only half the envisioned workers were hired, and the plant ultimately closed in July 1988.

4 National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition,* (Washington, D.C., 1995).

States continue to add business incentive programs.

Even in the midst of revenue shortfalls in the early 1990s, state legislatures created new business incentives and overhauled existing ones. In 1992, 40 percent of states responding to an annual survey said they had created new business development incentives.[5] In the following year, 59 percent said they had created new business development incentives, and 61 percent said they had created incentives for retention of existing businesses.[6] As state economies improved, legislatures across the country approved even more incentives for business. In 1995, 41 states reported that they offer loans for building construction, 43 reported offering loans for machinery and equipment, and 44 states reported providing financial assistance for the expansion of existing plants.[7]

Table 1.1 shows that, between 1985 and 1995, states continued to increase the number and variety of their business incentive programs. Also, more business executives are actively seeking government assistance. According to another *Site Selection* survey: "... corporate real estate executives who say they actively seek incentives jumped from twenty-eight to fifty-seven percent during 1988-1993."[8]

ARE BUSINESS FINANCIAL INCENTIVES EFFECTIVE?

There is disagreement about the effectiveness of incentives.

Many economists maintain that granting financial incentives to businesses to create jobs is a "zero-sum" game at the national level. In other words, they say that incentives do not actually create jobs, they just move them from one place to another. Art Rolnick, senior economist at the Minneapolis Federal Reserve Bank, goes further, maintaining that economic incentives are actually a "negative-sum" game because they misallocate resources. Rolnick and Federal Reserve counsel Melvyn Burstein have said that "there will be fewer public goods produced in the overall economy because, in the aggregate, states will have less revenue... In addition to this loss, the overall economy becomes less efficient because output will be lost as businesses are enticed to move from their optimal locations."[9] Rolnick advocates that the federal government intervene and use the commerce clause of the Constitution to prevent states from using financial incentives.

Some other economists argue that government interventions such as business financial incentives can be justified in cases of market failure. Advocates of this

5 Conway Data surveys state economic development officials annually to find out about economic development activity in each state. The results are published in the magazine *Site Selection and Industrial Development.*

6 *Site Selection and Industrial Development,* Vols. 37 and 38, No. 5. Business incentives include tax incentives, direct financial assistance, and other incentives.

7 *Site Selection and Industrial Development,* Vol. 40, No. 5, 796.

8 *Economic Development Review* (Summer 1995), 87.

9 Melvin Burstein and Arthur Rolnick, "Congress Should End the Economic War Among the States," *1994 Annual Report* (Federal Reserve Bank of Minneapolis), 7.

Table 1.1: Trends in the Use of Economic Development Incentives, 1985 to 1995

	Number of States Offering the Incentive						
	1985	1990	1991	1992	1993	1995[a]	Change 1985-95
State sponsored industrial development authority	38	40	40	40	40	42	4
Privately sponsored development credit corporation	37	36	38	38	39	39	2
State authority or agency revenue bond financing	41	44	43	44	44	44	3
State authority or agency general obligation bond financing	13	18	19	20	20	20	7
City and/or county revenue bond financing	49	49	49	49	49	49	0
City and/or county general obligation bond financing	31	37	36	37	37	37	6
State loans for building construction	34	40	41	40	40	41	7
State loans for equipment and machinery	33	42	42	41	42	43	10
City and/or county loans for building construction	26	39	41	44	45	46	20
City and/or county loans for equipment and machinery	26	38	41	44	45	46	20
State loan guarantees for building construction	26	28	25	26	28	27	1
State loan guarantees for equipment and machinery	21	29	28	28	31	30	9
City and/or county loan guarantees for building construction	n/a	10	10	13	15	16	n/a
City and/or county loan guarantees for equipment and machinery	n/a	8	10	13	15	16	n/a
State financing aid for existing plant expansion	39	44	44	44	44	44	5
State matching funds for city and/or county industrial financing programs	15	22	22	25	26	26	11
State incentive for establishing industrial plants in areas of high unemployment	25	36	40	41	41	41	16
City and/or county incentive for establishing industrial plants in areas of high unemployment	30	32	33	35	35	35	5
Tax incentive for job creation	30	40	43	44	44	44	14

Sources: 1985--*Site Selection and Industrial Development*, as cited in Chi, Keon S., *The States and Business Incentives: An Inventory of Tax and Financial Incentive Programs*, Council of State Governments, 1989, 5 and 10. Other years--*Site Selection and Industrial Development*, Vols. 35, 36, 37, 38, and 40, No. 5.

n/a = Information was not available.

[a]Information for 1994 was not available.

view cite market failures in access to productivity enhancing information[10] and in access to capital for smaller firms and firms in more rural areas of the state.[11] Economist Tim Bartik notes that government financial incentives can serve social goals by targeting programs at distressed or high unemployment areas.[12]

Despite economists' doubts, it may be rational for individual states to offer incentives.

Economists' arguments aside, it may be rational for an individual state to pursue financial incentives if the incentives can entice more firms to move into or expand in the state than in competing states or countries. However, studies of industrial plant location decisions show that financial incentives from governments play a relatively small part in decision-making. Table 1.2 shows the results of a recent Deloitte-Touche survey of corporate real estate executives on the relative importance of different site selection factors. It and other studies we reviewed suggest that traditional location factors such as access to markets, raw materials, transportation, and a quality work force are the primary determinants for site selection.

Table 1.2: Location Decision Factors (In Order of Importance)

Factor	Respondents
1. Real Estate Costs	108
2. Labor Force Issues	96
3. Transportation	95
4. Real Estate Availability	92
5. Market Access	91
6. Regulatory Environment	89
7. Labor Costs	82
8. Community Image	76
9. Tax Climate	76
10. Utility Services	71
11. Utility Costs	63
12. Quality of Life	61
13. Business Services/Technical Support	53
14. Incentives	50
15. Education System/Training Infrastructure	48
16. Proximity to Suppliers/Raw Materials	45
17. University Resources	20

Source: John Mackay, "The Evolving Importance of Incentives," *Economic Development Review* (Fall 1994), 5.

10 Tim Bartik, "Is State and Local Economic Development a Zero-Sum Game?" in *Proceedings: State and Local Economic Development Strategy Summit* (Minneapolis: University of Minnesota, 1994), 19-23.

11 Julia Mason Friedberg, "Improving Capital Market Efficiency Through State Programs," *Governor's 1987 Economic Report* (State of Minnesota), 128-156.

12 Bartik, "Is State and Local Economic Development a Zero-Sum Game?" See also Bartik, "Economic Development Incentive Wars," Upjohn Institute Employment Research (Spring 1995).

A 1989 review of the site selection and economic incentive literature done for the Council of State Governments concluded the following:

- **Business incentives, as defined in these studies, are not the primary or sole influence on business location decision-making;**
- **Business incentives, relative to other factors, do not have a significant or primary effect on state employment growth;**
- **Business incentives do become more effective when all other variables are equal among competing sites within a region or sub-state area; and**
- **Business incentives are important in that they are often used as a component in business climate indices.**[13]

A study by Brinton Milward and Heidi Newman, also based on a review of the literature on site selection, concluded:

> Traditionally, the overriding concerns in an industrial location decision were access to labor, transportation, markets, and raw materials. Although these business factors are still of paramount importance, research has recently highlighted the importance of state economic development programs and the fact that the location decision is a multistage process. Consideration is now given to local and state tax systems, education, the industrial climate, and labor skills.[14]

Studies conclude that state incentives can make a difference in some cases.

John Blair and Robert Premus have also noted that site selection is a multi-stage process with the earlier stages dominated by market and labor force considerations and later stages affected more by other variables such as quality of life.[15] It is at the last stage that business incentives might play a role in site selection. These findings are consistent with the Deloitte-Touche survey which found that 53 percent of the responding site selection executives said that incentives act as a tie-breaker when the decision among sites is narrowed to a few locations that are equally attractive.[16]

In spite of uncertainty about the effectiveness of financial incentives in increasing economic growth, they remain popular. There are several alternative explanations for this, but we find the "arms race" theory of Barry Rubin and C. Kurt Zorn[17]

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13 Roger Wilson, *Economic Development in the States: State Business Incentives and Economic Growth: Are They Effective? A Review of the Literature.* (Lexington, Ky.: Council of State Governments, 1989).

14 Brinton Milward and Heidi Newman, "State Incentive Packages and the Industrial Location Decision," *Economic Development Quarterly* (August 1989), 208.

15 John Blair and Robert Premus, "Major Factors in Industrial Location: A Review," *Economic Development Quarterly* (February 1987), 72-85.

16 John Mackay, "The Evolving Importance of Incentives," *Economic Development Quarterly* (Fall 1994), 4-6.

17 Barry M. Rubin and C. Kurt Zorn, "Sensible State and Local Economic Development," *Public Administration Review* (March/April 1985), 333-339.

and Paul Peretz[19] most convincing. Peretz notes that states are forced into the "arms race" of matching and beating incentives provided by other states because of their inability to act collectively. Rubin and Zorn explain:

> As regions, states and localities watch their neighbors attract jobs and economic activities the desire is to get a piece of the action. As more and more governmental units offer industrial location incentives to help tip business location decisions in their favor, support is lent to the belief that these incentives are necessary and that they significantly affect choices... Policymakers are afraid that if they do not participate in the economic development bidding game (e.g., business incentives), their jurisdiction will lose jobs, economic stability and the appearance of vitality and robustness.[20]

Support for the "arms race" theory was bolstered by remarks made recently by the DTED Director of Business and Community Development:

> We can't afford to unilaterally disarm ourselves. We'll jeopardize our growth and expansion in a very severe way. We simply want a tool to be able to respond in some manner when other states are putting substantial financial packages at these companies' feet.[21]

The National Governors' Association has responded to the concern about the increased use of financial incentives for business. Between 1991 and 1993 the Governors held three meetings on the issue of economic growth and incentives. The resulting policy on Economic Growth and Development Incentives was adopted by the Governors in 1993 and emphasizes partnership between state government and business.[22] The policy notes:

> States will always be in competition with one another for business investments. However, this competition should focus on how each state attempts to provide a business climate in which existing businesses can operate profitably and expand and new businesses can be established and survive. The competition should be judged on factors such as improvements in education, transportation, and telecommunications; stable fiscal conditions; tax policies; business regulation; and the provision of quality public services.[23]

MINNESOTA BUSINESS ASSISTANCE PROGRAMS

In this section we briefly review Minnesota's non-agricultural business assistance programs shown in Figure 1.1. The state Economic Recovery program is the main

19 Paul Peretz, "The Market for Incentives: Where Angels Fear to Tread?" *Policy Studies Review*, 5 (February 1986), 624-633.

20 Rubin and Zorn, 333-334.

21 Quoted in Dave Beal, "Will Depleted Development Fund be Replenished?" *St. Paul Pioneer Press* (October 30, 1995), 1B.

22 See Jay Kayne and Molly Shonka, "Rethinking State Development Policies and Programs," (Washington D.C.: National Governors' Association, 1994).

23 Ibid., 25.

Figure 1.1: State of Minnesota Business Assistance Programs by Department

Program	Department/Office and Statutory Authority	Purpose	Funding Level (not always available)
Advantage Minnesota, Inc.	Department of Trade and Economic Development 116J.693	To market the economic development potential of the state, in order to enhance the state's economic growth.	$200,000 (1995)
Minnesota Project Innovation	Department of Trade and Economic Development 116J	To help small, high technology businesses and individuals develop and market their leading technologies by securing research and development funds through the Small Business Innovation Research (SBIR) program.	$494,000 (1995)
Minnesota Technology, Inc.	Minnesota Technology, Inc. 116O.03	To "foster long-term economic growth and job creation by stimulating innovation and development of new products, services, and production processes through energy conservation, technology transfer, applied research, and financial assistance. To build on the existing education, business, and economic development infrastructure."	$5,198,000 (1995)
Agricultural Utilization Research Institute	Minnesota Technology, Inc. 116O.09	To "promote the establishment of new products and product uses and the expansion of existing markets for the state's agricultural commodities and products."	$3,958,000 (1995)
Project Outreach	Minnesota Technology, Inc. 116O.091	To, 1) facilitate the transfer of technology and scientific advice from the University of Minnesota and other institutions to businesses in the state that may make economic use of the information; and 2) to assist small and medium-sized businesses in finding technical and financial assistance providers that meet their needs.	$947,000 (1995)
Seed Capital Fund	Minnesota Technology, Inc. 116O.122	To "implement a centrally managed seed capital fund to invest in early stage companies and small companies in Minnesota through equity or equity-type investments."	$7 million (1992)
Economic Recovery Grants	Department of Trade and Economic Development 116J.873	To provide "money to carry out specified programs, services, or activities designed to create new employment, maintain existing employment, increase the local tax base, or otherwise increase economic activity in a community."	$6,017,000 (1996)
Capital Access Program	Department of Trade and Economic Development 116J.8761	To "provide capital to businesses, particularly small and medium-sized businesses, to foster economic development."	$500,000 (1995, from the Economic Recovery Grant fund) No new money appropriated.

Figure 1.1: State of Minnesota Business Assistance Programs by Department, continued

Program	Department/Office and Statutory Authority	Purpose	Funding Level (not always available)
Small Business Development Loan Program	Agricultural Resource Loan Guaranty Program 41A.036	To create jobs and provide loans for business expansion.	No appropriated funds. Revenue bonds.
Job Skills Partnership Program	Minnesota Job Skills Partnership 116L.02	To "act as a catalyst to bring together employers with specific training needs with educational or other nonprofit institutions which can design programs to fill those needs."	$1,987,000 (1996) $1,962,000 (1997)
Urban Challenge Grants Program	Urban Initiative Board 116M.18	To "encourage private investment, provide jobs for minority persons and others in low-income areas, to create and strengthen minority business enterprises, and to promote economic development in a low-income area."	$6 million (1994) No new appropriated funds.
Challenge Grant Program	Rural Development Board 116N.08	To "encourage private investment, to provide jobs for low-income persons, and to promote economic development in the rural areas of the state."	$6 million (1994) No new appropriated funds. (Repayments)

Source: Department of Trade and Economic Development.

state-level grant and loan program and we discuss it in detail in Chapter 2. The Challenge Grant, Small Business Development Loan, and Capital Access programs are discussed in Chapter 4.

Advantage Minnesota

Advantage Minnesota, created by the 1991 Legislature, is a nonprofit corporation responsible for marketing Minnesota's strengths as a place for doing business to companies outside the state borders.[24] The corporation is a public-private partnership governed by a 43-member board of directors, consisting primarily of Minnesota business leaders. The organization has a full-time staff of five.

Advantage Minnesota's budget is made up of public appropriations and private contributions, with the public dollars available only as long as there is at least a 1-to-1 match of private contributions. Since its creation, Advantage Minnesota has requested an annual appropriation of $500,000, but the Legislature has appropriated $200,000 annually.[25] The private sector has contributed between $400,000 and $500,000 annually, exceeding the private matching requirement.

24 *Minn. Stat.* §116J.693. Advantage Minnesota, Inc. is the formal name of the organization.

25 The 1992 appropriation was reduced by $125,000 to $75,000.

Advantage Minnesota brings Minnesota to the attention of executives in targeted industries through direct mail marketing campaigns, trade shows, advertising, and newsletters.[26] The targeted industries for 1995-96 are software development/corporate data centers, composite materials/plastics, and medical/biotech/health care products. Advanced manufacturing, service, and technology growth companies in Canada are also being targeted. According to Advantage Minnesota, it follows up with executives and acts as an account representative and a single point of contact for interested businesses.

Advantage Minnesota markets the state to out-of-state businesses.

One or two economic development professionals in each region work with Advantage Minnesota. Advantage Minnesota issues monthly "Alliance Alerts" listing businesses that are interested in Minnesota and the businesses' particular needs.[27] It sends the "Alliance Alerts" to the regional contacts, who are familiar with the capacities of the communities in their regions. Communities interested in a business provide requested information to the regional contacts, who forward the information to Advantage Minnesota. Program staff present the business with a response to its inquiry by packaging the local information, along with fact sheets about Minnesota covering topics such as labor force, education, quality of life, taxes, transportation, and financial resources. By working with existing economic development experts in the regions and communities, Advantage Minnesota tries to avoid duplicating work that is already being done. According to staff, if a business shows continued interest in Minnesota, Advantage Minnesota assists the business by answering questions and coordinating site visits.

In its 1995 year-end "Alliance Alert," Advantage Minnesota reported five companies it assisted had chosen to expand into Minnesota, with three-year job creation projections of about 500 employees. None of these five companies required state financial incentives to locate in Minnesota. Fourteen companies chose not to expand in Minnesota.

Minnesota Technology

Minnesota Technology focuses on manufacturing and high technology firms.

Minnesota Technology, formerly the Greater Minnesota Corporation, is a nonprofit corporation set up to assist Minnesota businesses to remain competitive in a global economy.[28] The corporation focuses on assisting manufacturing and high technology firms with a goal of creating and developing high-skill, high-wage jobs.

The organization operates from regional offices in Moorhead, Redwood Falls, Rochester, St. Cloud, Virginia, and the Twin Cities and is guided by both local and statewide boards of directors. It administers a number of technology and innovation transfer programs to aid manufacturers and it also operates the Upper Mid-

26 The process is somewhat different for the Canadian marketing efforts. Instead of approaching companies directly and possibly being accused of trying to steal business across the border, Advantage Minnesota works with contacts in Canada and presents Minnesota as a potential state for Canadian companies hoping to expand in the United States.

27 The identities of the companies are kept confidential; the listings are numbered with a brief description of the type of work the company does.

28 *Minn. Stat.* §116O. Minnesota Technology, Inc. is the formal name of the organization.

west Manufacturing Technology Center in conjunction with the National Institute of Standards and Technology. Minnesota Technology also manages a number of programs targeted toward work force development and quality development in several different industries.

In addition, Minnesota Technology makes equity investments in "early stage companies and small companies in Minnesota" from a Seed Capital Fund. The organization had approved $1.15 million for investments in seven companies through the end of calendar year 1994. It plans to continue to invest approximately $1 million per year in four to six companies.

Job Skills Partnership

The Job Skills Partnership program works with businesses to provide job training.

The Minnesota Job Skills Partnership program was created by the 1983 Legislature as the Jobs Partnership program.[29] When created, the program was governed by a 21-member board and was staffed by the State Planning Agency. The program has been organizationally located in several state agencies, moving to the Department of Economic Security in 1985, to the Higher Education Coordinating Board in 1987, and finally to the Department of Trade and Economic Development in 1989. It is currently governed by a 12-member board. The 1995 Legislature appropriated just under $2 million for each year in the 1996-1997 biennium. An additional $500,000 was appropriated to the Job Skills Partnership Board to assist Minneapolis and St. Paul employment programs.

The Job Skills Partnership funds cooperative training programs for companies located in or intending to locate in Minnesota. Grants of up to $200,000 are awarded to educational institutions with a new or expanding business as a partner. The business must match the state grant on a one-to-one basis. The business can match state funds by providing equipment or faculty. According to the program's executive director, training (in most cases retraining) has been provided for over 23,500 workers in 300 companies since the program's inception.[30]

OTHER STATES

In this section we describe the types of economic development tools used by states to influence business expansion and location decisions. We asked:

- **What are the national trends in state economic development efforts?**

Because state and local economic development policies are more likely to be a factor in business location decisions between states in the same region, we also asked:

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29 *Minn. Laws* (1983), Ch. 334.

30 Cited in Leonard Inskip, "At St. Cloud Freezer Factory, Job Skills Partnership Scores Again," *Minneapolis Star-Tribune* (November 28, 1995), 9A.

- **What state financial assistance do states surrounding Minnesota--specifically Illinois, Iowa, Michigan, North Dakota, South Dakota, and Wisconsin--offer businesses for economic development?**

National Trends in Economic Development

According to experts, state economic development strategies have evolved through three waves.[31] Subsequent waves do not necessarily replace the previous ones, but add new programs and sometimes shift emphasis. Though there is some disagreement among economic development practitioners and academics if the wave paradigm accurately portrays how economic development programs have changed over time, it is a useful tool for discussing and classifying programs.

The first wave of economic development programs developed in the 1930s when southern states attempted to lure manufacturers from the north to their states. Sometimes referred to as "smokestack chasing," first wave programs dominated economic development activity through the 1970s. Most states engage in these types of programs to some degree.

The second wave in economic development programs emerged in the 1980s. Second wave programs emphasize job creation. Rather than luring companies from other states, these programs assist existing business expansion or new development.

Improving the overall business climate and competitiveness is an emerging economic development focus.

Both first and second wave activities have been criticized. Economists cite the fact that these activities do not necessarily create new wealth or increase productivity. In addition, states have felt hostage to demands for incentives. Also, there is growing concern that businesses are being assisted to engage in activities they would do anyway, without the assistance. Finally, businesses that do not receive assistance see their tax dollars helping other businesses.

Third wave policies emerged in the early 1990s. One component of the third wave is investments that affect the overall business climate in the state, therefore benefiting all businesses and making the state more competitive in the global economy. These activities go beyond traditional state economic development programs to include education, job training, superior infrastructure, a favorable tax and regulatory environment, and a high quality of life.[32] The second component

31 For discussions of the "wave" metaphor and "third wave" economic development policy, see "Third Wave Economic Development Strategies: What Are They? Will They Work?" in *Proceedings: State and Local Economic Development Strategy Summit* (Minneapolis: University of Minnesota, 1994), 63-76; Lee W. Munnich, Jr., "Understanding Economic Development," in *Emerging Principles in Economic Development: A Benchmarking Tool* (Minneapolis: University of Minnesota, 1995), 7-11; and Peter Eisinger, "State Economic Development in the 1990s: Politics and Policy Learning," *Economic Development Quarterly* 9, no. 2 (May 1995), 146-158.

32 Dan Pilcher, economic development expert formerly at the National Conference of State Legislatures, argues that the first component activities we refer to are not really "third wave," but are investments that states already make. According to Pilcher, "third-wave" policies are more process oriented, facilitating industries and cluster of firms working together. Phone conversation (December 19, 1995). However, others do include these broader investments as part of the "third wave." See for example, Peter Eisinger, "State Economic Development in the 1990s: Politics and Policy Learning," *Economic Development Quarterly*, 9 no. 2 (May 1995), 146-158.

emphasizes the management of economic development activities. It focuses on developing business networks and allowing business sectors, networks, and clusters of firms to identify their economic development needs, rather than the state determining what is needed. The key distinction between third wave policies and others is that third wave policies are not firm specific.
Figure 1.2 shows the characteristics of the three waves of economic development.

States are not responding to the "third-wave" movement by abandoning existing economic development strategies. As we saw in Table 1.1, states provide a variety of programs to assist with business expansions, relocations, and startups.

Figure 1.2: Three Waves in State and Local Economic Development

	First Wave 1930s-1970s	Second Wave 1980s	Proposed Industrial Services Model 1990s?
Problem	Lagging regions	Structural change	Declining competitiveness
Universality of problem	Firm specific	Episodic, firm specific	General, systemic
Goal	Attract plants	Create jobs	Improve competitiveness
Targets of policy	Relocating or new plants of large corporations	New or expanding businesses (often small businesses)	Groups or clusters of manufacturing and technology-based firms
Means	Market the area; give subsidies	Separate programs (capital, etc.)	Integrated provision of industrial services
Mode of intervention	Smokestack chasing	Respond to requests that firms define	Lead firms in new directions
Regional economic focus	Large firm anchors	Sectoral diversification	Develop agglomerations
Organization	State departments of commerce	Multiple state organizations	State funded, locally or sectorally operated organizations
Intergovernmental mode	Federally led	States as labs of democracy	State-federal-local partnership
Measures of success	Number of firms attracted	Number of jobs created/retained	Increased firm competitiveness (e.g., productivity, new products, sales)

Source: Robert Atkinson, "Third Wave Economic Development Strategies: What Are They? Will They Work?" in *Proceedings: State and Local Economic Development Strategy Summit* (Minneapolis: University of Minnesota, 1994), 67.

Neighboring States

In order to determine the economic development strategies of neighboring states, we contacted state economic development officials in Illinois, Iowa, Michigan, North Dakota, South Dakota, and Wisconsin. We found:

- **A recurring theme in the economic development strategies of the six states in the Upper Midwest region is improving their overall economic climate.**

In its 1995 report to Governor Edgar, the Illinois Economic Development Board identified key components of a strong economic foundation. They include an educated and skilled work force; access to technology; advanced infrastructure; a favorable tax and regulatory environment; and access to capital for small businesses. The report focused on key industry clusters that make up the core of exporting industries in Illinois and the businesses that support them. So far this decade, the Illinois Legislature has addressed tort reform, unemployment compensation, investments in research and development, and worker training, among other issues.

Other upper Midwest states have programs similar to Minnesota's.

In the 1992 update to its five-year Economic Development Plan, the Iowa Department of Economic Development Board emphasized the need to move from the goal of job creation to the goal of income/wealth generation. According to the update, such a focus involves continued investment in people and technology and attention to economic diversification. A focus on income/wealth generation also places a priority on the types of jobs created. Since 1990, the Iowa Legislature has created incentives to encourage the use of new technology and investments in research and development and worker training.

Michigan created the Michigan Jobs Commission, the state's new economic development agency, in 1993. A board composed of private-sector members provides guidance on economic development policy. Priorities include restricting financial assistance for businesses to public infrastructure (as opposed to other business expenses), equipping Michigan's work force with needed skills, and improving the business climate.

In 1991 the North Dakota Legislature passed legislation adopting "Growing North Dakota," an economic development strategy for the state. In addition to addressing access to capital for business, Growing North Dakota emphasizes primary sector businesses (manufacturing, food processing, and exported-service business), creation and use of technology, and community involvement. The legislature has passed workers' compensation and unemployment compensation reforms, too.

The Governor's Office of Economic Development in South Dakota emphasizes primary sector job creation, with an emphasis on rural areas and economic diversification. The legislature approved workers' compensation and unemployment insurance reform, and addressed education issues in the past several years.

Wisconsin's economic development programs address technology development, research, worker training, and financial assistance. Since 1990, the legislature has expanded the customized worker training program and reformed workers' compensation.

- **At the same time, the states have not abandoned more traditional financial incentives for business attraction, expansion, and retention.**

We also asked economic development directors and managers about their general-purpose programs that provide grants or loans to businesses.[33] We found:

- **Like Minnesota, five of the six states contacted have programs that provide financial assistance to businesses through grants or loans to fund project costs other than infrastructure.**

Through the Small Business Development Loan Program, Illinois' Department of Commerce and Community Affairs provides loans of 25 percent of project costs up to $750,000. Iowa's Community Economic Betterment Account, administered by the Iowa Department of Economic Development, provides financial assistance to new, expanding, or relocating businesses up to $1,000,000 per project. North Dakota has several loan programs through the Department of Economic Development and Finance and the Bank of North Dakota. South Dakota's Revolving Economic Development and Initiative Fund (REDI fund) provides low-interest loans (generally 3 percent) to eligible businesses to cover up to 45 percent of project costs. Wisconsin's Department of Development provides financial assistance through Major Economic Development Loans.

Michigan is eliminating financial assistance through grants and loans to or on behalf of particular businesses, except to cover public infrastructure expense. However, in 1995 Michigan created the Michigan Economic Growth Authority (MEGA), a tax incentive for relocating or expanding businesses. MEGA was created in response to similar programs in Kentucky, Ohio, and Indiana in recent years. It provides a tax credit against the state's Single Business Tax based on increased Single Business Tax liability and personal income tax withheld attributable to the project. The maximum credit is 100 percent of what is attributable to the project for 20 years, and the credit can result in a tax refund to the business. There are strict job creation, retention, and wage requirements for businesses to qualify. For more details about these and other programs, see Figures 1.3 through 1.8.

Neighboring states use a variety of revenue sources to fund economic development activities. South Dakota capitalized its REDI fund through a 1-percent sales tax imposed in 1987. The goal of $40 million was reached in 10 months, at which time the tax was discontinued. The Michigan Strategic Fund was previously funded with oil and gas fees, and is now funded by a surtax on Indian casino gambling. Through the Bank of North Dakota, programs are financed by state tax deposits, other investments, and bank profits.

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33 We did not ask about venture capital programs; programs aimed at agricultural processing, technology, research, or exporting; or programs that target specific populations (such as low-income people, women, minorities, or people with disabilities).

Minnesota administers the Economic Recovery Grant program in tandem with the economic development portion of the federal Community Development Block Grant (CDBG) program. Community Development Block Grants are given to all states and can be used for a variety of purposes, including economic development. Some requirements for the use of the grants are outlined by the federal government, but states have some latitude in how funds are administered. Therefore, we asked the surrounding states how they use their economic development portion of CDBG funds. Figure 1.9 shows the different rules guiding their use in the states we contacted.

Minnesota bases its rules for the CDBG economic development set-aside on the rules for other CDBG funds. Other funds are limited to one application per local unit of government per year. This has two implications: (1) once a local unit of government has applied for $500,000, it may not request more funds, even if a very good project comes along, and (2) individual businesses can receive more than $500,000 per project by applying over several years or by applying through more than one unit of government (e.g., the city and the county). In our opinion, although grants should be distributed around the state, if there is more than one good project in a community in a particular year, state rules should not prevent funding.

- **Unlike Minnesota, the other six states in the Upper Midwest place a dollar-maximum of CDBG economic development funds on the business or project. Only one other state--Wisconsin--has a community maximum, which is twice the project maximum.**

Maximum funding ranged from $200,000 per project in South Dakota to $750,000 per project in Wisconsin. North Dakota is the only state to place the dollar maximum on the businesses. It is a $500,000 maximum at any one time; in other words, a business may receive $500,000, pay the principal down to $300,000, and then request $200,000 more.

North Dakota is the only state we contacted which allocates the CDBG economic development funds to regional councils. The revolving loan funds established with loan repayments are also administered regionally.

SUMMARY

The efficacy of state financial incentives and the influence of incentives on location decisions, job creation, and stimulating economic activity is uncertain. Yet most states offer incentives to businesses. Even if an incentive defrays only a fraction of the costs of a business location or expansion, the very fact that an incentive is or is not offered might affect the way a company perceives a state's attitude towards business in general or the company in particular.

In Chapter 2, we discuss Minnesota's primary business financial assistance program, the Economic Recovery Grant program, and Minnesota's use of federal Community Development Block Grant funds for economic development.

The state is not the only player in public financing of economic development. We were surprised by the participation of other public entities in projects assisted by the Economic Recovery and Community Development Block Grant programs. Chapter 3 focuses on local governments' participation in economic development and their use of local revolving loan funds.

While the Economic Recovery Grant program is the state's primary business assistance program, it is not the only one. In Chapter 4 we review three other state-level economic development programs administered by the Department of Trade and Economic Development: the Capital Access program, the Challenge Grant program, and the Small Business Development Loan program.

Figure 1.3: Business Assistance Programs in Illinois

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
Affordable Financing of Public Infrastructure Program (AFPIP)	Illinois Department of Commerce and Community Affairs	$13 million appropriation from revolving loan fund for FY1996 (shared with BDPIP, below).	Providing niche financing for public infrastructure projects necessary for health, safety, and economic development that are too small to make issuing of bonds or other traditional sources of infrastructure funding practical. The program provides grants or loans to local units of government up to a maximum of $100,000 per project.
Business Development Public Infrastructure Program (BDPIP)	Illinois Department of Commerce and Community Affairs	$13 million appropriation from revolving loan fund for FY1996 (shared with AFPIP, above).	Financing public infrastructure for projects by providing grants or loans to local units of government that demonstrate financial need and that the project will result in the creation/retention of private-sector jobs.
Small Business Development Loan Program	Illinois Department of Commerce and Community Affairs	Not available.	Providing financing to small businesses at market or below market interest rates in cooperation with other lenders. The program can fund up to 25 percent of total project costs or up to $750,000.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.4: Business Assistance Programs in Iowa

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
Community Economic Betterment Account	Iowa Department of Economic Development	$4 million to $5 million per fiscal year for the past several years.	Increasing direct and indirect job opportunities by providing financial assistance to businesses for start-up, expansion, or relocation to Iowa. The maximum assistance through the program is $1,000,000 per project. Assistance is provided through communities; communities may apply more than once per fiscal year.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.5: Business Assistance Programs in Michigan

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
Michigan Economic Growth Authority	Michigan Jobs Commission	Not applicable. Maximum credit is 100 percent of the amount attributable to the project for 20 years. (The maximum credit has been awarded once.)	Making Michigan competitive with other states for businesses considering expansion or relocation. This program is a tax credit against the Single Business Tax (SBT), the state's only business tax. The tax credit is based on increased SBT liability and/or the amount of personal income tax withholding attributable to new jobs created. There are job creation and wage requirements in order to receive the credit.
Capital Access Program (CAP)	Michigan Jobs Commission	The CAP is financed by the Michigan Strategic Fund. The balance of the fund is expected to be about $20 million in 1996. No specific amount is set aside for the CAP.	Encouraging banks to make loans to businesses that are slightly more risky than those they would usually make by contributing to a loan loss reserve pool.
Michigan Renaissance Fund (This is being proposed.)	Michigan Jobs Commission	This would be a program funded by the Michigan Strategic Fund. The balance of the fund is expected to be about $20 million in 1996.	Providing loans to communities for land assembly, site reclamation, and infrastructure or grants for infrastructure. Assistance to communities would be provided on behalf of particular businesses.

Note: Michigan does not make grants or loans to businesses. These are some of the economic development programs in Michigan.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.6: Business Assistance Programs in North Dakota

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
ND Development Fund	North Dakota Department of Economic Development and Finance	Not available.	Providing financing to businesses through loans, participation loans, subordinated debt, loan guarantees, or equity up to $300,000, but not to exceed $10,000 per job created in urban areas or $20,000 per job created in rural areas. Grants are available to Local Development Councils for construction and renovation and up to $100,000 is available for expenses incurred by businesses relocating from outside North Dakota. The latter is not to exceed $500 per job created in urban areas or $1,000 per job created in rural areas.
Small Business Loan Program	Bank of North Dakota	Not applicable.	Assisting new and existing businesses by participating in loans of up to $250,000. Maximum bank participation is $187,500 or 75 percent of the loan. There is a 15-25 percent balance sheet equity requirement for the business.
Business Development Loan Program	Bank of North Dakota	Maximum of $25 million in outstanding loans. ($6-7 million currently outstanding.)	Assisting new and existing businesses with a higher degree of risk than normally acceptable to lending institutions. The bank participates up to $500,000.
Partnership in Assisting Community Expansion (PACE)	Bank of North Dakota	Appropriation for buy down for FY1995-97 was $4.5 million, plus approximately $630,000 carried over from the previous biennium.	Creating new jobs and wealth in the state. There are two parts to this program: (1) the Bank of North Dakota participates in a loan at market interest rates and (2) the state and a local development entity fund an interest buy down up to 3 percent below NY prime or 5 percent below market. The state provides 65-85 percent of the buy down. The maximum state buy down is $250,000.
MATCH Program	Bank of North Dakota	Money for this program comes from investors such as the retirement funds. The bank gives them a certificate of deposit for the term of the loan at the US treasury note rate.	Attracting financially strong businesses to North Dakota. The bank participates in loans and charges an interest rate of the US treasury note rate plus .25 percent for borrowers with an "A" rating. The bank can participate up to about $8 million and can take up to 90 percent of the loan.

Note: Most of the state economic development programs in North Dakota are administered by the Bank of North Dakota, the only state-owned bank in the country. Its lending base is the state's tax dollars so the legislature restricts the type of lending it can do. The Bank operates like a conventional bank in administering the loans. Except for the PACE program, which is partly funded by state appropriations, there are not job creation requirements attached to loans made through the programs. The bank does not make grants and forgivable loans.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.7: Business Assistance Programs in South Dakota

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
Revolving Economic Development and Initiative Fund (REDI fund)	Governor's Office of Economic Development	$24 million in cash and investments on June 30, 1995. (The $24 million includes loan commitments of $8 million to businesses and other South Dakota economic development programs.)	Assisting company expansions, relocations, and start-ups, with a focus on private sector jobs. The REDI Fund provides low-interest (3 percent) loans to businesses. The loans may finance up to 45 percent of project costs and may be used for working capital.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.8: Business Assistance Programs in Wisconsin

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
Major Economic Development Loans	Wisconsin Department of Development	Awards for FY1993-94 reached approximately $6.6 million.	Providing financing to projects not eligible under other Wisconsin Development Fund programs. The program can be used to make grants or loans to businesses or other applicants on behalf of businesses for land, buildings, equipment, and other business operating expenses.
Rural Economic Development Program	Wisconsin Department of Development	$296,000 in FY1995.	Providing assistance for starting or expanding businesses in rural areas. The program has two parts. Part I provides grants and loans up to $30,000 for professional services. Part II provides loans of up to $25,000 for working capital or fixed assets. A business must receive professional services assistance to be eligible for a Part II loan.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.9: Community Development Block Grant Economic Development Programs

STATE	PROGRAM	FUNDING	DESCRIPTION
Illinois	Community Development Assistance Program--Economic Development component	$8 million for 1995. Has varied from $4 million to $8 million the past several years. (A fixed percent is not set aside.)	Illinois provides financial assistance of $25,000 to $500,000 per project. The maximum may be waived. There are limitations on when funds may be used to assist retail. Funds may be used for working capital.
Iowa	CDBG Economic Development Set Aside and	20 percent of block grant funds, or about $6 million, is set aside for these two programs. Usually, all the money is not used.	Maximum funding through this program is $500,000 per project through loans or forgivable loans. Assistance may not exceed $10,000 per job created or retained, but has never exceeded $5,000 per job. May be used for working capital. Funding for retail is not precluded, but retail projects tend not to receive enough points in the scoring system.
	CDBG Public Facilities Set Aside		This program finances public infrastructure associated with particular business projects that will increase job opportunities by providing grants to communities up to a maximum of $500,000 per application.
Michigan	Community Development Block Grants	About 67 percent of block grant funds in 1996, or about $30 million. (A fixed percent is not set aside each year.)	Michigan provides up to $750,000 per project and government unit per year, but the maximum may be exceeded if a community has more than one good project. Funds may be used only for public infrastructure. This is a competitive program limited to industrial projects; projects resulting in higher wage jobs will be funded over projects with lower wage jobs, other things being equal.
North Dakota	Community Development Loan Fund	50 percent of block grant funds, or about $3 million annually.	North Dakota allocates CDBG funds to eight regional councils, to which local units of government apply and to which loan repayments are credited by the state. The maximum loan amount is $500,000 per business at any one time. If a business receives a $500,000 loan and repays $300,000, the business may apply for an additional $300,000. Loans for retail may be made up to $150,000. Revolving loan funds are established at the regional council level.
South Dakota	Special Projects Account	$3 million in 1995. (South Dakota sets aside a fixed dollar amount. It used to be $2 million. The state receives about $8.5 million in CDBG funds each year.)	The maximum amount of funding available through this program is $200,000 per project. Funding is also limited to $5,000 per full-time equivalent job created. Funds may not be used for retail projects or for working capital.
Wisconsin	CDBG Economic Development Program	35 percent of block grant funds in 1994, or about $11 million. (The set aside can reach 75 percent.)	The maximum amount of funding a business may receive in a calendar year is $750,000; the community maximum is $1.5 million. These funds may be used for working capital.
	CDBG Public Facilities for Economic Development Program	About $1 million in 1994 through a revolving loan fund established from previous CDBG awards	The maximum amount of funding a company may receive is $750,000; the community maximum is $1.5 million. This program provides funding to local communities on behalf of businesses to finance infrastructure improvements.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Economic Recovery Grant Program

CHAPTER 2

The Economic Recovery Grant program is the state's main program for job creation.

The Economic Recovery Grant program is the state's main program for job creation and retention. The program originated in 1984, following the recession of the early 1980s, and it operates in tandem with a similar federal program, the Small Cities Community Development Block Grant (CDBG). Both programs are administered by the Department of Trade and Economic Development (DTED) and are referred to collectively as the "Economic Recovery Fund." Since 1984, the two programs have loaned or provided grants of more than $100 million to over 400 companies.

In this chapter we address the following questions:

- **Are the current criteria for reviewing and awarding grants under the Economic Recovery Grant program adequate? Does DTED attempt to determine what level of financial support is necessary for projects to proceed? How does the staff determine whether the project should receive a loan or a grant?**

- **How have program funds been used? What types of projects have been funded?**

- **What is the track record of the Economic Recovery Fund in creating and retaining jobs?**

- **What wages have been paid by the jobs created?**

We used a variety of methods to answer these questions. We interviewed department staff and other economic development professionals around the state. We also reviewed and collected data from the department's files for all projects funded between 1991 and 1995.[1] In addition, we interviewed 40 executives from companies that were assisted by loans or grants and verified companies' job creation claims by checking data on employment and wages as reported on companies' unemployment tax returns.

1 An index of the projects is included as Appendix A.

PROGRAM DESCRIPTION

The Economic Recovery Fund finances "activities designed to create new employment, maintain existing employment, increase the local tax base, or otherwise increase economic activity in a community."[2] According to state rules, 51 percent of the jobs created must be filled by or made available to low or moderate income people.[3] Businesses do not apply for assistance directly to the state; rather, local units of government apply to the state on the businesses' behalf. The maximum amount of money that may be awarded to any local government is $500,000 per year. The state can provide assistance in the form of a grant, loan, or forgivable loan. A forgivable or deferred loan has a term and interest rate but the state waives principal and interest payments if the company meets its job creation and retention goals.[4]

The state has awarded over $100 million through the Economic Recovery Fund since 1984.

Table 2.1 shows that state appropriations for the Economic Recovery Grant program for fiscal years 1984 through 1996 exceeded $68 million. The state also spent $35 million in federal funds for the Small Cities CDBG program since 1984.[5]

The Business Development and Finance Unit in the Department of Trade and Economic Development administers the Economic Recovery Fund. The unit consists of a supervisor and five senior loan officers and has a budget of about $535,000 per year. The unit reviews grant and loan applications and oversee projects for which the department has awarded grants.[6] DTED's organization chart is presented in Figure 2.1.

Although DTED administers both the federal and state programs under state rules, there are some important differences in how the two funds are administered. For example, all local units of government and recognized Indian tribal governments may apply for state funds, but cities and counties that receive CDBG funds directly from the federal government and Indian tribal governments are not eligible for federal funds through the Small Cities program. Also, federally funded construction projects are subject to labor and environmental standards that state pro-

2 This is the definition of economic development projects in *Minn. Rules,* Ch. 4300.0100, Subp. 6.

3 "Low and moderate income' means income which does not exceed 80 percent of the median income for the area, with adjustments made for smaller and larger families." *Minn. Rules*, Ch. 4300.0100, Subp. 13. The state median household income was $33,682 in 1993; 80 percent of $33,682 is $26,946. (Median income is adjusted using the Consumer Price Index for All Urban Consumers (CPI-U). Source: U.S. Census, Current Population Reports, P60-188.)

4 For example, a business might receive a $500,000 forgivable loan for the creation of 75 jobs that would allow half of the loan to be "forgiven" if the jobs are maintained for 5 years and the other half to be "forgiven" if the jobs are maintained for 10 years. Sometimes the state requires the business to repay the first $100,000 to the local unit of government to capitalize a local revolving loan fund.

5 The 15 percent set aside for economic development grants is set by state rule (*Minn. Rules*, Ch. 4300.2000, Subp. 2). The rest of the CDBG funding is allocated between single purpose and comprehensive grants. The Department of Trade and Economic Development is proposing to modify the rules to allow the commissioner to change the proportion of funding among the three types of grants if there is a shortage of fundable applications in any area.

6 An additional position is vacant, and a supervisor, who has other responsibilities, spends time working on the program.

Table 2.1: Economic Recovery Fund, 1984-1996

State Appropriations: FY 1984-1996		Federal Community Development Block Grant Funds:[a] FY 1984-1995	
FY 1984-1985	$6,000,000	FY 1984	$3,188,424
		1985	3,190,482
1986-1987	11,329,400	1986	2,210,727
		1987	2,663,193
1988-1989	11,329,400	1988	2,569,113
		1989	2,224,120
1990-1991	11,328,000	1990	2,172,183
		1991	2,910,447
1992-1993	11,034,000	1992	3,171,404
		1993	3,294,852
1994-1995	11,034,000	1994	3,655,443
		1995	3,827,874
1996	6,017,000		
TOTAL	$68,071,800		$35,078,262

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Department of Trade and Economic Development.

[a]Federal fiscal year.

jects are not required to meet. Finally, if federal funds finance a project, the local unit of government keeps the full amount of the grant upon repayment by the business. When a company repays a loan of state funds, the local government keeps only the first $100,000 and the balance is repaid to the state. The local government uses the funds it retains from loan repayments to capitalize a local revolving loan fund. Repayments for state loans greater than $100,000 are deposited in the state's General Fund.

The 1995 Legislature modified the program.

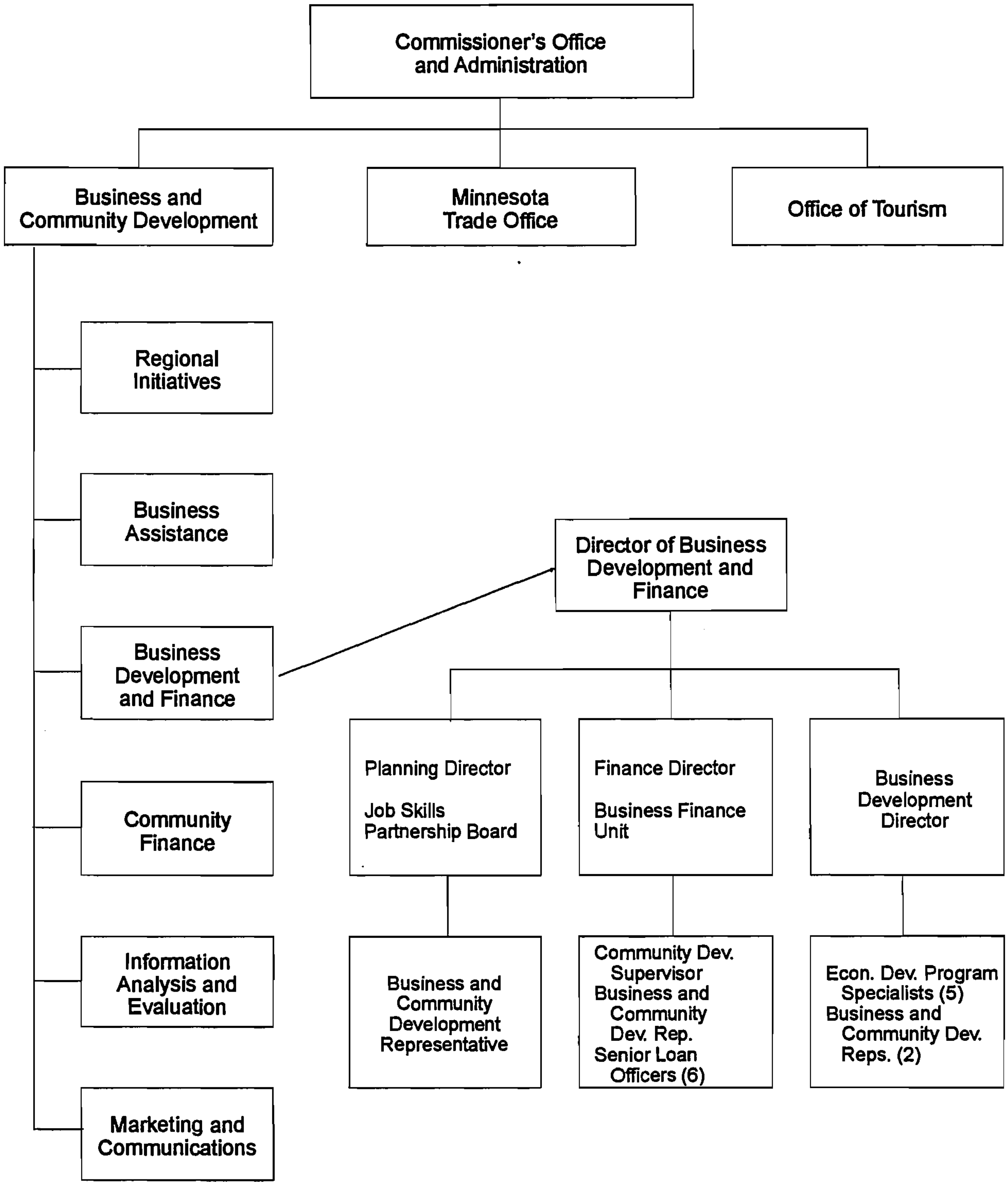
As we discuss later in this chapter, the 1995 Legislature modified the Economic Recovery Grant program in two important respects: first, it stipulated that projects cannot be funded if the only rationale is to attract an out-of-state business or to keep an in-state business from leaving the state unless there is evidence of excessive infrastructure costs or insufficient funding from other sources.[7] Second, it required state and local government agencies that provide economic development assistance through grants or loans in excess of $25,000 or tax increment financing to establish wage level and job creation goals and to report the results for each business assisted. Businesses that do not meet their job or wage goals are required to repay the assistance.[8]

It is not clear how this latter law will work in practice. For example, if a firm received a loan from the state and did not meet its job goals it is unclear what action DTED could take. However, the department already has implemented some procedures that might be able to accommodate the requirements of this law. DTED has

7 *Minn. Laws* (1995), Ch. 224, Section 55.

8 *Minn. Laws* (1995), Ch. 224, Section 58.

Figure 2.1: Department of Trade and Economic Development Organization Chart, July 1995



Source: Department of Trade and Economic Development.

DTED requires companies to report on job creation, wages, and benefits.

included provisions in recent grants and forgivable loans to recapture state assistance if job goals specified in the loan or grant agreements are not met.[9] Since 1993, the department has required local units of government to provide wage and benefit information for the jobs created. DTED includes the job projections in the loan or grant agreement, but, until recently, has not included the projected wages. In 1995 the department started to include the wage goals in the grant or loan agreement and it will have to develop a process for monitoring whether wage as well as job creation goals are met.

GRANT CRITERIA AND APPROVAL PROCESS

Application Process

The Department of Trade and Economic Development uses a single application process, consisting of two parts, for several of its programs. The Part I application asks for information about a community's need for assistance and the project(s) for which the community is seeking funding, including cost estimates and potential impact. A contract manager reviews the application and refers it to the most appropriate department program. When a Part I application is referred to the Business Development and Finance Unit and the project appears to be one that will meet eligibility requirements for the Economic Recovery or Small Cities program, a loan officer contacts the applicant about completing a Part II application.

The Part II application seeks more detail about the proposed project, including a more exhaustive community need narrative. At this stage, the applicant describes the project activities, projected number and type of jobs to be created, and budget, including a list of actual or potential sources of funding and sources that have denied requests for funding. The applicant must provide assurance of compliance with state and federal requirements, provide a statement of support from the local unit of government, supply evidence of and minutes from a public hearing about the project, and submit extensive financial information about the company on whose behalf the funds are being requested. The department, community, and business negotiate the terms of the financial assistance.

In 1994, DTED loan officers completed approximately 60 in-person interviews with economic development specialists around the state to collect opinions on the program. Most respondents (60 percent) did not like the single application process. Some felt there should not be a Part I application and others thought the department should eliminate Part II. One applicant commented that the Part I should be a pre-application from the business, another that Part II should be program-specific.

9 The department is proposing legislation to formalize this repayment, or so called "clawback" provision.

Despite these complaints, we found nothing inherently wrong with the single application process. It allows DTED to obtain preliminary information about a proposed project and direct it to the most suitable program, with more detailed information submitted only for those projects that may be eligible.

We have some concerns about how companies apply for awards, and about how DTED and the companies negotiate the terms and type of award. The loan officers and the respondents to the in-person interviews also noted some of these concerns. First, we found that:

- **Since the beginning of the program in 1984, some businesses have gotten around the normal application and negotiation processes by directly approaching the Governor or the commissioner or deputy commissioner at DTED.**

The businesses still go through the mechanics of completing an application, but with an understanding of the amount and type of award they will receive assuming the application scores the minimum 400 points. Businesses circumventing the normal application process can create the appearance of political favoritism and prevent the loan officer from having input. A respondent to the department's in-person interviews voiced a related concern: sometimes the loan officer negotiates terms without the community's input. In our view, all participants have an interest in the type and terms of an award and should be included in the bargaining process. We also found:

- **The department does not have written criteria for determining the type of award to offer under different circumstances.**

DTED should adopt clear minimum standards for forgivable loans and grants.

Other than always funding improvements to public infrastructure (e.g., water and sewer systems or roads) with grants, there are no formal guidelines about what type of award to make. Though there are no official guidelines about when to offer loan forgiveness, a letter in the file of one business indicated that the department offers forgiveness "only in rare circumstances, such as when there is a real threat that the company may relocate all or a portion of its business to another state." The lack of criteria allows the type of award to be a negotiated item. It also may create a perception of preferential treatment for certain businesses, if businesses that do not need financial assistance receive grants and forgivable loans while those that are in greater need receive loans. In our opinion, DTED should adopt minimum standards that businesses must meet in order to receive grants or forgivable loans for purposes other than public infrastructure. The standards should be higher than those for businesses receiving loans, and all businesses should be held to the standards. We recommend that:

- **DTED should establish criteria that projects must meet before they will be considered for a grant or forgivable loan for purposes other than public infrastructure.**

These criteria could be part of the scoring process, and might include factors such as the number and type of jobs created and the wages and benefits provided, and other factors that demonstrate that the projects are valuable to the state. The department notes that it is in the process of revising its scoring system for applications.

Evaluation and Scoring of Projects

Loan officers evaluate Part II applications to see that the proposed projects meet eligibility and financial thresholds. To be eligible, both state and federal projects must benefit low and moderate-income persons and meet two of three state objectives.[10] The state objectives include: (1) creation or retention of permanent private sector jobs, (2) leverage of private investment, and (3) increase to the local tax base.[11] To provide a benefit to low and moderate-income (LMI) persons requires that "at least 51 percent of the jobs will be held by, or will be available to low- and moderate-income persons." The department has required that federally funded projects actually create jobs that are "held by" LMI persons, while state projects must only be "made available to" LMI persons. According to the state Economic Development Program Manual, "To make jobs available to LMI persons, the jobs created should not require specialized training other than that which will be provided by the employer."[12]

The department is proposing changes to the rules that would do several things: add a fourth state objective ("improved employment and economic opportunity for Minnesota citizens to create a reasonable standard of living"); eliminate the requirement that applicants for the state program have to meet federal objectives; and allow a varying percentage of federal CDBG funds to be used for economic development.

The loan officers do financial analyses of the companies by reviewing existing debt, credit reports, three years of historical financial statements, two years of projected financial statements, audits, personal financial statements of the owners if a personal guarantee is involved, aging of accounts receivable and payable, cost estimates, and business plans. The project must also meet certain financial thresholds: (1) all other financial sources must have been considered and found inappropriate, unavailable, or insufficient; (2) the business must be committed to completing the project according to the terms of the agreement; (3) letters of commitment must have been received from other financial sources; (4) the cash-flow needs to be sufficient to cover the proposed debt service; and (5) the business to be assisted must have a positive net worth.

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10 Federal Community Development Block Grant money must be used for one of three federal objectives: to provide a benefit to low and moderate income persons, to prevent or eliminate slums or blight, or to alleviate urgent community development needs. In the case of economic development projects, the federal objective met is always to benefit low and moderate income persons. The state program has the same requirements because the Economic Recovery Grant statute requires the program to be administered according to the rules for the federal program.

11 The state has required that the jobs are to be created within two years of the award, that at least one job be created for every $20,000 of funds awarded, that at least one dollar of private funds be leveraged for every dollar of funding, or that there be a 50 percent increase in the value of the parcel of land that would be assisted.

12 Economic Development Program, *Program Manual,* (St. Paul: Minnesota Department of Trade and Economic Development, October 1992), 6.

If a project meets the eligibility and financial thresholds, the loan officer evaluates the request for funding based on a 600 point scale: 400 points are based on community need, project impact, and the capacity of the applicant to complete the project; 200 points are based on financial feasibility. An application must score 400 points, with at least half the possible points obtained from each section, to be eligible for funding. Because the loan officers provide technical assistance to the applicants, projects that will not score 400 points do not submit Part II applications. A copy of the scoring sheet is included as Appendix B.

The application provides ample information about the financial health of a company and the soundness of the project. No review process can eliminate all possibility that weak projects will be funded, but as long as the information required by the department is being utilized by loan officers in a thorough and systematic way, we feel that application and review procedures are adequate.

Changes should be made to DTED's scoring system for grant and loan applications.

We noted several aspects of the Economic Development Score Sheet, however, that we think should be eliminated or revised. The current score sheet allows for too much subjective consideration (175 points) under the guise of an objective process. Subjectivity and consideration of individual circumstances are required to maintain flexibility of the program but should not be part of the scoring process.[13] The scoring sheet also measures some of the same criteria more than once.[14]

We also question the appropriateness of the scale used for the demographic criteria (i.e., county unemployment rate, median income, and poverty rate). The department awards all or none of the possible points for each demographic criterion. Communities with demographic characteristics only slightly worse than the state median will score the same as very distressed communities, receiving all of the possible points. At the same time, because the metro area tends to set the state median for the demographic characteristics, it is difficult for metro area applicants to receive any points for demographics. Finally, while median income is used as an indicator of community need, it is not adjusted for the cost of living in the community.

Loan officers score project impact based on the number of jobs the business projects it will create and the amount of dollars requested per job to be created. We see two problems with this. First, DTED does not consider the wages, benefits, or type of jobs created in the scoring system.[15] In our opinion, the scoring system should reflect that jobs providing higher wages and/or employee benefits are "worth more" to the state. Second, it is difficult for small companies, particularly

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13 For example, a loan officer can check up to twenty items under "community and economic needs" and "beneficial results and tangible effects" and award up to 110 points based on the level of need. It is not clear how many items need to be checked to reflect the different levels of need. On three applications, 60 points (indicating moderate need) were awarded: one application had 6 items checked, one had 10, and one had 12. At the same time, an application with 9 items checked received 80 points (indicating substantial need).

14 Unemployment, job training for low-income persons, ratio of dollars requested to jobs created, amount of private investment, and increases in the local property tax base are measured more than once.

15 Loan officers do consider the type and wage level of jobs informally.

in the metro area, to be funded using this scoring system. It is difficult for smaller companies in the metro area to score 400 points because projects creating fewer than five jobs receive no points for job creation (regardless of the dollars requested per job), and because metro area applicants rarely receive points for demographic characteristics.

Some criteria do not differentiate between projects because the scores do not vary much across projects. Examples include: "Increase to the local tax base (in excess of 50 percent)," "Interest rate on grant funds over the term of the loan," and the score assigned under financial feasibility gap.

Recently requests have exceeded available funds.

Until 1994, the amount of money available through the Economic Recovery Fund equalled or exceeded requests for funding, however, demand for the funds has increased in the last two years. The department has implemented a "pipeline" list -- projects that will be approved contingent on future appropriations. When there were sufficient funds the scoring system served as a minimum threshold and the department could fund all projects scoring at least 400 points. Since the department cannot fund all projects at the requested amount, the scoring system should mean something. However, the funding received by projects does not appear to bear a relationship to the points a project received. Instead, the department either negotiates with the businesses to determine how much money the business will receive or determines the amount of the award based on how much money remains to be lent.

We recommend:

- **DTED should revise its scoring system for the Economic Recovery Fund.**

In our opinion, the revised scoring sheet should eliminate subjective criteria and criteria that do not differentiate projects and it should consider the job type, wage, and benefit level. The scoring system should also consider demographic factors on some type of relative sliding scale basis.

The department should identify the characteristics of the community and the project that lend themselves to quantification and that are important for differentiating projects funded through this program and include them in a scoring system. The department should count each characteristic only once and should weight each characteristic to reflect its importance relative to others. The scoring system should reflect the value of the project so that projects with more points are understood to be "better" than projects with fewer points, other things being equal. The department also should consider developing different scoring systems for federal- versus state-funded projects. Different minimum point requirements might be appropriate for grants versus loans or infrastructure versus other projects. After projects have been scored, specific subjective criteria that have been determined to be important to the state should be considered, and those criteria, in combination with the projects' score, should be used to determine funding. DTED officials note that they are in the process of revising their application scoring process.

"GAP FINANCING" VERSUS "INCENTIVE FINANCING"

Another important issue is whether the Economic Recovery Grant program should provide assistance only to businesses that can demonstrate financial need, or whether it can be used as an incentive for business without a financial need to remain, relocate, or expand in Minnesota. The former strategy, known as "gap financing," was the clear preference expressed by the Legislature in 1995 when it modified the terms under which grants could be made. The Legislature stipulated that projects were to be evaluated based on the following conditions:

> (1) whether assistance is necessary to provide equity to business owners who do not have the capacity to invest in a project;
> (2) whether there is an inability to secure sufficient financing from other public or private sources at market interest rates or on favorable market terms;
> (3) whether assistance is necessary to attract out-of-state businesses or to retain existing businesses within the state;
> (4) whether there are excessive public infrastructure or improvement costs beyond the means of the affected community and private participants in the project.[16]

The statute also requires that the decision cannot be based on clause 3 alone. We believe the Legislature's intent was to target aid to businesses that faced a financing "gap." Indeed, several of DTED's program documents imply that a financial need must exist for projects to receive funding. For example, the Economic Development Program Manual states:

> The program is not intended to substitute for conventional business financing or to be used in place of other more specialized state, federal, or local programs that may be better suited to specific project needs. Instead, grants from this program are intended to be used in situations in which a funding "gap" exists, and alternative sources of public and private financing are inadequate or unavailable.[17]

There has been a trend to award more grants and forgivable loans.

However, in our review of projects funded after 1991, we noted many projects where there was no evidence of financial need for the company assisted. Indeed, there has been a trend toward increasing funding for large companies, compared to the early years of the program, as well as an increasing trend toward awarding grants and forgivable loans as opposed to loans.

- **Even though the 1995 Legislature tried to limit "incentive financing," DTED has continued to award a number of "incentive" grants and loans.**

The department has given a liberal reading to clause 2 of the 1995 legislation, interpreting it to mean that a company being offered incentives by other states cannot otherwise secure sufficient financing "on favorable market terms." This interpretation has allowed DTED to make awards to firms that considered relocat-

16 1995 Laws of Minnesota, Chapter 224, Section 55.

17 Economic Development Program, *Program Manual,* (St. Paul: Minnesota Department of Trade and Economic Development, October 1992), 1.

ing parts of their business in other states but were able to fund their project internally or through market financing.

Because of the seeming inconsistency between the statute and DTED's current practice, we recommend:

- **The Legislature should further clarify the goals and purpose of the program and provide clearer direction on whether it wants to allow "incentive financing."**

The Legislature needs to provide clear direction on the program's purpose.

There are two aspects to this: first, deciding whether "incentive financing" should be included under the program, and, second, if "incentive financing" is permissible, under what rules should it be administered. The Legislature may 1) allow unrestricted incentive financing, 2) allow incentive financing under some circumstances, 3) prohibit "incentive financing" altogether (and strengthen the language in statute), or 4) provide for separate pools of money for the two types of financing, each with its own eligibility criteria.

If "incentive financing" is to be allowed, are there policies that could be adopted that would maximize the benefit to the state? We saw in Chapter 1 that there is general agreement that "incentive financing" does not create greater economic activity on the national level. Economists do agree that in some circumstances the state can play a role in alleviating market failures. There is also agreement that some sorts of state government investments for business make more sense than others. We were particularly impressed by the ideas of Mary Waits and Rick Heffernon:

Incentives for businesses can represent good public policy, but only if they meet certain conditions:

- Incentives should be used to accomplish clearly defined goals based on an overall economic development strategy, not simply to win bidding wars.
- Incentives should be subject to a rigorous cost-benefit analysis in both the short and long term.
- Incentives should be made contractual so that recipient businesses are held accountable for their promises and performances.[18]

Waits and Heffernon suggest the following guidelines for a state incentive policy:

- Link incentives to quality jobs and advancement opportunities, not simply numbers of jobs (e.g., company must pay higher than average wages for the industry in the county it is located).
- Encourage recipient companies locating in rural areas to fill a certain percentage of new jobs with local people.

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18 Mary Waits and Rick Heffernon, "Forging Good Policy on Business Incentives." *Economic Development Review*, Fall 1994, 21.

- Link incentives to company investments in technology and people. (e.g., company must meet a threshold of investments in property and/or worker training).

- Encourage recipient companies to offer health insurance to all employees.

- Insist that recipient companies have strong environmental management and compliance records.

- Target companies that are important to key clusters that provide clear economic benefits.

- Make public investments such as customized job training or infrastructure development the priority offer to companies because these programs will continue to provide community wide benefits even if a company moves or shuts down.

- Minimize the need for special deals by ensuring the state has strong economic foundations (e.g., competitive tax and regulatory policies, advanced infrastructure, educated work force).

- Use tax based incentives (tax breaks) as a last resort, or for purposes of catalyzing business investments in productivity.

- Avoid legislation aimed at specific companies, unless the opportunity is unique. Make new incentive programs broad based in application (i.e., applicable to a broad spectrum of existing and new businesses).

- Analyze the costs and benefits of all incentive packages to ensure the best decision possible. Specify an organization to conduct the analysis and, if possible, an economic model to be used.

- Set performance standards with clawback provisions to hold companies that receive incentive benefits (especially those that are taxed based) accountable for their end of the bargain.

The Legislature might consider restricting "incentive financing" to infrastructure or job training projects.

As we saw earlier, there is a great deal of competition between states for expanding companies. In light of this reality, the Legislature might consider allowing incentive financing in some circumstances, but restricting the funding to infrastructure or job training purposes. In that way, the funding would provide an investment in the state's physical or human capital while providing a less direct subsidy to the benefiting company. This option will probably restrict DTED's ability to assist some businesses in some cases.

A task force in North Carolina developed guidelines that one writer called "the nation's most advanced set of guidelines for awarding location incentives to corporations" that might be instructive for Minnesota.[19] Applications to North Carolina's

19 Peirce, Neal R., "State of the States: The Gold in Them Thar States," *National Journal*, November 11, 1995, 2820.

Industrial Recruitment Competitive Fund, which provides "incentive financing" to businesses, are scored on four main dimensions: job quality, industry quality, economic impact, and local impact. The task force identified three aspects of job quality: the wage the firm will be paying relative to the average manufacturing wage in North Carolina; a measure of job stability of the firm's industry; and a measure of job safety of the firm's industry. The task force also developed measures of industry quality intended to reflect the use of technology and the productivity of the firm's industry. The economic impact is measured by the number of jobs, the number of spin off jobs, and the spin off earnings. Local impact is measured by wages and the county unemployment rate compared to the state average. All criteria are scored on a scale and each criterion is weighted to reflect its importance to the state. In addition, companies are judged on environmental impact and financial stability.

North Carolina recognizes that no rating system can account for all contingencies and also identified four factors that could result in special consideration: (1) the area the firm would expand in has experienced a sudden and severe economic dislocation; (2) the firm will create an unusually high number of jobs; (3) the firm agrees to negotiate special hiring arrangements for low income people; or (4) the firm will bring an exceptional technology or is a recognized industry leader.

ECONOMIC RECOVERY FUND ACTIVITY: FISCAL YEARS 1991 THROUGH 1995

We reviewed grants and loans made to businesses through the Economic Recovery Grant and Small Cities programs in fiscal years 1991 through 1995. During this time, the Department of Trade and Economic Development approved 185 projects for funding.[20] Nine of the projects were never funded either because they never occurred or because the company chose not to draw down the loan funds they were awarded. Thirteen companies received more than one grant or loan during the five year period. The 176 projects which were funded helped 158 companies.

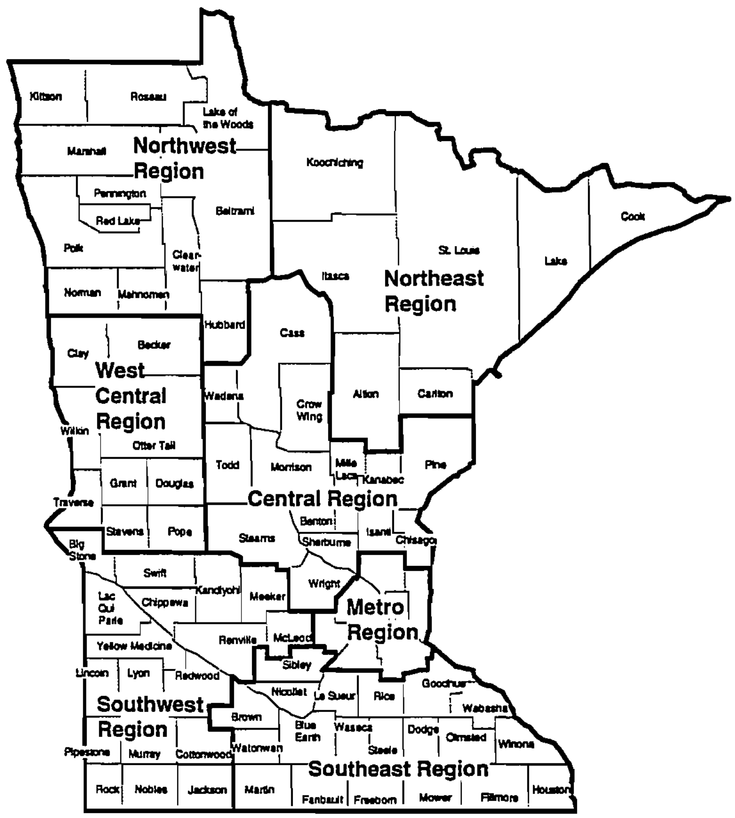
Figure 2.2 shows the department's seven economic development regions. Seven cities and four counties are ineligible to receive federal money through the Small Cities program because they receive Community Development Block Grant funds directly from the federal government.[21] Therefore, we looked at the distribution of funds among the regions as a whole and by their source: federal or state.[22] As Table 2.2 shows,

20 In the discussion of the Economic Recovery Grant program, "projects" will refer to the incidence of a business receiving money through a local unit of government. A local unit of government may receive one grant that funds two projects. The instance of a company receiving more than one infusion of money through this program, even for the same purpose (such as receiving a loan from the city and one from the county for one expansion), will be counted as multiple "projects."

21 The cities are St. Cloud, Duluth, Rochester, Moorhead, St. Paul, Minneapolis, and Bloomington. The counties are Hennepin, Ramsey, Anoka, and Dakota.

22 The figures do not reflect the federal funds that cities and counties receive directly.

Figure 2.2: DTED Economic Development Regions



- **Regions outside the Twin Cities metro area received 85 percent of the grant and loan funds.**

We also looked at the distribution of program dollars among industries. Table 2.3 shows that manufacturing companies received 80 percent of the funds awarded between fiscal years 1991 and 1995.

Some Legislators indicated that the Economic Recovery Grant program originally was intended to help smaller businesses that might have difficulty obtaining financing in the private sector. Table 2.4 shows the distribution of establishments and funding by the size of the establishment as measured by the number of employees.[23] We looked at both the number and size of awards because smaller

23 The U.S. Census Bureau defines an establishment as a location of doing business. One firm may have more than one establishment. Throughout this discussion, "establishment," "business," and "company" are used interchangeably to indicate a location of doing business. "Firm" is used to indicate organizations with multiple locations of doing business.

Table 2.2: Economic Recovery Fund, FY 1991-95, Distribution of Funds by Region

Region	Number of Projects	Percent of Projects	State Funded	Federal Funded	Amount of Grants and Loans	Percent of Dollars	Percent of 1990 Population
Central	39	22.2%	$7,263,750	$2,954,814[a]	$10,218,564	24.4%	11.5%
Metro	24	13.6	5,791,261	500,000[b]	6,291,261	15.0	52.3
Northeast	15	8.5	4,378,420	100,000[c]	4,478,420	10.7	7.1
Northwest	12	6.8	2,229,490	1,415,000	3,644,490	8.7	3.6
Southeast	40	22.7	3,907,434	4,704,739[d]	8,612,173	20.5	14.5
Southwest	27	15.3	3,464,000	2,048,000	5,512,000	13.2	6.5
West Central	19	10.8	2,409,000	750,000[e]	3,159,000	7.5	4.5
Total	176		$29,443,355	$12,472,553	$41,915,908		

Note: "Economic Recovery Fund" refers to both the state and federal funded programs. The population figures are included only to give an idea of the size of the region.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development reports. Population source: U.S. Census Bureau data as reported in Economic Resource Group, *1992 Economic Report to the Governor* (St. Paul: Author), 26-27.

[a]St. Cloud is ineligible to receive federal funds through this program.

[b]St. Paul, Minneapolis, Bloomington, Hennepin County, Ramsey County, Anoka County, and Dakota County are ineligible to receive federal funds through this program.

[c]Duluth is ineligible to receive federal funds through this program.

[d]Rochester is ineligible to receive federal funds through this program.

[e]Moorhead is ineligible to receive federal funds through this program.

Table 2.3: Economic Recovery Fund, FY 1991-95, Distribution of Funds by Industry Type

Industry	Number of Projects	Percent of Projects	State Funded	Federal Funded	Amount of Grants and Loans	Percent of Dollars	Percent of Minnesota Establishments[1]
Agriculture, Forestry, Fishing	2	1.2%	$ 60,000	$ 77,739	$ 137,739	0.3%	2.1%
Manufacturing	132	79.0	22,698,189	9,668,814	32,367,003	80.2	6.5
Wholesale and Retail Trade	12	7.2	2,090,000	1,000,000	3,090,000	7.7	31.7
Finance, Insurance, Real Estate	8	4.8	1,746,256	0	1,746,256	4.3	9.5
Services	13	7.8	2,073,910	940,000	3,013,910	7.5	34.2
Total[2]	167		$28,668,355	$11,686,553	$40,354,908		

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Sources: Program Evaluation Division analysis of Department of Trade and Economic Development files. Establishment data from Department of Trade and Economic Development, *Business Tracking System Quarter Report* (September 1995). Data are from 4th Quarter, 1994, and were not adjusted for late or missing employer reports.

[1]Percents do not add to 100 percent because not all industry groups received assistance through the Economic Recovery Fund.

[2]The total number of grants and loans and the total dollars do not match previous tables because nine projects were missing Standard Industrial Classification codes.

Table 2.4: Economic Recovery Fund, FY 1991-95, Distribution of Funds by Establishment Size and Location

Establishment[1] Size	Number of Projects[2]	Percent of Projects	Amount of Grants and Loans[2]	Percent of State Dollars	Percent of Federal Dollars	Percent of 1993 Establishments In The State
NON-METRO						
0 to 4 employees[3]	33	19.0%	$7,262,324	19.2%	13.4%	25.8%
5 to 9	7	4.0	843,000	2.5	0.9	8.4
10 to 19	10	5.7	997,339	3.2	0.6	5.0
20 to 49	26	14.9	5,298,000	15.1	7.2	2.8
50 to 99	22	12.6	4,429,490	8.9	14.7	0.8
100 to 249	19	10.9	6,878,000	15.4	19.1	0.6
250 to 499	20	11.5	5,881,074	9.3	24.7	0.2
500 to 999	5	2.9	1,323,920	2.8	4.0	0.1
1,000+	8	4.6	2,515,000	3.8	11.3	0.0
Total	150	86.2%	$35,428,147	80.1%	96.0%	43.7%
METRO						
0 to 4 employees[3]	2	1.1%	$750,000	2.6	0.0%	30.5%
5 to 9	1	0.6	500,000	1.7	0.0	10.1
10 to 19	3	1.7	455,000	1.6	0.0	6.9
20 to 49	4	2.3	610,000	2.1	0.0	5.1
50 to 99	2	1.1	445,513	1.5	0.0	1.8
100 to 249	8	4.6	2,180,748	5.8	4.0	1.2
250 to 499	1	0.6	100,000	0.3	0.0	0.3
500 to 999	1	0.6	500,000	1.7	0.0	0.1
1,000+	2	1.1	750,000	2.6	0.0	0.1
Total	24	13.8%	$6,291,261	19.9%	4.0%	56.3%
Total	174	100.0%	$41,719,408	100.0%	100.0%	100.0%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Sources: Program Evaluation Division analysis of Department of Trade and Economic Development files. Establishment numbers from: U. S. Bureau of the Census, County Business Patterns 1993 - Minnesota, CBP-93-25.

[1]Establishments are locations of doing business. One firm may have more than one establishment. Retail establishments are excluded from these figures. For businesses receiving fiancial assistance, "establishment size" is the number of full-time equivalent employees at application reported by the business.

[2]Total numbers of awards and dollars do not match those on previous tables because two companies did not report size at application.

[3]"0 to 4 employees" includes start-up businesses receiving financial assistance from the state. The census figures are for establishments with one to four employees.

businesses might receive a large number of awards that are, on average, smaller.[24]

We found:

- **Establishments with fewer than 100 employees received about 58 percent of state grant and loan funds, but they represent about 97**

24 There are two possible problems with the data. First, the U.S. Census Bureau reports the distribution of establishments by the number of employees, not full-time equivalent employees. Applicants are supposed to report jobs to DTED in full-time equivalencies. Therefore, the number of employees at businesses receiving assistance may be larger than the U.S. Census Bureau establishments of the same size. Second, we recorded the number of employees at the business location or subsidiary requesting assistance at the time of application, unless only total firm or parent company employment was available on the application. The number of employees at the business location indicates establishment size and is more comparable to the U.S. Census Bureau data. However, total firm employment may be a more accurate indication of borrowing strength.

percent of all firms in the state. The disproportion was even greater in the metro area.

Larger establishments received disproportionately more grants and loans.

Larger establishments received disproportionately more grants and loans. Establishments with 500 or more employees, while accounting for less than one-half a percent of establishments in the state, received 12 percent of dollars awarded. Larger companies with more than 500 employees, however, make up almost 25 percent of non-retail employment. This pattern also may be in part a function of the inability of small firms to create a large number of jobs or to leverage private investment. Also, Twin City metro area applicants, particularly small firms, have difficulty qualifying for the program. Another possible explanation is that small businesses in the non-metro area might approach the Challenge Grant program instead of the Economic Recovery Fund.[25] In fact, one loan officer told us that he avoids loans to smaller businesses and encourages them to apply for financial assistance to the Challenge Grant program, that is designed to help businesses with smaller capital needs.

Table 2.5 shows the type of award used to distribute almost $42 million in fiscal years 1991 through 1995. Businesses received over half of the assistance in the form of loans. However, the department awarded over $14 million in awards that will not be repaid if job creation goals are met and maintained. Most of these awards were grants, which the department usually reserves for public infrastructure projects. The metro region received 15 percent of program funds, but 23 percent of forgivable loan dollars and 20 percent of granted funds.

Table 2.5: Economic Recovery Fund, FY 1991-95, Distribution of Funds by Type of Award

Type of Award	Number Awarded	Dollars Awarded	Average Award
Loan	119	$24,470,419	$205,634
Forgivable Loan	11	4,250,000	386,364
Grant	37	9,808,489	265,094
Other[1]	9	3,387,000	376,333
Total	176	$41,915,908	$238,159

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development files.

[1]"Other" includes awards that are some combination of grants, loans, and forgivable loans.

Table 2.6 shows that companies with 100 or more employees received 88 percent of the dollars distributed through forgivable loans and 61 percent of the grants. Companies with fewer than 100 employees received 60 percent of loaned dollars and 78 percent of funds distributed through awards that were some combination of grants, loans, and forgivable loans.

25 We discuss the Challenge Grant program in Chapter 4.

Table 2.6: Economic Recovery Fund, FY1991-95, Type of Award by Establishment Size

	Award Type							
	Loan[1]		Forgivable Loan		Grant		Other[2]	
Establishment Size	#	Dollars	#	Dollars	#	Dollars	#	Dollars
0 to 4 employees[3]	26	$4,920,400	1	$500,000	6	$1,591,924	2	$1,000,000
5 to 9	5	343,000	0	0	1	500,000	2	500,000
10 to 19	10	979,000	0	0	3	473,339	0	0
20 to 49	23	3,968,000	0	0	5	970,000	2	970,000
50 to 99	21	4,452,263	0	0	2	255,740	1	167,000
100 to 249	20	6,321,256	3	1,500,000	4	1,237,492	0	0
250 to 499	10	2,790,000	0	0	10	2,691,074	1	500,000
500 to 999	1	400,000	2	750,000	3	673,920	0	0
1,000+	1	100,000	5	1,500,000	3	1,415,000	1	250,000
Total	117	$24,273,919	11	$4,250,000	37	$9,808,489	9	$3,387,000
Under 100 employees	72.6%	60.4%	9.1%	11.8%	45.9%	38.7%	77.8%	77.9%
100 or more employees	27.4	39.6	90.9	88.2	54.1	61.3	22.2	22.1
Under 250 employees	89.7%	86.4%	36.4%	47.1%	56.8%	51.3%	77.8%	77.9%
250 or more employees	10.3	13.6	63.6	52.9	43.2	48.7	22.2	22.1

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development files.

[1]Totals do not equal totals on previous tables because two firms did not report number of employees at application.

[2]"Other" includes awards that are some combination of loans, grants, and forgivable loans.

[3]"0 to 4 employees" includes start-up businesses receiving financial assistance from the state.

Table 2.7 shows businesses most often used Economic Recovery funds for machinery and equipment, construction and renovation, or infrastructure. DTED always funds public infrastructure projects such as roads or sewer systems with grants, but has sometimes awarded grants to finance other parts of a project such as working capital and employee training. The department awarded five of the seven grants for other uses prior to 1993.

The department awarded $3.3 million in working capital to ten different projects in fiscal years 1991 and 1992. One of the changes made by E. Peter Gillette when he became commissioner of DTED was to stop the use of funds for working capital.

Most of the projects funded were expansions of Minnesota businesses.

Most of the projects funded by the Department of Trade and Economic Development were expansions of Minnesota businesses. Table 2.8 shows that only two awards were made to relocate a company from another state. However, this does not reflect the only activity involving out-of-state businesses. We noted four awards that the department made to Minnesota firms to help them relocate some of their out-of-state facilities to Minnesota, awards to at least two out-of-state firms to open facilities in Minnesota as part of their expansion plans, and awards to firms to expand their Minnesota operations instead of locating in other states.

Table 2.7: Economic Recovery Fund, FY 1991-95, Type of Award by Use

	Loan		Forgivable Loan		Grant		Other[1]		Total	
Use	Number	Dollars	Number	Dollars	Number	Dollars	Number	Dollars	Number	Dollars
Building	7	$2,070,000	1	$500,000					8	$2,570,000
Construction/Renovation	37	7,407,650	1	250,000	1	$100,000	1	$500,000	40	8,257,650
Machinery and Equipment	62	11,251,369	8	3,000,000	2	550,000	6	2,250,000	78	17,051,369
Equity	1	500,000							1	500,000
Infrastructure					30	7,658,489			30	7,658,489
Property	1	150,000							1	150,000
Site Improvement					1	250,000			1	250,000
Training					1	500,000			1	500,000
Working Capital	9	2,791,500			1	500,000			10	3,291,500
Multiple Uses[2]	2	299,900	1	500,000	1	250,000	2	637,000	6	1,686,900
Total	119	$24,470,419	11	$4,250,000	37	$9,808,489	9	$3,387,000	176	$41,915,908

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development files.

[1]"Other" includes awards that are some combination of loans, grants, and forgivable loans.

[2]"Multiple uses" includes one loan for building and infrastructure, one "other" for building and infrastructure, one loan for construction and equipment, one forgivable loan for equipment and infrastructure, one grant for property taxes and training, and one "other" for training and construction.

Table 2.8: Economic Recovery Fund, FY 1991-95, Type of Award by Project Type

	Loan		Forgivable Loan		Grant		Other[1]		Total	
Project Type	Number	Dollars	Number	Dollars	Number	Dollars	Number	Dollars	Number	Dollars
Startup	17	$4,016,000	1	$500,000	7	$1,786,924	2	$1,000,000	27	$7,302,924
Expansion	87	17,357,419	9	3,250,000	23	6,200,965	5	1,417,000	124	28,225,384
Relocation							2	970,000	2	970,000
Retention	1	200,000	1	500,000	1	75,600			3	775,600
Expansion/Relocation[2]	8	1,480,000			5	1,245,000			13	2,725,000
Startup/Retention[3]	6	1,417,000	—		1	500,000	—		7	1,917,000
Total	119	$24,470,419	11	$4,250,000	37	$9,808,489	9	$3,387,000	176	$41,915,908

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development files.

[1]"Other" includes awards that are some combination of grants, loans, and forgivable loans.

[2]"Expansion/Relocation" is the expansion of a Minnesota company that is accomplished either by relocating operations from another state or relocating from one Minnesota location to another.

[3]"Startup/Retention" is facilitating new ownership of an existing company, usually to prevent the business from closing.

JOB CREATION

It is difficult to know the precise effects of job creation programs.

The department views the primary purpose of the Economic Recovery Fund as creating new jobs and retaining existing jobs in the state. But evaluating the effect of DTED loans or grants on job creation is difficult for at least three reasons. First, it is impossible to determine whether an observed change in the number of jobs is attributable to a particular program. There are many complex forces in the economy, making it difficult to know what might have happened in the absence of the state program. Second, it is generally difficult to determine whether the creation of new jobs in one location did or did not come at the expense of jobs in another location within the state. According to economists, this so-called "displacement effect" is particularly common when aid is given to retail businesses. Finally, it is difficult to evaluate the secondary and side effects of jobs that are created. A business might spin off additional economic activity and, hence more jobs, or it might create more pollution or affect other jobs in a negative way.

Nevertheless, in this section we address several issues concerning the effect of the Economic Recovery Fund on job creation or retention. We used a variety of methods to do this. First, we reviewed job and wage information recorded in project progress reports that all grantees must file with DTED. We also reviewed unemployment compensation tax returns for companies that received grants and loans to verify the companies' self reported data. In addition, we contacted 40 companies that received grants or loans to try to get a better idea of whether they would have created the jobs without state assistance.

DTED Progress Reports

Grantees (primarily city governments) must produce a progress report every six months through completion of the project, by obtaining project information from the company involved. The department uses the project reports to track whether the project is on budget and whether job creation goals are being met. The accuracy of the progress reports is critical for monitoring project progress and evaluating the effectiveness of the Economic Recovery Fund. Progress reports are often completed by the companies themselves with no verification of job creation from either the grantee or DTED.

We found that project progress reports contained some job creation and wage and benefit information that was inconsistent, incomplete, and in a few cases, inaccurate. Nonetheless, the progress reports are the best available source of information and we believe they provide a reasonable estimate of the jobs created after a DTED loan or grant is awarded. Progress reports are available for 155 of the 176 projects between 1991 and 1995. Reports are not available for 21 newly established projects.[26]

According to the department, projects are generally to achieve job creation goals within two years of receiving funds. Because the projects are at varying stages of

26 There were 185 projects awarded but nine projects were terminated before the money was disbursed.

The Economic Recovery Fund has assisted in creating over 8,300 jobs since 1991.

completion, we divided them into three subgroups: closed, open for more than two years, and open for less than two years. Projects are "closed out" when DTED determines that the project has made satisfactory progress towards budget and job creation goals. When DTED "closes" a project, the project's original goals have not necessarily been met. Loan officers told us that they would sometimes re-score projects and close them if they would score the minimum 400 points with fewer jobs created than originally planned.[27]

As Table 2.9 shows, DTED has received final progress reports and has formally "closed out" 96 of the 155 projects. We consider job creation information for these projects to be complete. There are nine open projects that received funds in fiscal years 1991 and 1992 that should have met their job creation targets and closed by now. There are 50 open projects that received funds in fiscal years 1993, 1994, and 1995 that are still working to accomplish job creation goals. As a result, job creation information for these projects is preliminary. We found:

- **Economic Recovery Fund grants and loans for fiscal years 1991 through 1995 have assisted in the creation or retention of 8,337 jobs.**

Table 2.9: Economic Recovery Fund, FY 1991-95, Distribution of Funds and Jobs Created by Project Status

Project Status	Number of Projects	Percent of Projects	Amount of Grants and Loans	Percent of Total Dollars	Jobs Created	Percent of Total Jobs Created
Open < 2 years[1]	50	32%	$12,410,654	35%	1,947	23%
Open > 2 years[2]	9	6	2,482,500	7	491	6
Closed[3]	96	62	20,988,754	58	5,898	71
Total	155	100%	$35,881,908	100%	8,337	100%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development reports.

[1]Includes all projects originating in FY 1993-95 that have not been completed for which job creation information was provided.

[2]Includes all projects originating in FY 1991-92 that have not been completed for which job creation information was provided.

[3]Includes all projects that have been completed for which job creation information was provided.

Table 2.10 shows the distribution of the projects, grant and loan amounts, and jobs by area of the state. The table shows that:

- **Projects in the Metro region created the highest number of jobs.**

The percentage of total jobs created was higher than the percentage of total funds received within the following areas: Metro, Northwest, and West Central. It was lower in the Central, Northeast, Southeast, and Southwest areas.

27 The department informs us that they have "closed out" 16 of the 96 closed projects we reviewed with fewer jobs than originally projected.

Table 2.10: Economic Recovery Fund, FY 1991-95, Distribution of Funds and Jobs Created by Region

Region	Number of Projects	Percent of Projects	Amount of Grants and Loans	Percent of Total Dollars	Jobs Created	Percent of Total Jobs Created
Central	33	21%	$8,668,564	24%	1,677	20%
Metro	22	14	5,566,261	16	1,974	24
Northeast	15	10	4,478,420	12	721	9
Northwest	10	6	3,033,490	8	1,481	18
Southeast	37	24	7,862,173	22	1,112	13
Southwest	21	14	3,864,000	11	780	9
West Central	17	11	2,409,000	7	592	7
Total	155	100%	$35,881,908	100%	8,337	100%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development reports.

Individual projects received between $20,000 and $500,000 in grants or loans. Table 2.11 shows the job distribution by award amount. The number of jobs created is fairly commensurate with the size of the award. That is, in general, the larger the award the larger the number of jobs created.

We noted earlier that small businesses received a disproportionately smaller amount of awards and funds. This may be due to the inability of small firms to create jobs at the same level as larger firms. Table 2.12 shows the job distribution by establishment size. As the table shows, firms with less than 20 employees created 25 percent of the total jobs, and larger companies created more jobs with less money than smaller companies. Firms with more than 500 employees created 22 percent of the total jobs with only 10 percent of total funds received.

Table 2.11: Economic Recovery Fund, FY 1991-95, Distribution of Funds and Jobs Created by Award Amount

Amount in Thousands	Number of Projects	Percent of Projects	Amount of Grants and Loans	Percent of Total Dollars	Jobs Created	Percent of Total Jobs Created
Under $50	11	7%	$392,934	1%	163	2%
$50 to 99	20	13	1,351,739	4	251	3
$100 to 149	26	17	2,825,324	8	631	8
$150 to 199	30	19	5,373,792	15	1,208	14
$200 to 249	9	6	1,914,609	5	351	4
$250 to 299	12	8	3,001,500	8	766	9
$300 to 349	5	3	1,521,500	4	510	6
$350 to 399	5	3	1,839,490	5	863	10
$400 to 449	8	5	3,276,000	9	568	7
$450 and over	29	19	14,385,000	40	3,026	36
Total	155	100%	$35,881,908	100%	8,337	100%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development reports.

Table 2.12: Economic Recovery Fund, FY 1991-95, Distribution of Funds and Jobs Created by Establishment Size

Establishment Size	Number of Projects	Percent of Projects	Amount of Grants and Loans	Percent of Total Dollars	Jobs Created	Percent of Total Jobs Created
0 to 4 employees	33	21	$7,764,324	22%	1,704	20%
5 to 9	8	5	1,343,000	4	117	1
10 to 19	12	8	1,392,339	4	292	4
20 to 49	27	17	5,2983,000	15	793	10
50 to 99	21	14	3,875,003	11	658	8
100 to 249	25	16	8,058,748	22	1,823	22
250 to 499	17	11	4,570,074	13	1,124	13
500 to 999	4	3	1,223,920	3	504	6
1,000 or more	6	4	2,265,000	6	1,312	16
Unknown	2	1%	106,500	0	10	0
Total	155	100%	$35,881,908	100%	8,337	100%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

Table 2.13 shows the distribution of jobs by the Standard Industrial Classification (SIC) codes. We found SIC numbers for 146 companies from their application forms or from the Department of Economic Security. Table 2.13 shows:

- **Manufacturing companies created over 60 percent of total jobs.**

As we discussed earlier, grants and loans are more likely to truly "create" jobs when they are awarded to manufacturing firms with no Minnesota competitors. DTED awarded almost 80 percent of Economic Recovery funds to manufacturing firms between 1991 and 1995. In 1993, the manufacturing industry in Minnesota accounted for approximately 20 percent of total state employment. Projects in the services industry created 22 percent of total jobs with eight percent of total dollars received.

Table 2.13: Economic Recovery Fund, FY 1991-95, Distribution of Funds and Jobs Created by Industry Type

Industry	Number of Projects	Percent of Projects	Amount of Grants and Loans	Percent of Total Dollars	Jobs Created	Percent of Total Jobs Created
Agriculture, Forestry, Fishing	2	1%	$ 137,739	0%	22	0%
Manufacturing	118	76	27,981,003	78	4,982	60
Transportation, Public Utilities	0	0	0	0	0	0
Trade	6	4	1,490,000	4	515	6
Finance, Insurance, Real Estate	8	5	1,746,256	5	664	8
Services	13	8	3,013,910	8	1,830	22
Unknown	8	5	1,513,000	4	323	4
Total	155	100%	$35,881,908	100%	8,337	100%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

Job Creation by Type of Award

We were interested in whether the type of award was related to the number of jobs created. To answer this question, we separated projects into three award types: loans, grants, and grant/loans. The grant/loan category includes forgivable loans and awards that are a combination of grants, loans and forgivable loans. In most cases, projects in the grant/loan category are grants or forgivable loans where the first $100,000 of the award is a loan repaid to the local government to capitalize a revolving loan fund. Table 2.14 shows that projects receiving grants created 35 percent of total jobs with only 20 percent of funds distributed. Grants created jobs at the lowest cost per job of $2,516, or $2,198 for projects that were completed. Of course, grants are not paid back and, therefore, do not generate any future economic activity. Most of the program's loans are repaid to the General Fund for future use.

Table 2.14: Economic Recovery Fund, FY 1991-95, ERF Dollars Spent per Job Created by Project Status and Award Type

Project Status	Award Type	Number of Projects	Amount	Jobs Created	Dollars per Job
Open < 2 years[1]	Loan	32	$6,620,800	792	$8,355
	Grant/Loan[4]	9	3,970,000	603	6,584
	Grant	9	1,819,854	552	3,297
	All Types	50	$12,410,654	1,947	$6,374
Open > 2 Years[2]	Loan	6	$1,495,000	245	$6,102
	Grant/Loan	1	250,000	64	3,906
	Grant	2	737,500	182	4,052
	All Types	9	$2,482,500	491	$5,056
Closed[3]	Loan	72	$13,669,111	3,097	$4,414
	Grant/Loan	6	2,417,000	571	4,236
	Grant	18	4,902,643	2,230	2,198
	All Types	96	$20,988,754	5,898	$3,559
Total	Loan	110	$21,784,911	4,134	$5,269
	Grant/Loan	16	6,637,000	1,238	5,363
	Grant	29	7,459,997	2,964	2,516
	All Types	155	$35,881,908	8,337	$4,304

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

[1]Includes all projects originating in FY 1993-95 that have not been completed for which job creation information was provided.

[2]Includes all projects originating in FY 1991-92 that have not been completed for which job creation information was provided.

[3]Includes all projects that have been completed for which job creation information was provided.

[4]Includes forgivable loans and awards that are a combination of grants, loans, and forgivable loans.

Job Promises

Most companies meet their job creation goals.

At the beginning of a project, each company promises to create a specific number of jobs and the promise becomes part of the grant or loan agreement in most cases. We compared the job creation goal found in the project files with the number of new jobs actually reported on progress reports. As Table 2.15 shows, we found:

- **Ninety-five of the 155 projects met or exceeded promised job creation goals. Overall, the companies receiving grants or loans created more jobs than they promised. As a group, 78 of the 96 projects that are closed created as many jobs as they promised.**

Table 2.15: Economic Recovery Fund, FY 1991-95, Jobs Promised and Created by Project Status

Project Status	Number of Projects	Projects that Met Job Goals[4]	Number of Jobs Promised	Number of Jobs Created	Percent of Jobs Promised
Open < 2 years[1]	50	13	2,101	1,947	93%
Open ≥ 2 years[2]	9	4	570	491	86
Closed[3]	96	78	5,594	5,898	105
Total	155	95	8,264	8,337	101%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

[1]Includes all projects originating in FY 1993-95 that have not been completed for which job creation information was provided.

[2]Includes all projects originating in FY 1991-92 that have not been completed for which job creation information was provided.

[3]Includes all projects that have been completed for which job creation information was provided.

[4]Includes all projects that met or exceeded job goals or were below job goals by less than 1 FTE job.

The table shows that for closed projects and projects more two years old, 82 of the 105 companies had met job creation goals. The 23 companies that had not met job goals fell short by a total of 1,022 jobs including nine firms that went out of business during the period resulting in 885 fewer jobs than promised. The 50 projects that have been open less than two years have yet to create 665 new jobs.

Table 2.16 shows that projects with grants created the highest percentage of jobs promised (130 percent). As Table 2.17 shows, firms with over 50 employees had greater success than smaller firms at creating more jobs than promised.

Table 2.16: Economic Recovery Fund, FY 1991-95, Jobs Promised and Created by Award Type

Award Type	Number of Projects	Number of Jobs Promised	Number of Jobs Created	Percent of Jobs Promised
Loan	78	3,779	3,342	88%
Grant/Loan[1]	7	528	635	120
Grant	20	1,857	2,412	130
Total	105	6,164	6,389	104%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs. It includes all projects that have been completed and all projects more than two years old that have not been completed for which job creation information was provided.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

[1]Includes forgivable loans and awards that are a combination of grants, loans, and forgivable loans.

Table 2.17: Economic Recovery Fund, FY 1991-95, Jobs Promised and Created by Establishment Size

Establishment Size	Number of Projects	Number of Jobs Promised	Number of Jobs Created	Percent of Jobs Promised
0 to 4 employees	20	1,807	1,473	82%
5 to 9	4	124	101	81
10 to 19	10	156	170	109
20 to 49	15	552	545	99
50 to 99	16	541	580	107
100 to 249	19	1,214	1,474	121
250 to 499	13	774	943	122
500 to 999	2	182	145	80
1,000 or more	5	806	948	118
Unknown	1	8	10	125
Total	105	6,164	6,389	104%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs. Includes all projects that have been completed and all projects more than two years old that have not been completed for which job creation information was available.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

Wages and Benefits

In 1993, the Legislature added a requirement that DTED report on wages and benefits of the jobs created with the department's assistance.[28] Beginning in July 1994, DTED began requiring companies to report wage and benefit information in progress reports.

28 *Minn. Laws* (1993), Ch. 252, subd 1 (18).

Wages

One hundred five projects provided wage information for 4,979 of the 8,337 jobs created between 1991 and 1995. Most of the projects that reported wage information originated between 1993 and 1995. As we noted earlier, companies were inconsistent in providing wage information.[29] Some companies reported the wages for jobs created every six months over the two year period. Others reported all of the wages for jobs created over the past two years in the final report. The date of hire and the wage paid were unclear many times.[30] Frequently, we were unable to accurately match dates with the wages reported so adjusting for inflation was impossible.

Nonetheless, our examination of wages gives a picture of the level of jobs the state has assisted in creating with the Economic Recovery Fund subsidy. Table 2.18 shows the distribution of wages per hour for all jobs, by project status. We found:

The average wage of the jobs created was $8.64 and the median was $7.20.

- **The average wage for the jobs created was $8.64 per hour. The median wage was $7.20 per hour.**

Table 2.18: Economic Recovery Fund, FY 1991-95, Average and Median Wage by Project Status

Project Status	Number of Projects	Number of Jobs	Average Wage	Median Wage
Open < 2 years[1]	43	1,971	$9.79	$8.00
Open > 2 years[2]	5	121	8.21	7.25
Closed[3]	57	2,887	7.87	7.00
Total	105	4,979	$8.64	$7.20

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

[1]Includes all projects originating in FY 1993-95 that have not been completed for which wage information was provided.

[2]Includes all projects originating in FY 1991-92 that have not been completed for which wage information was provided.

[3]Includes all projects that have been completed for which wage information was provided.

As Table 2.19 shows, the average wage of jobs created by Economic Recovery Fund projects was lower than the average wage of jobs in all regions in the state in 1993. Figure 2.3 shows the distribution of wages for the jobs. The department notes that the jobs they are assisting in creating are usually entry-level and as a

29 We refer here to companies because, although grantees (mostly cities) are responsible for filing the progress reports, in almost all cases the report is prepared by the company and forwarded by the local unit of government to DTED.

30 For example, a company would report the creation of 100 production jobs between 1991 and 1992 with wages starting between 8 and 10 dollars an hour.

Table 2.19: Economic Recovery Fund, FY 1991-95, Average and Median Wage by Region

Region	Number of Projects	Number of Jobs	Median Wage	Average Wage	1993 Region Average Wage[1]
Central	22	1,173	$7.00	$8.18	$9.54
Metro	16	1,069	9.00	10.78	13.85
Northeast	9	483	7.26	9.35	10.63
Northwest	6	600	5.95	6.73	8.88
Southeast	29	913	7.71	9.12	10.48
Southwest	13	253	6.58	7.95	8.89
West Central	10	488	5.50	6.20	8.62
Total	105	4,979	$7.20	$8.64	$12.36

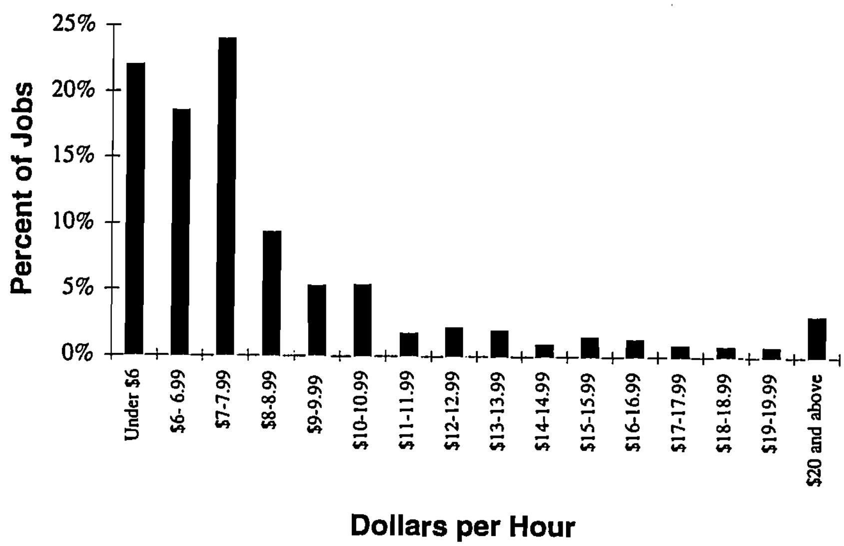
Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

[1]1993 Minnesota Average Covered Employment and Wages, Department of Economic Security.

Sixty-three percent of the jobs paid wages less than $8.00 per hour.

Figure 2.3: Economic Recovery Fund, FY 1991-95, Wage Distribution



Source: Program Evaluation Division analysis of Department of Trade and Economic Development wage reports.

result they tend to pay lower wages. As one can see from examining the figure, the distribution of the jobs created is skewed towards the lower wage levels with 63 percent of the jobs paying less than $8.00 per hour. About 42 percent of the jobs paid less than $7.00 per hour. In comparison, the 1993 poverty level for a family of four was $14,350, or the equivalent of $6.89 per hour.

Table 2.19 also shows that the Metro area had the highest average wage at $10.78 per hour and a median wage at $9.00 per hour. The Northwest and West Central areas reported the lowest average wages per hour at $6.73 and $6.20 respectively, with a median wage of $5.95 in the Northwest region and $5.50 in the West Central region. Approximately 90 percent of jobs created in these two regions had wages below $8.00 per hour. Projects receiving forgivable loans and combination loan/grant awards created jobs with higher wages than projects receiving loan or grant awards. Establishments with fewer than 20 employees created jobs with higher average wages than larger firms.

Table 2.20 shows the average and median wages by the year of the project's origination. Because of the way companies report to DTED, the jobs could have been created in any fiscal year. For example, projects originating in 1991 could have hired people and reported to the department in 1993. The table shows a slight trend of increasing wages by the year of project origination, although some of the increase may be due to inflation. Table 2.21 shows that state grants and loans tended to create jobs with higher wages than those from the federal program.

There is a trend toward increasing wages but inflation probably accounts for some of the increase.

Table 2.20: Economic Recovery Fund, FY 1991-95, Average and Median Wage by Fiscal Year of Award

Fiscal Year Project Originated	Number of Projects	Number of Jobs	Median Wage	Average Wage
1991	7	205	$6.79	$7.36
1992	17	619	7.00	7.57
1993	26	1,070	7.40	9.22
1994	32	1,682	7.00	8.31
1995	23	1,404	7.50	9.26
Total	105	4,979	$7.20	$8.64

Note: "Economic Recovery Fund" refers to both state and federal funded programs.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

One partial explanation for distribution of wages being skewed towards lower paying jobs is because the state and federal program are linked. The federal program predated the state program by one year, and partially as a result, the state program adopted the same rules for awarding grants as the federal program. The Economic Recovery Grant statute clearly focuses on job creation as a goal of the program. Projects funded by the federal Community Development Block Grant are required to fill 51 percent of the jobs created with low and moderate income (LMI)

Table 2.21: Economic Recovery Fund, FY 1991-95, Average and Median Wage by Source

Source	Number of Projects	Number of Jobs	Average Wage	Median Wage
State	89	4,160	$8.87	$7.50
Federal	16	819	7.51	6.00
Total	105	4,979	$8.64	$7.20

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

State-funded projects have created higher-paying jobs than federal-funded projects.

individuals.[31] The state-funded program requires that jobs be filled by or made available to LMI persons. Jobs that do not require specialized training are considered "available to" LMI persons. In many cases this has resulted in the approval of projects that created lower-skill, lower-wage jobs. However, in the current economic environment, when unemployment rates in many areas of the state are around 3 percent, the state might want to reconsider the LMI restriction on state funds. In our opinion, the state program should have the flexibility to assist companies that might require specialized training and offer higher salaries.

We recommend:

- **DTED should separate the requirements for state funds from the federal CDBG program.**

Benefits

Most jobs provided employee benefits.

Eighty-three companies, primarily from projects funded between 1993 and 1995, provided information about benefits for 3,619 of the 8,337 jobs created between 1991 and 1995. Table 2.22 shows that projects in the Northwest region had the lowest percentage of jobs with health and life insurance benefits. Large firms provided more benefits to a larger percentage of jobs created than smaller firms. When information was available, we found that:

- **Approximately 90 percent of the jobs created provided health care, 56 percent dental, 85 percent life, and 62 percent retirement benefits.**

Verification of Job Creation

We wanted to determine if companies' self-reported job creation data was accurate, and whether jobs created were retained after the project was "closed out" by

31 The federal government requires the jobs be filled by or made available to LMI persons. The state has chosen the stricter standard.

Table 2.22: Economic Recovery Fund, FY 1991-95, Benefits Provided by Region

Region	Number of Projects	Jobs Providing Benefits: Health	Dental	Life	Retirement	Number of Jobs
Central	16	871	460	869	384	928
		94%	50%	94%	41%	100%
Metro	14	757	747	759	681	764
		99%	98%	99%	89%	100%
Northeast	6	372	239	342	379	398
		93%	60%	86%	95%	100%
Northwest	5	144	140	140	140	236
		61%	59%	59%	59%	100%
Southeast	22	493	182	490	329	639
		77%	28%	77%	51%	100%
Southwest	10	190	67	150	104	206
		92%	33%	73%	50%	100%
West Central	10	396	180	330	226	449
		88%	40%	73%	50%	100%
Total	83	3,222	2,015	3,080	2,243	3,619
		89%	56%	85%	62%	100%

Note: "Economic Recovery Fund" refers to both the state and federal funded programs.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

DTED. We examined data from Department of Economic Security (DES) unemployment tax returns to determine employment levels on various dates.[32]

With the assistance of DES research staff, we collected information on wages and employment at the quarter nearest the grant award date for all awards made between July 1990 and December 1993. We were able to collect information on 112 of the 143 awards made in that time period. Twenty-six companies appeared to be reporting incorrectly to DES, and five companies had more than one award during the period. We collected the same information at a point two years later when job creation is supposed to be complete. Finally, we collected information on employment and wages for all companies in December 1994.

32 There are some limits to the DES data. Firms are supposed to report separately for all locations in the state. Unfortunately, not all firms report correctly. Many multi-location companies report all locations in the state as one, resulting in a decrease in the number of companies whose employment could be verified. Another limitation is that the number of employees reported includes anyone who worked during that quarter. As a result, part-time employees inflate the reported employment level. Fortunately, the reporting creates a bias in a conservative direction. We can be comfortable knowing that if the data show less employment than promised, it is not an artifact of the way the data is collected or reported.

We found:

- **Almost all companies' employment levels reported on their tax returns were consistent with employment reported to DTED.**

In other words, companies appear to be reporting the same employment levels to both of these state agencies. Since companies would have an incentive to over-report employment to DTED and under-report it to DES, we believe reported employment levels are accurate.

Because businesses are supposed to create permanent jobs, we also reviewed whether companies had met their job creation goals and had retained the jobs. The Department of Trade and Economic Development "closes out" a project as soon as it has met the job creation goal. Companies often meet their job goal within six months to a year of the loan or grant award date. We found:

- **Ninety-one of the 112 companies maintained employment levels at the level agreed to in the loan or grant agreement.**

Sometimes the jobs created were not permanent.

Unfortunately, sometimes employment decreases after the project is "closed out" by DTED. Twenty-one companies did not meet or did not maintain employment at the agreed to level. Three of the companies had gone out of business, five companies did not meet their job goal within two years, and 13 companies met their job creation goals but employment levels fell after the project was "closed out."[33] Employment levels at five companies fell to levels lower than when they had applied for the loans. One company had a forgivable loan but had not met its job goals in the required two year period.

We also found that:

- **DTED does not consistently follow-up on companies' job creation claims.**

Grantees had not submitted many of the progress reports that we were interested in; in some cases they were years late. We also found some companies are supposed to continue to report job creation status after their grant/loan is "closed out" but we noted several instances where the reports had not been filed and there was no follow-up from DTED. DTED has also failed to follow-up on at least one company with a "forgivable" loan that had not met its job creation goal. We recommend:

- **DTED should develop a system to consistently follow-up on job creation progress reports. DTED should also develop a process for following up on and collecting repayments from companies that do not meet job creation requirements.**

We think periodically checking the companies' job and wage levels using unemployment insurance information would also be a good idea. By getting wages and

33 Since December 1994, one additional company with 109 jobs has gone out of business.

employment information when the project starts and at periodic benchmark dates, the department will have a better idea of the economic effects of the program.

PERSPECTIVES OF FIRMS RECEIVING GRANTS

We also wanted to determine whether companies would have undertaken the job creation projects if they had not received a loan or grant from the state.[34] We asked key decisionmakers (Presidents, CEOs, General Managers, Vice Presidents, etc.) at a sample of 40 companies that had received loans or grants what they thought would have happened if they had not received public assistance. Our sample was not a random one and so we do not know if it is representative of all companies that received grants. We talked with representatives of almost all of the firms receiving grants or loans of the maximum amount of $500,000 between 1991 and 1995 and also a number of firms receiving smaller awards.[35] The executives we spoke with represented firms that had received $16.5 million in Economic Recovery Funds. Because we wanted the executives to speak freely, we told them their remarks would not be associated with their company in our report.

We asked the executives if they had considered other locations in Minnesota and or in other states. Sixty-five percent (26 of 40) had considered other locations for their expansion. Twenty of the 26 companies had considered locations in other states. Fourteen of the companies only considered locations in Minnesota, four of those because the project was tied to a specific Minnesota location. Some of the 14 companies that only considered Minnesota locations told us that they had not seriously consider other states although they had been contacted by them.

The most important factor for companies choosing Minnesota locations was the good labor force.

Fifteen of twenty-six companies that considered other locations mentioned more than one factor as being important in their location decision. The most important factors for companies in choosing a Minnesota location were traditional factors such as Minnesota's good labor force, the economics of the project worked out here, and good access to markets. These reasons were coupled in many cases with the fact that most companies (36 of 40) were already located in Minnesota. Almost one-half of the executives already living in Minnesota explicitly mentioned the desire to remain at their current location or to expand in Minnesota if at all possible. It appears that "quality of life" factors played an important part in many of the decisions. However, the most frequently mentioned factor (17 of 40 executives) was city and state financial incentives. For most executives this was not the most important factor, but for six it was the most important factor. Some sample comments about the most important location decision factors:

34 We acknowledge that there is no precise way to determine what would have happened at these companies if they had not received a grant of a loan. Also, company executives, knowing that we were evaluating the effectiveness of the Economic Recovery Fund and having benefited from it in the past, might have overstated the influence of the incentive on their location or expansion decisions.

35 Two firms receiving large grants refused to speak with us and we did not pursue the matter.

- Economic viability, availability of raw product, labor pool, taxes, regulations, incentives.

- Existing labor pool, availability of education, facility capacity, economic variables, and incentives.

- We would always prefer to expand in Minnesota if the economics are appropriate.

- Labor force was the most critical factor, also relationship with the state university, and the (Economic Recovery Grant) funding mitigated financial advantages of locations in other states.

Another executive told us:

> We all live in this community and wanted to stay. But we received offers from all over the country and if we want to stay competitive we have to ... go where it is best financially for the company. The (Economic Recovery Grant) funding allowed us to stay.

Three-fourths of the executives heard about the Economic Recovery Fund program through city or local economic development officials although several mentioned more than one source of information. Many of the executives we interviewed had been extensively "wooed" by other states. One executive told us that they really had not thought of relocating until they were approached by Iowa, South Dakota, and Kansas with offers that made them realize it was expensive to do business in Minnesota.

Seventeen of 40 executives said that without state assistance, their companies' expansion would have occurred in another state.

Twenty-eight of the executives said that the "same project" would probably or definitely not have happened in Minnesota without the state's participation, although one company told us that the same project would have definitely gone ahead and six said that it probably would have. Fifteen said that some expansion would have occurred in Minnesota regardless of the loan/grant, but it would have been smaller, taken longer, or created fewer jobs. Seventeen executives said the expansion would have occurred in another state without the ERF assistance.

Discussions with these 40 executives leads us to several conclusions. First, there is real competition for Minnesota businesses to move or expand in surrounding states rather than in Minnesota. Second, the Economic Recovery Fund has been an important factor for some companies deciding to stay and expand their business in Minnesota. Third, although there is no way to know for sure, we believe many (22 of 40) of the Economic Recovery Fund projects, would have gone forward even without the state's assistance. Some projects, however, might have been smaller or taken longer without the state aid.

Local Economic Development

Chapter 3

The focus of this report is on state-level business financial incentive programs operated by the Department of Trade and Economic Development (DTED). However, there are a number of other local economic development efforts going on in the state that in many respects overshadow the state-level programs. In order to put the state-level programs in context, in this chapter we discuss the interaction of the Economic Recovery Fund with local governments. We asked:

- **How has the Economic Recovery Fund interacted with local economic development programs?**
- **Has the state received the repayments from past loans? How many loans have been "forgiven?" What is the repayment schedule to the General Fund for future years?**
- **How has the money retained in local revolving loan funds been used?**

LOCAL ECONOMIC DEVELOPMENT

In reviewing the Economic Recovery Fund we were somewhat surprised to learn that it was only a small component of most of the projects it financed. We found:

Most projects funded by the Economic Recovery Fund had additional public funding.

- **Local and regional level programs are very important components of economic development in Minnesota.**

For example, we found that most projects funded by the Economic Recovery Fund between 1991 and 1995 had multiple participants. Almost all projects had local or regional financial participants such as city, county, or regional revolving loan funds, tax increment financing (TIF), Economic Development Agencies (EDAs), Regional Development Commissions, regional initiative funds, power companies, and a wide variety of other financial entities. Also, as we will discuss later in this chapter, our survey of local revolving loan programs showed capital balances of over $110 million on June 30, 1995.

The Economic Recovery Fund provided only 29 percent of public financing for the projects we reviewed.

We found that the average Economic Recovery Fund project between 1991 and 1995 had three sources of financing in addition to the state. Public financing other than the Economic Recovery Fund was a part of 136 of the 176 funded projects: 35 of the projects used local revolving loan funds, 40 used tax increment financing, and 56 used loans from the Minnesota initiative funds. These 136 projects received an average of over $586,000 in public grants or loans for a total of about $80 million, not including $33 million from the Economic Recovery Fund program. In other words, the state program provided only slightly over 29 percent of the public financing for the projects that were funded. As a result, one should view with caution the assertions of DTED or local loan and grant providers about the number of jobs created, the amount of funds leveraged, and the cost per job created, because none of the numbers we reviewed considered that there were multiple sources of public subsidy for the projects. In fact, DTED considers most other publicly subsidized financing to be leveraged funds in its application scoring process.

We found that tax increment financing (TIF) is probably the economic development tool used most often by cities. Basically, tax increment financing allows a city to capture the additional tax paid by new businesses within a tax increment district for a certain period for use in a variety of ways, including economic development. TIF is commonly used to help companies build new buildings, acquire capital equipment, make site improvements, and for infrastructure improvements.[1] In 1995, there was over $275 million in tax increments available for use in Minnesota annually, mostly for redevelopment and economic development purposes.

LOAN REPAYMENTS AND DEFAULTS

Loans made from the state portion of the Economic Recovery Fund are repaid by businesses to local communities and to the state. Local units of government receive and keep the first $100,000 for use in local revolving loan programs. The state receives repayment for loans greater than $100,000. Repayment of loans are deposited in the General Fund. Funds from the federal CDBG program are all retained by the local government.

We found that:

- **The state has received repayment for nearly all past loans over $100,000, although some companies have gone out of business and defaulted.**

Table 3.1 shows that since 1984, 33 of 318 grantees (10.4 percent) have gone out of business, defaulting on 6.7 percent of the funds lent. A few other companies have gone out of business but have kept current on the loans because of personal guarantees by the business owners. For federally financed projects, 11.3 percent

1 For more information about tax increment financing, see our previous report on the subject *Tax Increment Financing* (St. Paul: Office of the Legislative Auditor, 1987), and forthcoming *Tax Increment Financing* (St. Paul: Office of the Legislative Auditor, 1996).

Table 3.1: Economic Recovery Fund, FY 1985-95, Distribution of Funds and Company Defaults by Year

	State				Federal			
Year	Number of Loans	Dollars	Number of Defaults	Amount of Defaulted Loans	Number of Loans	Dollars	Number of Defaults	Amount of Defaulted Loans
1985	32	$5,909,598	7	$1,273,800	9	$1,523,596	1	$227,427
1986	30	4,998,774	6	840,561	10	1,852,244		
1987	36	5,665,712	9	1,220,059	11	2,065,305	3	307,899
1988	32	5,454,700	5	325,000	10	1,760,531	3	700,000
1989	25	5,926,139	4	364,538	13	3,775,318	2	536,000
1990	26	5,621,600	1	191,200	8	2,263,500	1	216,000
1991	25	5,863,350			5	1,990,000		
1992	23	5,347,490			8	1,977,314	1	190,000
1993	29	5,315,920			4	977,739		
1994	31	7,353,248	1	70,000	4	1,393,000		
1995	29	6,412,800			15	4,751,500		
Total	318	$63,869,331	33	$4,285,158	97	$24,330,047	11	$2,177,326

Note: One additional loan made in 1993 for $500,000 is not technically in default status because loan payments had been deferred. However, the company is out of business and has defaulted on other loans for the project. The department does not receive repayment of federal loans or the first $100,000 of state loans and does not consistently track their repayment to local governments. Therefore, the default figures may be understated.

Source: Department of Trade and Economic Development.

of the companies have gone out of business, defaulting on 8.9 percent of the funds lent.

The default rate appears to be decreasing.

These figures likely understate the default rate on the more recent loans because many companies have not yet had to make payments. Many loans were originally structured to begin repayment of principal and interest at some date between 5 and 10 years in the future. The table also shows that the default rate appears to have decreased in recent years. In part that is because some of the more recent loans have not had to begin repayment to the state yet. It is also probably partially attributable to a change of policy, initiated by former DTED Commissioner Peter Gillette, to not make loans for working capital. Loans for working capital tend to be riskier and have a higher default rate.

Forgivable loans are loans that have a term and interest rate but are "forgiven" in whole or part depending on job creation and retention goals specified in the loan agreement. It appears that the number of forgivable loans has increased in recent years. We found that between 1991 and 1995 there have been 57 grants or forgivable loans made from the state Economic Recovery Fund. In comparison there were 26 grants or forgivable loans made from the state program in the five years between 1985 and 1989.

The state General Fund is scheduled to receive repayments of $1,205,000 in fiscal year 1996, $1,455,000 in fiscal year 1997, and $1,174,000 in fiscal year 1998. As of June 30, 1995, over $1.7 million had been repaid to the General Fund and an additional $19.3 million is scheduled to be repaid in the future.

As of June 30, 1995, almost $3.5 million in loans had been repaid to the Economic Recovery Fund to be lent again. Since 1995, all repayments have gone to the state's General Fund.

LOCAL REVOLVING LOAN FUNDS

An interesting feature of the Economic Recovery Fund is the use of loan repayments to capitalize local revolving loan funds. The repayments from loans made from the federal Small Cities Community Development Block Grant program all stay with the local community, and up to $100,000 in repayments from the state Economic Recovery Grant program also may stay with the local community.

We identified over 237 revolving loan funds with over $110 million in total assets.

At our roundtable discussion in mid-1995, Legislators expressed interest in how the local loan funds are being used. Unfortunately, there is no central source of information about local revolving loan funds. A 1989 survey identified 157 funds with over $42 million in capital but no more current information was available.[2] As a result, we conducted a survey of local governments to identify revolving loan funds and to find out about the uses of the funds. We surveyed all communities that had received economic recovery loans, all cities over 1,000 in population, and all 87 counties.[3] We sent a total of 531 surveys and received 483 responses for a response rate of 90 percent.[4] We believe we have identified almost all of the local revolving loan funds in the state.

Our survey revealed the existence of over 237 revolving loan funds.[5] We found that the use of local revolving funds has continued to increase. Since the 1989 survey, 80 additional funds have formed and the amount of capital available in the loan funds rose from $42 million in 1989 to over $110 million in 1995. We heard from many communities that they did not have a revolving loan fund but that they might form one. Although one community started its fund in 1948, we found over half of the communities responding to our survey had started their loan funds since 1988, with 25 originating in 1994 alone. Only 14 communities had loan funds before the start of the Economic Recovery Fund in 1984.

The fact that the state will let communities keep a portion of Economic Recovery Fund repayments has created an incentive for communities to start revolving loan funds. DTED has been the source of capital for 129 of the 237 funds, either through the Small Cities or Recovery Grant program. Economic Development Ad-

2 Tom Stinson and Andrea Lubov, "Revolving Loan Funds: Funding Economic Development in Non-Metro Cities," *Minnesota Agricultural Economist*, No. 669, Spring 1992, 1-11.

3 We also sent surveys to any respondents to Stinson and Lubov's 1989 survey that were not already on our list.

4 We included a postcard for communities to send back if they did not have an economic development revolving loan fund.

5 An additional 15 surveys were received after our analysis was completed.

ministration or Urban Development Action Grants capitalized 23 of the funds and other sources capitalized 96 of the funds. Most often cities contributed to the funds from their general revenues or they contributed excess TIF reserves to capitalize their funds. However, cities have started funds with sources of capital as varied as local business persons' contributions, federal government grants, and grants from various foundations.

City councils or city economic development administration agencies are responsible for administering most revolving loan funds (over two-thirds). Other administrative agencies include Housing and Redevelopment Agencies (4.7 percent), Regional Initiative Funds (3.9 percent), Port Authorities (3.4 percent), and Regional Development Commissions (1.7 percent).

Table 3.2 shows the distribution and total capital available by region. The table shows that loan funds are present throughout the state, but they are pervasive in southeastern Minnesota with 64 funds and a capitalization of over $23 million. The Minneapolis Community Development Agency and the City of St. Paul operate several loan programs that are not revolving loan programs. As a result, we understate the amount of capital available in the metropolitan area from loan funds.

Table 3.2: Revolving Loan Funds, June 30, 1995, Total Capital by Region

Region	Number of Funds	Total Capital
Central	38	$8,556,533
Metro	29	34,618,467
Northeast	21	12,342,553
Northwest	18	10,694,226
Southeast	64	23,490,619
Southwest	38	12,888,299
West Central	24	7,849,354
State Total	232[a]	$110,440,071

Source: Program Evaluation Division analysis of survey of local revolving loan funds, December 1995.

[a]There are an additional two funds in the Central region, one fund in the Northwest region, and two funds in Southwest region that responded to the survey but the total capital was missing.

There is a lack of lending opportunities for 47 percent of funds.

The 237 funds made almost 2,300 loans between 1990 and 1994. However, 27 funds made no loans, another 27 made only one, and 20 funds made only two loans during the five year period.[6] The most active fund made 287 loans, but the average number of loans made was ten and the median number was five. Twelve percent of funds had no loans outstanding on June 30, 1995; the median fund had four loans outstanding and one fund had 250 loans. Overall, this suggests a lack of lending opportunities for some funds. Forty-seven percent of fund administrators told us they had more capital available than the amount of loans requested during the previous 12 months, 23.9 percent responded that the amount of capital was equal to the loans requested, and 22.9 percent said that the capital was inadequate

6 The reader should note that some of these funds were recently established.

for the loans requested. Although there was over $110 million in total capital statewide, the median fund had only $101,000 in total assets. Of the $110 million in total assets, there was over $35 million available to lend.

Partially as a result of the average fund's small capitalization, the average loan size is small. Twenty-seven percent of the loans are for less than $10,000, 20 percent are for between $10,000 and $20,000, and another 26 percent are for between $20,000 and $50,000.

Local revolving loan funds are used more flexibly than state Economic Recovery funds.

In Table 3.3 we show local revolving loan funds are used more flexibly than state funds. The primary use was for buildings and/or equipment although local governments were more likely to make loans for working capital and inventory financing than the state. Table 3.4 shows that local funds focus on existing and startup businesses, but they are more likely to fund retail and service businesses than state programs.

Table 3.3: Revolving Loan Funds, Types of Uses

Use	Percent of Respondents
Buildings/Equipment	89.4%
Other Fixed Assets	44.0
Working Capital	44.5
Inventory	41.3
Bridge Financing	19.7
Loan Guarantee	13.3
Interest Writedown	7.3
Infrastructure	11.0
Equity	4.1
Other - Storefront Rehabilitation	8.3

Source: Program Evaluation Division analysis of survey of local revolving loan funds, December 1995.

Table 3.4: Revolving Loan Funds, Types of Businesses That Can Receive Loans

Type of Business	Percent of Respondents
Existing businesses located in your area	95.6%
Startup businesses	89.1
Businesses in other states that will relocate or expand in your area	71.6
Businesses in Minnesota that will relocate or expand in your area	74.7
Manufacturing/Industrial firms	88.6
Retail firms	64.6
Service firms	65.5
Other	7.4

Source: Program Evaluation Division analysis of survey of local revolving loan funds, December 1995.

We found that over two-thirds (67.4 percent) of the funds had written loan policies governing their use. Almost 50 percent restricted the total portion of a project they would fund. Of that 50 percent, over 85 percent restricted the amount they would fund to less than one-half of the total project's cost. Over 50 percent of the funds also restricted the maximum amount loaned. The restrictions fit the small capitalization of most of the funds. Over 85 percent of the funds had loan limits less than $100,000. One-half of funds had a maximum loan amount of $50,000 and the average fund's maximum limit was $69,000. Almost all funds (89 percent) required equity or private financing participation by the business.

Regional administration of revolving loan funds might allow for more use of loanable funds and more portfolio diversification.

We reviewed the many loan policies that were sent to us by communities with revolving loan funds. There was a wide range in the sophistication of the policies. They varied from one page statements that there were no restrictions on the use of the funds to quite sophisticated policies that reflected careful thought about the use and targeting of the funds to be lent. The typical terms offered on the loans were 3 years for working capital, 7 to 10 years for equipment, and 10 to 20 years for real estate, although some communities offered longer terms. Interest rates were below market rates in most cases. Many funds individually negotiate rates based on job creation. All policies we reviewed required some collateral for the loan and many required personal guarantees.

Many policies explicitly stated that the funds could not be used in such a way that they would provide an unfair competitive advantage to existing local businesses. For that reason many funds also prohibited loans to retail firms. Almost all funds would not allow the refinancing of existing debt or speculative land investments.

Based on our findings we believe a suggestion first made by Tom Stinson and Margaret Dewar makes sense. They recommended that instead of individual communities having loan funds they should be managed on a regional level.[7] Administering loan funds regionally allows for portfolio diversification that only the very largest funds have now. Most funds now are very vulnerable to defaults because they are so small in size. Regional funds also could avoid the problem of having large amounts of capital not lent out to businesses because of a lack of good lending opportunities. As we noted above, 47 percent of funds noted a lack of lending opportunities in 1995. Regional funds could also benefit from economies of scale and could afford more professional management than individual communities. Therefore, if the Legislature wants to continue to provide loan funds to local communities, we recommend:

- **The revolving loan funds should be administered at the regional level.**

Potentially the regional initiative funds or regional development commissions could serve as administrative entities for regional revolving loan funds. If the initiative funds were to manage the loan funds, oversight from DTED would be needed since the funds are not public bodies. Another possibility could be counties joining together in joint powers agreements to administer the loan programs.

7 "Strategies for Economic Development," *CURA Reporter*, May 1995, University of Minnesota, 1.

Other DTED Loan Programs

CHAPTER 4

Though the Economic Recovery Grant program is the state's primary business lending tool, the 1995 Legislature asked us to look at other business assistance programs as well. In this chapter we focus on the other business financing programs administered by the Business and Community Development Division of the Department of Trade and Economic Development (DTED). We describe the Challenge Grant programs, the Capital Access program, and the Small Business Development Loan program. For each program, we asked:

- **How much loan activity has occurred through the program? How many jobs has the program helped to create?**

- **What are the perspectives of people who have used the program?**

To answer the first two questions we used data reported by program participants to DTED. Though job creation data are self-reported and unverified for accuracy, we have no reason to believe that companies are consistently misreporting job creation figures, especially given our findings about the self-reported data for the Economic Recovery Fund programs. To learn about the perspectives of program users, we contacted some of them by phone to get their feedback.

CHALLENGE GRANT PROGRAMS

There are two Challenge Grant programs: one focused on rural businesses and the other on urban businesses. The Rural Challenge Grant program was initiated in the 1980s in response to a faltering economy in outstate Minnesota. The purpose of the Rural Challenge Grant program is to provide job opportunities for low-income individuals, stimulate private investment, and promote economic activity in rural areas.[1] The Urban Challenge Grant program was modeled after the Rural Challenge Grant program following the Los Angeles riots in 1992. The purpose of the Urban Challenge Grant program is to stimulate private investment and create job opportunities in low-income areas of the Twin Cities by assisting minority-owned and operated businesses and others.[2]

1 *Minn. Stat.* §116N.08, Subd. 1.

2 *Minn. Stat.* §116M.18, Subd. 1.

RURAL CHALLENGE GRANT PROGRAM

In the early to mid-1980s, the McKnight Foundation was establishing six initiative funds around the state to encourage economic activity in the non-metro area. The initiative funds cover the six non-metro economic development regions outlined in Figure 2.2. The foundation approached the Legislature to see if the state would be interested in working with the initiative funds by matching initiative fund economic development loans dollar-for-dollar. In response, the 1987 Legislature created the Rural Development Board and the Rural Challenge Grant program.[3]

The original appropriation for the Rural Challenge Grant program included $5 million of federal funds and $1 million of state funds. The Rural Development Board capitalized a rural rehabilitation account with the appropriation and designated $1 million for use by each of the six regional initiative funds according to statute. In 1993, the Legislature appropriated an additional $6 million to the Rural Challenge Grant program to re-capitalize the funds.

Regional initiative funds accept and evaluate applications for Challenge Grants.

The Regional Initiatives Office in the Business and Community Development Division of DTED administers the Rural Challenge Grant program at the state level. Businesses apply to the regional initiative funds for a loan. Though legislation sets some restrictions on the use of funds, the initiative funds set their own application review and loan approval policies and procedures. Upon approval of a loan by an initiative fund, the initiative fund requests a disbursement of funds through the Regional Initiatives Office. Because of the project review processes carried out by the initiative funds, the Rural Development Board, chaired by the Commissioner of DTED, has rarely had to deny a request for disbursement. Money from the rural rehabilitation account provides up to half of the Challenge Grant dollars and the initiative fund provides the rest. A Challenge Grant can cover no more than 50 percent of total project costs with private sources financing the remaining costs.

When a business repays a loan, the initiative fund returns the state's contribution and interest to the state rural rehabilitation account for additional loans to the region. An initiative fund must first exhaust the original appropriation for the region before it can make loans from repayments of the original Challenge Grants. Loans using funds from the loan repayments do not require a match by the initiative funds.

The Challenge Grant program provides smaller loans than the Economic Recovery Fund, on average. The minimum Challenge Grant to a business is $5,000 and the maximum is $100,000. Changes by the 1995 Legislature allow the initiative funds to make microenterprise loans to "qualified retail businesses" to assist people who are trying to escape poverty.[4] The loans may range from $1,000 to $10,000 and do not require a match of private funds.[5]

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3 *Minn. Stat.* §116N.

4 The original legislation prohibited loans to retail establishments.

5 *Minn. Laws* (1995), Ch. 224, Section 65, Subd. 5a.

Loan Activity

The average Challenge Grant loan is smaller than the average Economic Recovery award.

Between fiscal years 1989 and 1994, initiative funds made 393 Challenge Grant loans for a total of almost $23 million. The average loan size statewide was $58,032, but the average varied by region from approximately $49,000 in the Southeast region to about $81,000 in the Northwest region. Table 4.1 shows that the Southeast Minnesota Initiative Fund made the greatest number of loans, accounting for 24 percent of all loans made. Table 4.2 shows that the initiative funds distributed approximately 44 percent of Challenge Grant loans and dollars in fiscal years 1989 and 1990. Initiative funds made a decreasing number of loans from 1991 through 1993 with a slight upturn in fiscal year 1994.

Table 4.1: Rural Challenge Grant Program, FY 1989-94, Distribution of Loans by Region

Region	Number of Projects	Percent of Projects	Amount of Loans	Percent of Dollars Lent	Average Loan
Central	81	21%	$4,355,420	19%	$53,771
Northeast	50	13	2,973,000	13	59,460
Northwest	43	11	3,491,097	15	81,188
Southeast	93	24	4,523,925	20	49,644
Southwest	72	18	3,936,300	17	54,671
West Central	54	14	3,526,750	15	65,310
Total	393	100	$22,806,492	100%	$58,032

Source: Program Evaluation Division analysis of Department of Trade and Economic Development and Initiative Fund data.

Between 1989 and 1994, 393 loans were made through the Rural Challege Grant program.

Table 4.2: Rural Challenge Grant Program, FY 1989-94, Distribution of Loans by Fiscal Year

Fiscal Year	Number of Projects	Percent of Projects	Amount of Loans	Percent of Dollars Lent	Average Loan
1989	82	21%	$4,639,450	20%	$56,579
1990	89	23	5,573,020	24	62,618
1991	61	16	3,390,285	15	55,578
1992	51	13	2,420,917	11	47,469
1993	37	9	1,929,750	8	52,155
1994	73	19	4,853,070	21	66,480
Total	393	100%	$22,806,492	100%	$58,032

Source: Program Evaluation Division analysis of Department of Trade and Economic Development and Initiative Fund data.

Table 4.3 shows that about 10 percent of state dollars lent and 16 percent of loans were written off or were more than 12 payments past due as of June 30, 1995.[6] The percent of loans written off or past due varied by region with a range of 6 percent in the Northeast to 25 percent in the Southwest. The Northwest region has the lowest percent of dollars past due or written off (4.9 percent) and the Southeast has the highest (16.6 percent).

Table 4.3: Rural Challenge Grant Program, June 30, 1995, Loan Status by Region

Region	Number of Projects	Amount of Loans	Total State Share	State Amount Written Off[1]	State Amount Past Due[2]	Percent of State Dollars Past Due[2] or Written Off[1]	Percent of Loans Past Due[2] or Written Off[1]
Central	81	$4,355,420	$1,979,074	$34,730	$143,821	9.0%	12.3%
Northeast	50	2,973,000	1,588,001	87,749	0	5.5	6.0
Northwest	43	3,491,097	1,607,841	79,456	0	4.9	9.3
Southeast	93	4,523,925	2,249,463	280,716	93,312	16.6	23.7
Southwest	72	3,936,300	1,956,400	177,374	117,390	15.1	25.0
West Central	54	3,526,750	1,751,125	89,783	75,738	9.5	14.8
Total	393	$22,806,492	$11,131,904	$749,808	$430,261	10.6%	16.5%

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

[1]Loans that have been written off by the Department of Trade and Economic Development Fiscal Services Unit as of June 30, 1995, are included in this figure.

[2]Loans more than 12 payments past due according to the Department of Trade and Economic Development Fiscal Services Unit as of June 30, 1995, are included in this figure.

Job Creation

We were interested in finding out how many jobs were created by companies with the assistance of Challenge Grant loans and what wages and benefits the jobs provided. We examined information on job creation through fiscal year 1994 reported by companies to the initiative funds. The figures on job creation that we present are those appearing in the initiative funds' 1994 annual reports.

We have some concerns about the consistency of the data across initiative funds. The initiative funds reports data in different formats and do not clearly define job creation, wage, and benefit information presented in the annual reports.[7] We compared the 1995 annual reports from the initiative funds to figures reported separately for inclusion in DTED's performance report.[8] Some job creation, wage, or benefit information was different in the annual and department reports for over half of the companies receiving loans in 1994. It is our understanding that the con-

6 Figures for loans written off and past due were obtained from the Department of Trade and Economic Development Fiscal Services Unit. If initiative funds negotiated refinancing of or wrote off past due loans and did not communicate the information to the Fiscal Services Unit prior to June 30, 1995, these figures do not reflect those actions.

7 For example, it is unclear whether the number of jobs created represents full-time, part-time, or full-time equivalent jobs. It is also unclear if the companies' report of average wage for new jobs represents all jobs or all new jobs, and whether companies weighted the average for full and part-time employment.

8 Both reports were as of June 30, 1995.

tracts the department has with the initiative funds require an annual report by November 15 of each year for the fiscal year ending June 30 of that year. However, before November 15, the department must obtain job creation, wage, and benefit information on the previous year's loans for inclusion in the performance report. It is in the process of reporting this information twice--once for the performance report and once for the annual report--that the initiative funds' annual reports disagree with the information provided for the department's performance report. In our view, these discrepancies should be reconciled and consistent data should be reported in the future. We recommend that:

- **DTED should provide guidance and instruction to the initiative funds on collection, calculation, and reporting of data. Further, the department should standardize the reporting format.**

We found:

The average wage of jobs created with Challenge Grants was $7.67 per hour.

- **Challenge Grants to 369 projects between fiscal years 1989 and 1994 created over 6,400 full-time and over 740 part-time jobs.**

As of June 1994, 262 of the 369 projects (71 percent) experienced growth in full-time employment since the time of their awards.[9] Eighty-nine projects (24 percent) reported no full-time employment growth, and 18 projects (5 percent) reported a decrease in full-time employment. Companies in the Southwest region accounted for approximately one-third of all jobs created.

As Table 4.4 shows, the average wage of new full-time jobs created by projects that reported wage information was approximately $7.67 per hour.[10] Of the companies reporting benefit information, approximately 54 percent offered health care, 11 percent offered dental, 36 percent offered life, and 23 percent offered retirement benefits.[11]

Perspectives of Firms Receiving Loans

We contacted 15 companies that received loans through the Challenge Grant program to get their feedback about the program. Approximately half of the companies had considered other locations for their project. Seven of the 15 company representatives cited loyalty to the area as an important factor in their location decision. We asked decision makers in the companies whether they would have done the same project in the same place without the Challenge Grant loan. Ten of them reported that they would probably not or definitely not have proceeded with the same project. Without the loan, according to what we were told, four projects would not have happened at all. A representative from a company receiving two challenge grant loans said, "Without the first loan we would not have opened the

9 Job creation information was not available for 24 projects.

10 Ninety-eight percent of projects reporting positive full-time job growth also provided wage information.

11 Ninety-seven percent of projects reporting positive full-time job growth provided benefit information. The Central Minnesota Initiative Fund does not collect information on dental insurance.

Table 4.4: Rural Challenge Grant Program, FY 1989-94, Average Wage by Region

Region	Full-Time Jobs Wage Information[1]	Average Wage
Central	1,135	$8.50
Northeast	329	8.10
Northwest	733	6.46
Southeast	859	9.89
Southwest	2,171	7.49
West Central	1,055	6.05
Total	6,282	$7.67

Source: Program Evaluation Division analysis of Department of Trade and Economic Development and Initiative Fund data.

[1]Includes all projects with wage information and positive full-time employment growth.

doors and without the second loan we would have had to close them." Others said their project would have been smaller, taken longer, or occurred at a different location.

All but one of the company representatives felt that the program was easy to work with and effective. Many of the businesses (at least one from each region) indicated that the initiative funds were very helpful throughout the process. Companies suggested that additional technical support before and after the loan approval, reducing paperwork, and speeding up the application and approval process would improve the program.

URBAN CHALLENGE GRANT PROGRAM

The first loans through the Urban Challenge Grant program were made in mid-1995.

In response to the Los Angeles riots in 1992, Governor Arne Carlson convened a task force to address issues of economic opportunities for minorities and other low-income people in urban areas. The Urban Challenge Grant program was one of the recommendations that emerged from the task force. The purpose of the Urban Challenge Grant program is the creation of job opportunities in low-income areas of the Twin Cities by assisting minority-owned and operated businesses and others.

The Legislature created the Urban Challenge Grant program in 1993,[12] modeling it after the Rural Challenge Grant program, and appropriated $6 million to the program. Rules for the Urban Challenge Grant program were written in 1994 and 16 local non-profit organizations were chosen to make and manage loans. The minimum and maximum loan amounts are $5,000 and $150,000, respectively, except for microenterprise loans that may range from $1,000 to $10,000. Because of the time taken to write rules for the program and select the non-profits organizations

12 *Minn. Stat.* §116M.18.

that would administer the program, the first Urban Challenge Grant loans were made in the summer of 1995.

CAPITAL ACCESS PROGRAM

The 1989 Legislature created the Capital Access program to encourage banks to make loans to businesses, particularly small and medium-sized businesses, that have difficulty obtaining commercial loans.[13] Although initiated in 1990, the program actually started two years later. The program lost its funding in the first year and a change in the language of the bank agreement caused additional delays.

The Capital Access program allows banks to make loans that are slightly riskier than conventional loans.

Banks apply to DTED to participate in the Capital Access program. Participating banks make loans to businesses for industrial, commercial, or agricultural projects and apply to the department to enroll the loans in the program.[14] The Commissioner of DTED opens a reserve fund at the lending institution upon enrollment. The borrower and lender each contribute between 1.5 and 3.5 percent of the loan to the reserve fund.[15] For the first $2 million of loans enrolled by a bank, the state contributes 150 percent of the combined contributions of the borrower and lender to the reserve fund. After the bank has enrolled $2 million in loans, the state contributes 100 percent of the combined contributions. For example, a bank approaches the department to enroll a $50,000 loan. Upon approval, the bank and the borrower each contribute $1,000 (2 percent of the $50,000 loan) to a reserve fund opened by the department and maintained by the bank. If the bank has under $2,000,000 enrolled with the Capital Access program, the state contributes $3,000 to the reserve fund (150 percent of the combined contributions of the lender and borrower). In this example, the bank now has a reserve fund of 10 percent of the principal of the loan. The balance in the reserve fund will increase with interest and additional enrolled loans.

The idea behind the program is that a bank will enroll several loans, creating a portfolio covered by the reserve fund containing the contributions for all of the enrolled loans. The loans are to be financially sound, but the reserve fund allows the banks to make loans that are slightly riskier than conventional loans. The banks set the terms of the loans with the borrowers and administer the loans. The non-refundable contribution to the reserve account may act to deter businesses with less expensive borrowing options from using the program. Banks tend to use this program for smaller loans that either do not justify the amount of paper work required by Small Business Administration (SBA) programs or for projects that require faster turn-around than the SBA programs provide.

Minnesota modeled the program after Michigan's Capital Access program. According to the Director of Strategic Planning in Michigan, their program is very successful with an increasing number of banks choosing to participate. In Minne-

13 *Minn. Stat.* §116J.8761.

14 The Department of Trade and Economic Development will reject a loan only if it is for housing, for passive ownership of real estate, or to refinance a bad loan that is not enrolled in the program.

15 The lender may recover its contribution from the borrower.

Only 6 percent of commercial banks in Minnesota paticipate in the Capital Access program.

sota, the department has approved 34 banks to participate in the program (approximately 6 percent of commercial banks in Minnesota) but only half have enrolled loans. The department suggested that the low level of bank participation might be due to the program's slow start, the popularity of SBA programs in Minnesota, and economic factors, such as the strength of the state's lending community.

Loan Activity

As of October 30, 1995, 17 banks had enrolled 128 loans worth over $4.5 million in the Capital Access program.[16] Banks enrolled fewer than 30 loans in 1992, 1993, and 1995. Fifty-two loans were enrolled in fiscal year 1994, accounting for over 40 percent of loans. The average loan enrolled in the Capital Access program is $36,315. However, loans have ranged from under $2,000 to $300,000, with the median being $21,500. The state contributed almost $340,000 to reserve funds to cover these loans. Borrowers and lenders contributed over $225,000. Three banks have made a total of about $46,400 in claims on reserve funds due to loan defaults.

We were interested in finding out if there is an even distribution of participating banks and enrolled loans around the state and what types of businesses have received loans enrolled in the program. Table 4.5 shows that banks in the Central, Southeast, and Metro areas accounted for most of the loans and dollars enrolled in the Capital Access program. Banks in the Central region used the program the most accounting for 60 percent of the loans and almost 40 percent of dollars enrolled in the program. Companies in the Southeast region received 24 percent of the loans and 33 percent of the enrolled dollars. The Metro area received approximately 15 percent of both loans and dollars. The regional distribution of loans reflects the location of banks that have enrolled in the program. The Northeast, Northwest, Southwest, and West Central areas show little activity in this program. One explanation for this is that a small percentage of Minnesota's banks are located in these regions.

Table 4.5: Capital Access Program, FY 1992-95, Loan Information by Region

Region	Number of Projects	Percent of Projects	Covered Loan Amount	Percent of Loan Amount	Bank and Borrower Contribution	State Contribution	Average State Contribution	Job Creation Estimates at Application[1]
Central	77	60%	$1,763,858	38%	$109,570	$164,355	$2,134	59
Metro	15	12	744,100	16	27,992	41,988	2,799	19
Northeast	0	0	0	0	N/A	N/A	N/A	N/A
Northwest	1	1	300,000	6	21,000	31,500	31,500	0
Southeast	31	24	1,547,433	33	54,470	81,705	2,636	67
Southwest	4	3	292,870	6	13,450	20,195	5,049	20
West Central	0	0	0	0	N/A	N/A	N/A	N/A
Total	128	100%	$4,648,261	100%	$226,482	$339,743	$2,654	165

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

[1]This number is an estimate of the number of jobs the company would create. Information is provided by the bank when a loan is enrolled.

16 The fiscal year was recorded for 125 of the 128 loans.

Table 4.6 shows that most of the loans enrolled by banks were loans to companies in the trade, manufacturing, and services industries. Companies in each of these industries received between 20 and 30 percent of all loans.

Table 4.6: Capital Access Program, FY 1992-95, Loan Information by Industry Type

Industry	Number of Projects	Percent of Projects	Covered Loan Amount	Percent of Dollars Lent	Bank and Borrower Contribution	State Contribution	Average State Contribution	Job Creation Estimates at Application[1]
Agriculture, Forestry, Fishing	11	9%	$574,000	12%	$40,180	$60,270	$5,479	7
Construction	11	9	360,957	8	15,022	22,533	2,048	12
Manufacturing	32	25	1,303,818	28	60,650	90,975	2,843	60
Transportation, Public Utilities	4	3	81,961	2	4,600	6,900	1,725	2
Trade	39	30	1,405,417	30	59,345	89,037	2,283	36
Finance, Insurance, and Real Estate	3	2	65,400	1	3,162	4,743	1,581	0
Services	28	22	856,708	18	43,523	65,285	2,332	48
Total	128	100%	$4,648,261	100%	$226,482	$339,743	$2,654	165

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

[1]This number is an estimate of the number of jobs the company would create. Information is provided by the bank when a loan is enrolled.

Job Creation

Job creation is not an explicit goal of the Capital Access program.

Job creation is not an explicit goal of the Capital Access program. However, at the time of application, companies estimate the number of jobs that they will create with assistance from the program. The department reported that companies receiving Capital Access loans between fiscal years 1992 and 1995 estimated that they would create 165 jobs. The department does not regularly follow up on job creation and retention estimates.

Perspectives of Participating Banks

We contacted 12 banks participating in the Capital Access program to find out about their perceptions of the program. All of the loan officers that were familiar with the application and loan enrollment processes felt that the processes were both simple and easy. Five of the banks we contacted had applied to the program but had yet to enroll a loan. Three of the loan officers stated that the loan officer who was the original Capital Access program contact was no longer with the bank and no other loan officers were familiar with the program. One of the bankers said that customers found the Capital Access loan fee to be too high. Another felt that unless the bank enrolled a number of loans, the reserve fund would be too low to secure the loans.

Seven of the banks we contacted had enrolled at least one loan with the program. Bankers told us that they used the Capital Access program to fund riskier projects such as start up companies and companies low in capital. All but one of these loan officers stated that the Capital Access program had allowed their banks to increase the number and volume of loans to small businesses and businesses that

Bankers who had used the Capital Access program spoke favorably about it.

ordinarily would not be financed. Many of the bankers stressed their enthusiastic support for the program. One loan officer said, "The program is too good to be true." Another said, "The Capital Access program is the best program that any state or federal government entity has come up with."

We asked all of the loan officers for possible reasons why so many banks have chosen not to participate in the Capital Access program. Some stated that banks that have "preferred lending status" with the Small Business Administration may not feel the need for another program. The most common response, though, was that banks may not know enough about the program and do not understand how easy and beneficial other banks have found it to be. Some loan officers reflected that there was very little marketing after the initial introduction of the program in 1992.[17] Many suggested that there be another push to market the program not only to banks but also to businesses.

- **We found the Capital Access program to be one of the best received and least utilized of all the programs we reviewed.**

DTED indicated that the few banks that use the program are satisfied with it, but there is little interest among bankers who have not used the program in the past. As a result we recommend:

- **The Department of Trade and Economic Development should investigate why more banks do not use the Capital Access program.**

It may be that there is not a need for the program in its present form or that there is not enough marketing of the program, as suggested by participating banks.

SMALL BUSINESS DEVELOPMENT LOAN PROGRAM

Small Business Development loans are financed with tax-exempt bonds.

The Minnesota Agricultural and Economic Development Board administers the Small Business Development Loan program.[18] The purpose of the program is to provide loans to small businesses and create jobs. The board finances business expansion or relocation through the issuance of tax-exempt revenue bonds. The businesses must be manufacturers and have fewer than 500 employees. The use of tax-exempt bonds to finance loans allows the board to make loans to businesses at an attractive, fixed interest rate.

Since the federal government loses the tax revenue from tax-exempt industrial revenue bonds, it caps the annual amount of tax-exempt bonds each state can issue to $50 per capita based on the most recent Census estimates, or $150 million, whichever is greater. The Department of Finance administers Minnesota's total allocation of tax-exempt bonds, dividing the industrial revenue bonding capacity

17 The department says that it markets the Capital Access program at banking conferences and meetings.

18 *Minn. Stat.* §§41A.036 - 41A.04.

among three loan pools: the small issue loan pool, the housing pool, and the public facilities pool. The Minnesota Agricultural and Economic Development Board is only one of several issuers that apply for bond allocations through the small issue loan pool. The small issue loan pool's allocation is approximately 25 percent of aggregate capacity each year.[19]

For the Small Business Development Loan program, the Legislature specified in statute a preference for businesses that: are in distressed rural areas; will provide permanent employment in rural areas; are in border communities and are experiencing a competitive disadvantage; have been unable to obtain other financing; are in enterprise zones; and use state resources, reduce dependence on outside resources, and produce products or services consistent with long-term needs of the state.[20] The maximum allowed loan amount is 20 percent of all outstanding bond issues.

Businesses can apply directly for Small Business Development loans.

A business may apply to the board through DTED. Although the state requires a resolution from the local government unit in which the project will be located, businesses can approach the board directly for financial assistance. The department determines the project viability based on a business plan and other financial documents. The 1990 Legislature passed a law requiring all bond issuers, including the board, to score manufacturing projects using a public purpose scoring worksheet when applying for a bond allocation. Statute specifies the scoring details.[21] The scoring system considers job creation and payroll goals, estimated property tax increase, and the unemployment rate in the project's community. So far, only one project in the Small Business Development Loan program has required the use of the score sheet.

DTED staff present the project to the board to get project approval. By agreement, underwriters buy all of the bonds issued and sell the bonds to the public. A separate bond issue funds each new project. The board maintains a reserve fund called the general guaranty fund to back each project in case of default. This guaranty fund provides a credit enhancement for the business, allowing the business to obtain financing at a lower interest rate than would be available without the reserve fund.

19 Prior to 1995, the annual allocation for the small issue loan pool was about 30 percent of aggregate capacity. The 1995 Legislature reduced the cap for the small issue loan pool and increased the cap for the housing pool. (*Minn. Laws* (1995) Ch. 167, Section 6.)

20 Minn Stat. §§ 41A.036, Subd. 2. If a loan is made in excess of $1,000,000, additional criteria must be met. (Minn. Stat. §§ 41A.036, Subd. 5)

21 Minn. Stat. §474A.045.

Loan Activity

There have been 38 small business development loans to date, ranging from \$250,000 to over \$4 million.[22] The average Small Business Development loan is approximately \$1.4 million, with a median of \$1 million. Table 4.7 shows the status of loans made through the Small Business Development Loan program. Companies have paid off eight of the 38 loans. Four loans have defaulted resulting in a loss of over \$2 million. Between July 1, 1985, and July 31, 1995, the program issued over \$50 million in bonds.

Table 4.7: Small Business Development Loan Program, FY 1985 - July 1995, Loan Information by Loan Status

Loan Status	Number of Projects	Percent of Projects	Amount of Loans	Percent of Dollars Lent	Current Balance	Default Amount[a]
Paid in full	8	21%	\$10,285,000	18%	\$ 0	\$ 0
Current	26	68	38,730,000	69	28,342,500	0
Defaulted	4	11	7,000,000	12	965,000	2,870,000[b]
Total	38	100%	\$56,015,000	100%	\$29,307,500	\$2,870,000

Note: Figures are as of August 1, 1995.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

[a]The "Default Amount" equals the amount of the loan written off minus funds recovered from the granteur or sale of property.

[b]This number includes a \$1.35 million default that was subsequently partly recovered by the sale of a building for \$850,000, resulting in a loss of \$500,000.

Companies in some regions of the state have used the Small Business Development Loan program more than others. Table 4.8 shows that companies in the Central and Metro regions each received approximately one third of both loans and dollars loaned. There was little or no participation by companies in the Northwest and West Central regions.

Table 4.9 shows the number of loans made through the program by fiscal year. The department made no Small Business Development loans in 1992, 1993, or 1994. First, the federal law permitting the sale of tax-exempt industrial revenue bonds expired in 1992. Congress reauthorized the sale of such bonds in late 1993. Second, the board was unable to make new loans until 1995 because of the four loan defaults. The board must maintain a general guaranty fund balance of at least 25 percent of outstanding bonds. The defaults brought the general guaranty fund below the required level. Reserved funds have recently recovered and the program resumed lending in fiscal year 1996. The current balance of the general guaranty fund is approximately \$12 million.

22 In 1992, a company with a small business development loan sold property to two different companies who assumed the remainder of the loan. The state did not issue additional bonds to fund the two new loans. We included all three loans in this figure. The board currently oversees a loan of over \$5 million to a company who received funds through the now defunct Agricultural Resource Loan Guaranty program.

Table 4.8: Small Business Development Loan Program, FY 1985 - July 1995, Loan Information by Region

Region	Number of Projects	Percent of Projects	Amount of Loans	Percent of Dollars Lent	Current Balance
Central	13	34%	$17,725,000	32%	$9,915,000
Metro	13	34	16,320,000	29	9,515,000
Northeast	3	8	8,815,000	16	4,347,500
Northwest	0	0	0	0	N/A
Southeast	5	13	4,625,000	8	2,210,000
Southwest	3	8	7,530,000	13	2,590,000
West Central	1	3	1,000,000	2	730,000
Total	38	100%	$56,015,000	100%	$29,307,500

Note: Figures are as of August 1, 1995.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

No Small Business Development loans were made in fiscal years 1993 through 1995.

Table 4.9: Small Business Development Loan Program, FY 1985 - July 1995, Loan Information by Fiscal Year

Fiscal Year	Number of Projects	Percent of Projects	Amount of Loans	Percent of Dollars Lent	Current Balance
1985	9	24%	$6,470,000	12%	$2,005,000
1986	6	16	8,625,000	15	3,770,000
1987	3	8	8,015,000	14	5,067,500
1988	2	5	1,690,000	3	1,290,000
1989	2	5	4,075,000	7	1,515,000
1990	8	21	9,920,000	18	6,190,000
1991	5	13	13,605,000	24	5,920,000
1992	2	5	1,085,000	2	1,020,000
1996[a]	1	3	2,530,000	5	2,530,000
Total	38	100%	$56,015,000	100%	$29,307,500

Note: Figures are as of August 1, 1995.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

[a]No loans were made from FY1993 - FY 1995.

Job Creation

The department reports that 20 of 23 companies contacted had met or exceeded their job creation goals.

The department requires companies that receive Small Business Development loans to report job creation information. But, due to the age of most of the loans, the department did not have job creation reports for this program. However, 27 companies provided an estimate of the number of jobs they expected to create on their application and DTED obtained job creation information for 23 of these 27 companies through phone calls conducted over a period of approximately five years. The 23 companies promised to create 642 jobs, and ended up creating 1,312. Twenty of the companies reported meeting or surpassing their job creation goals.[23]

Perspectives of Firms Receiving Loans

We talked to ten companies that received Small Business Development loans. We wanted to determine whether the projects would have occurred without the loans and to get the companies' feedback on the program. We asked the companies if they had considered other locations for the projects and what the most important factors were in the location decisions. About half of the companies considered other locations and only one considered another state. The most important location factor for six of the companies was that they were already established at the location. Three companies cited the importance of city or state financial incentives. One representative said that the company never really wanted to move but used the possibility of relocation to gain leverage with the city.

We asked the companies if they would have done the same project in the same location without the small business development loan. Five of the companies said that they probably would have proceeded without the loan. Others said the project would have been smaller, taken longer, or would have moved out of state. One company said their project would not have gone through in any form without the loan.

We then asked the companies for their comments about the program. Four of the representatives reported that there was too much paperwork and they spent too much money on attorney fees to put the loan agreement together. Almost all of the company representatives stated that the Small Business Development Loan program had worked very well for them.

SUMMARY

The three programs reviewed in this chapter are smaller than the Economic Recovery Fund, but each serves a different niche and addresses economic development in different ways. The Challenge Grant program helps regions pursue economic development activities, with the state contribution increasing the amount of money available to pursue those activities. The Challenge Grant program pro-

23 Companies had received loans one to five years prior to the follow-up phone call.

vides, on average, smaller loans to businesses. The Capital Access program encourages sound but riskier-than-conventional lending by banks. Administration at the state level is minimal, since banks process, approve, and administer the loans. By requiring the borrowers to make contributions to the reserve fund, the program does not attract businesses that could obtain less expensive financial assistance from private sources and requires the borrowers to help cover the added risk of their loans. Finally, the Small Business Development Loan program can assist businesses with larger financing needs than can be met by the other state programs reviewed in the report.

Because we found the available job creation data to be wanting in the case of the Challenge Grant program and the Small Business Development Loan programs, it is hard to reach any conclusions about their effectiveness or make any recommendations about how they might be improved, beyond improving the data. It appears that businesses assisted by these programs do create jobs, but the effect of the public assistance cannot be isolated. In the case of the Challenge Grant program, the wage level of jobs becomes a consideration, as it did with the Economic Recovery Fund.

As mentioned in the chapter, the Capital Access program is well-received by users and administrators of the program. We recommend that the Department of Trade and Economic Development investigate why more banks do not use the program and modify the program or its marketing, as appropriate. It might increase the opportunity for small or risky businesses to find borrowing opportunities, making the program more successfully achieve its purpose.

Economic Recovery Fund, FY 1991-95, Project Index

APPENDIX A

Company	Grantee	Grant/ Loan Amount	Jobs Promised	Jobs Created
FY 1991				
CARLSON MARKETING GROUP, INC.	PLYMOUTH, CITY OF	$500000	508	580
CHANDLER IND., INC.	MONTEVIDEO, CITY OF	198000	30	32
CLEAR WITH COMPUTERS, INC.	MANKATO, CITY OF	440000	84	84
COMPLETE PACKAGING SERVICES, INC.	AUSTIN, CITY OF	300000	57	60
DEE, INC.	CROOKSTON, CITY OF	300000	30	61
DIAMOND BRANDS, INC.	CLOQUET, CITY OF	100000	40	66
DONNELLY CUSTOM MOLDING CO.	ALEXANDRIA, CITY OF	150000	27	26
FARMSTEAD FOODS, INC.	ALBERT LEA, CITY OF	500000	600	0
FRONTIER IND., INC.	WESTBROOK, CITY OF	46000	5	8
HOWARD BEEF PROCESSORS	PIPESTONE, CITY OF	500000	60	53
HUISKEN MEAT CENTER, INC.	CHANDLER, CITY OF	500000	50	53
LAKELAND MOLD	BRAINERD, CITY OF	50000	11	11
LE SUEUR FOUNDRY CO., INC.	LE SUEUR, CITY OF	185000	26	30
LOR*AL, INC.	BENSON, CITY OF	195000	30	33
LUIGINO'S	DULUTH, CITY OF	500000	50	50
LUPIN, INC.	COOK, COUNTY OF	67500	5	5
M E INTERNATIONAL	ST. CLOUD, CITY OF	250000	50	50
MICROTRON, INC.	MINNEAPOLIS, CITY OF	245613	35	35
MINNESOTA BEEF IND., INC.	BUFFALO LAKE, CITY OF	200000	43	48
NORTHERN CAP MANUFACTURING CO.	LITTLE FALLS, CITY OF	133750	30	30
NORTHSTAR GUARANTEE, INC.	ST. PAUL, CITY OF	500000	102	81
NORTHWESTERN NATIONAL LIFE CO., INC.	JACKSON, CITY OF	100000	100	100
PAULUCCI INT'L. LTD., INC.	ST. LOUIS, COUNTY OF	500000	75	75
PINE RIVER WOOD PRODUCTS	PINE RIVER, CITY OF	100000	15	15
POLARIS IND. L.P.	ROSEAU, CITY OF	450000	50	55
SEAFEST	MOTLEY, CITY OF	500000	40	43
STOKELY USA, INC.	WELLS, CITY OF	75600	18	24
TINO'S, INC.	YOUNG AMERICA, CITY OF	100000	22	24
FY 1992				
ANDERSON FABRICS, INC.	BLACKDUCK, CITY OF	$195000	30	32
APV DOUGLAS MACHINE CORP.	ALEXANDRIA, CITY OF	195000	40	75
B & L INDUSTRIES, INC.	MORGAN, CITY OF	25000	15	18
CHRISTIANSON SYSTEMS, INC.	KANDIYOHI, COUNTY OF	100000	10	9
CUSTOM EYES, INC.	BENTON, COUNTY OF	60000	30	13
DESIGNER WOOD PRODUCTS	LITTLE FALLS, CITY OF	190000	29	0
HARVEY CHARLES VOGEL, JR. D/B/A HARVEY VOGEL MFG.	WOODBURY, CITY OF	250000	65	67
HEAT-N-GLO FIREPLACE PRODUCTS, INC.	LAKE CITY, CITY OF	195000	77	107
HERBERGERS, INC.	SARTELL, CITY OF	500000	115	149

Company	Grantee	Grant/ Loan Amount	Jobs Promised	Jobs Created
FY 1992, continued				
HIAWATHALAND TOOL, INC.	KASSON, CITY OF	$61500	7	5
HYGENIC SERVICE SYSTEMS, INC.	RED WING, CITY OF	45000	14	28
IMPACT PLASTICS ADV., INC.	MAYNARD, CITY OF	101500	21	21
INTERNATIONAL GRAIN AND MILLING CO.	CLARA CITY, CITY OF	195000	43	27
ITASCA MEDICAL CENTER	ITASCA, COUNTY OF	100000	8.2	26
KRAFT FOOD INGREDIENTS	ALBANY, CITY OF	205740	15	18
LUIGINO'S, INC.	ST. LOUIS, COUNTY OF	375000	50	51
LUIGINO'S, INC.	DULUTH, CITY OF	375000	50	50
MCGLYNN BAKERIES, INC.	FRIDLEY, CITY OF	250000	33	64
MILTON G. WALDBAUM CO.	GAYLORD, CITY OF	436000	64	22
MINNESOTA BREWING CO.	ST. PAUL, CITY OF	500000	77.5	85
PRIME EGG, LTD.	PERHAM, CITY OF	130000	22	26
PRISON CORP.	APPLETON, CITY OF	301500	162	160
PSG HOLDING CORP. D/B/A ST. JAMES AUTOMOTIVE	ST. JAMES, CITY OF	200000	93	41
RAPAT CORPORATION	HAWLEY, CITY OF	150000	20	19
REMMELE ENGINEERING, INC.	BIG LAKE, CITY OF	134074	10	10
SHOOTING STAR CASINO	MAHNOMEN, CITY OF	364490	341	733
STERN RUBBER COMPANY	STAPLES, CITY OF	250000	22	27
SYSTEM TACKLE CO., INC.	LAKE PARK, CITY OF	40000	8	7
TRUSS JOIST MACMILLAN	IRONDALE, TOWNSHIP OF	500000	102	148
VESPER CORP./COLUMBIA GEAR	AVON, CITY OF	400000	35	40
WOODCRAFT INDUSTRIES, INC.	ST. CLOUD, CITY OF	500000	80	135
FY 1993				
AMERICAN CRYSTAL SUGAR COMPANY	EAST GRAND FORKS, CITY OF	$500000	34	30
AMISH OVENS BAKERY, INC.	LEWISTON, CITY OF	21500	5	6
AROPLAX CORPORATION	MONTICELLO, CITY OF	170000	15	17
CHANDLER INDUSTRIES, INC.	MONTEVIDEO, CITY OF	75000	5	5
COMPOSITE PRODUCTS, INC.	WINONA, CITY OF	400000	40	33
DAVISCO INTERNATIONAL, INC.	LE SUEUR, CITY OF	199000	45	44
DUININCK, INC., D/B/A/ ROYAL TIRE & ASSOCIATES	STEARNS, COUNTY OF	125000	10	11
ENVIROSYS L.P.	MOORHEAD, CITY OF	500000	80	0
FRENCH MEADOW BAKERY	MINNEAPOLIS, CITY OF	85000	11	12
HEARTLAND WOOD PRODUCTS	BELVIEW, CITY OF	30000	4	4
HENDERSON HARDWOODS, INC.	SIBLEY, COUNTY OF	77500	7	6
IMPROVEMENT LIMITED PARTNERSHIP/REGENCY INN	ST. LOUIS, COUNTY OF	117000	32	27
INDUSTRIAL RESOURCE CORPORATION	DULUTH, CITY OF	500000	25	25
KOMO MACHINE, INC.	SAUK RAPIDS, CITY OF	250000	113	198
MASTER FORCE MARKETING, INC	OWATONNA, CITY OF	125000	25	28
MATHIAS DIE COMPANY, INC.	SOUTH ST. PAUL, CITY OF	185000	30	20
MICRO COMPONENT TECHNOLOGY, INC.	SHOREVIEW, CITY OF	200000	50	48
MINNESOTA DIVERSIFIED, INC.	GRAND RAPIDS, CITY OF	73920	110	24
NATIONAL POLY PRODUCTS, INC.	MANKATO, CITY OF	500000	100	108
NORTH CENTRAL PLASTICS, INC.	ELLENDALE, CITY OF	200000	20	10
NORTHWESTERN NATIONAL LIFE INSURANCE	JACKSON, CITY OF	199000	72	117
PARK MANUFACTURING CORPORATION	EAST BETHEL, CITY OF	50000	20	27
PEPIN HEIGHTS ORCHARD, INC.	LAKE CITY, CITY OF	77739	10	12
PHOTOLITH COMPONENTS, INC.	KASSON, CITY OF	46500	12	0
POWER SENTRY, INC.	WHEATON, CITY OF	100000	20	20
SLEEPY EYE FOODS, INC.	SLEEPY EYE, CITY OF	150000	40	0

Company	Grantee	Grant/ Loan Amount	Jobs Promised	Jobs Created
FY 1993, continued				
STEARNS MANUFACTURING COMPANY	PAYNESVILLE, CITY OF	$250000	100	55
STERN RUBBER CO.	STAPLES, CITY OF	50000	2	2
TANGER DEVELOPMENT	BRANCH, CITY OF	195000	200	224
TESCOM CORPORATION	ELK RIVER, CITY OF	250000	45	96
TWF INDUSTRIES, INC.	BARRETT, CITY OF	30000	10	7
VINE RIPE INCORPORATED	OWATONNA, CITY OF	60000	8	10
WEBWAY, INC.	ST. CLOUD, CITY OF	500000	60	50
FY 1994				
AUTOMATED COMMUNICATIONS INC.	TWIN VALLEY, CITY OF	$ 48000	85	72
AUTUMN LODGE TRADING COMPANY	ST. LOUIS PARK, CITY OF	250000	50	0
BARREL O' FUN SNACK FOOD CO	PERHAM, CITY OF	60000	20	18
BARRETT AUTOMATIC PRODUCTS	BARRETT, CITY OF	35000	8	8
BROWN & BIGELOW INC	ST. PAUL, CITY OF	500000	200	335
CASEWORKS, INC.	SAUK RAPIDS, CITY OF	500000	80	23
CIRRUS DESIGN CORPORATION	DULUTH, CITY OF	470000	35	23
CLEAR WITH COMPUTERS, INC.	MANKATO, CITY OF	500000	85	73
DEMCO	ST. LOUIS, COUNTY OF	400000	50	14
DOMBROVSKI MEATS, INC.	FOLEY, CITY OF	95000	8	11
EVERGREEN PRODUCTS INC	PRESTON, CITY OF	251500	31	15
EXCEL MANUFACTURING INC	ST. CHARLES, CITY OF	61500	21.5	47
FINGERHUT CORPORATION	STEARNS, COUNTY OF	280000	112	n/a
FINGERHUT CORPORATION	ST. CLOUD, CITY OF	250000	100	n/a
FULFILLMENT SYSTEMS, INC.	ST. CLOUD, CITY OF	250000	30	30
LONG LIFE FOODS, LTD	PERHAM, CITY OF	100000	16	5
NELSON'S CONFECTIONERY, INC.	PERHAM, CITY OF	199000	50	27
NORDIC TRACK, INC.	CHASKA, CITY OF	162492	65	66
NORDIC WOOD PRODUCTS, INC.	NEWFOLDEN, CITY OF	144000	15	16
NORTH STAR MUTUAL	COTTONWOOD, CITY OF	199000	24	18
OAK RIDGE POND RENTALS	WHITE BEAR LAKE, CITY OF	243256	30	51
PARADIGM SPORTS	MONTGOMERY, CITY OF	176500	15	6
PEMSTAR INC	ROCHESTER, CITY OF	500000	70	82
PEPIN MANUFACTURING, INC.	LAKE CITY, CITY OF	25934	8	5
POLAR TANK & TRAILER, INC.	STEARNS, COUNTY OF	220000	28	66
POLARIS INDUSTRIES LP	ROSEAU, CITY OF	465000	100	364
POLARIS TELECOM, INC.	CHOKIO, CITY OF	75000	17	12
R&R FOODS INC D/B/A KANDI-COUNTRY MEATS	KANDIYOHI, COUNTY OF	100000	12	4
RANGE PRINTING CO.	BRAINERD, CITY OF	115000	8	8
RINK SYSTEMS, INC.	ALBERT LEA, CITY OF	100000	15	13
ROCHESTER FERTILIZER CO	WINONA, CITY OF	150000	15	7
SCHOTT POWER SYSTEMS	ST. LOUIS, COUNTY OF	100000	15	2
SLEEPY HOLLOW MILLWORK	CROW WING, COUNTY OF	200000	37	34
STANDARD IRON WIRE WORKS, INC.	WRIGHT, COUNTY OF	250000	80	65
STRAIGHT RIVER ENGINEERING & MANUFACTURING INC.	PARK RAPIDS, CITY OF	400000	82	90
STYROTECH INC.	BROOKLYN PARK, CITY OF	100000	15	14
TELNET SYSTEMS,INC	NEW YORK MILLS, CITY OF	300000	140	154
THE LITTLE RED SLED, INC.	HENNING, CITY OF	70000	29	0
VALLEY INDUSTRIES INC	EDEN VALLEY, CITY OF	150000	18	17

Company	Grantee	Grant/ Loan Amount	Jobs Promised	Jobs Created
FY 1995				
A&L PARTNERSHIP/UNITED HEALTH CARE	INTERNATIONAL FALLS, CITY OF	$400000	276	278
AG CHEM EQUIPMENT COMPANY	JACKSON, CITY OF	100000	79	n/a
BALZER MANUFACTURING CORPORATION	MOUNTAIN LAKE, CITY OF	500000	12	n/a
BERKLEY INFORMATION SERVICES	LUVERNE, CITY OF	350000	35	29
CLEAN PLUS, INC.	WEST CONCORD, CITY OF	51500	8	1
CORN PLUS	WINNEBAGO, CITY OF	150000	32	33
CUSTOM AG. PRODUCTS INC.	BENSON, CITY OF	100000	10	25
CYPRESS SEMICONDUCTOR (MINNESOTA) INC.	BLOOMINGTON, CITY OF	500000	150	214
DL MANUFACTURING INC	DETROIT LAKES, CITY OF	250000	60	n/a
DURA-SUPREME, INC.	HOWARD LAKE, CITY OF	300000	50	n/a
ELECTROCHEMICALS, INC.	MAPLE PLAIN, CITY OF	320000	65	75
ENGINEERED POLYMERS, INC.	MORA, CITY OF	500000	74	57
FINGERHUT CORPORATION	ST. CLOUD, CITY OF	250000	100	n/a
FINGERHUT CORPORATION	STEARNS, COUNTY OF	220000	88	n/a
GEOTEK INC	STEWARTVILLE, CITY OF	150000	33	n/a
GVL, INC.	MEEKER COUNTY	48000	8	n/a
H WINDOW COMPANY	MONTICELLO, CITY OF	250000	45	n/a
HEARTLAND CORN PRODUCTS	WINTHROP, CITY OF	150000	26	26
HI TECMETAL GROUP, INC	ALBERT LEA, CITY OF	100000	12	n/a
HUSSONG MANUFACTURING COMPANY	LAKEFIELD, CITY OF	199000	20	0
IB INDUSTRIES, INC.	MOWER, COUNTY OF	100000	20	11
JONTI CRAFT, INC.	WABASSO, CITY OF	250000	25	n/a
KAPPERS FABRICATING INC	SPRING VALLEY, CITY OF	199900	24	15
LAKELAND MOLD COMPANY	BRAINERD, CITY OF	100000	10	10
LAMB WESTON/RDO FROZEN, INC.	HUBBARD, COUNTY OF	111000	50	n/a
LAMB WESTON/RDO FROZEN, INC.	PARK RAPIDS, CITY OF	500000	100	n/a
LULL INDUSTRIES, INC.	EAGAN, CITY OF	250000	100	100
MAMMOTH/CES GROUP	CHASKA, CITY OF	100000	45	47
MEDICAL DEVICES, INC.	NEW BRIGHTON, CITY OF	199900	30	21
MILLTRONICS MANUFACTURING, INC.	WACONIA, CITY OF	225000	58	n/a
MINNESOTA FOREST PRODUCTS, INC.	ONAMIA, CITY OF	375000	25	0
PEMSTAR INC	ROCHESTER, CITY OF	500000	70	82
PLASTICS INC.	COON RAPIDS, CITY OF	75000	30	8
PLATO WOODWORKING	PLATO	250000	32	n/a
POWER SENTRY, INC.	WHEATON, CITY OF	100000	44	64
POWER SENTRY, INC.	FERGUS FALLS, CITY OF	175000	100	124
PRODUCT RESEARCH AND DEVELOPMENT, INC.	BAGLEY, CITY OF	167000	20	28
QUEBECOR CORPORATION	SAUK RAPIDS, CITY OF	500000	33	33
RIVERTOWN TRADING CORPORATION	WOODBURY, CITY OF	500000	190	n/a
SCHOTT POWER SYSTEMS, INC.	DULUTH, CITY OF	400000	43	6
TYLER MANUFACTURING	SWIFT COUNTY	500000	100	n/a
WELLS TRUSS MANUFACTURING, INC.	WELLS, CITY OF	150000	40	17
WEST CENTRAL TURKEYS	PELICAN RAPIDS, CITY OF	500000	100	n/a
WINLAND ELECTRONICS INC	MANKATO, CITY OF	500000	85	21
WINONA KNITTING MILLS, INC.	WINONA, CITY OF	500000	75	n/a

n/a = Information was not available.

Source: Program Evaluation Division analysis of the Department of Trade and Economic Development reports.

Economic Development Score Sheet

APPENDIX B

Applicant ________________________________

_______ 1. Application has been completely filled out, signed and dated.

_______ 2. A resolution designating an authorized representative and executed by the governing body has been received.

__/__/__ 3. Date of public hearing.

_______ 4. Evidence was received that the applicant obtained the required credit information and reports.

OTHER INFORMATION

Staff has verified that this application for state assistance is necessary and appropriate for the project to succeed; there is a need for state assistance; and the level of state assistance is commensurate with the public benefit received.

FINANCIAL FEASIBILITY THRESHOLD (Documentation of the following:)

_______ 1. That all other financial sources, both public and private, have been considered for this project and are inappropriate, unavailable, or insufficient.

_______ 2. Letter of commitment from the business pledging to complete the project in accordance with the terms and conditions of the application.

_______ 3. Letter of commitment from all financial sources stating terms and conditions of participation in the project.

_______ 4. The cash flow is sufficient to cover proposed debt service.

_______ 5. That the business to be assisted has a positive net worth.

I. COMMUNITY NEED

	Points Possible	Awarded
A. Demographics County ______________________		
1. Annual unemployment rate ______Applicant ______State Median If applicant rate is greater than state median, award 20 points	20	_____
2. Unemployment rate for the quarter proceeding application. (table below) If applicant rate if greater than state median, award 20 points.	20	_____
3. Percent of poverty persons ______Applicant ______State Median If applicant's % is greater than state median, award 20 points.	20	_____
4. Median Income $________Applicant $________State Median If applicant rate is lower than state median, award 20 points.	20	_____
Subtotal - Part A	80	

Month/Yr	County	State

B. Narrative

1. Community and Economic Needs (check those below that apply)
   a. _____ Economic vulnerability of the community
   b. _____ Events contributing to depressed economy
   c. _____ Unemployment (long range, chronic, current, seasonal)
   d. _____ Need to attract or retain essential services
   e. _____ Events contributing to a unique situation
   f. _____ # of businesses lost and started in past 3 years
   g. _____ Infrastructure conditions if pertinent to economic development
   h. _____ Outmigration due to lack of jobs
   i. _____ Opportunity or timelines to implement project
   j. _____ Labor pool needs

2. Beneficial Results and Tangible Effects (check those below that apply)
   a. Employment (jobs created and/or retained)
      1. _____ LMI: Demonstrated use of employment assistance or job training programs
      2. _____ Number of jobs is certain and achievable
      3. _____ Ratio of requested grant dollars per job is low
   b. Private Capital Investment
      1. _____ Letters of commitment from private parties
      2. _____ Amount and nature of the private investment
      3. _____ Ratio of committed $ to grant funds is high
   c. _____ Project will generate a substantial increase in local property tax base
   d. _____ The project will serve other value economic purposes
   e. _____ The project will support the economic viability of small, minority or women-owned businesses

	Points Possible	Awarded
Critical Need - 110 Substantial - 80 Moderate - 60 Minor - 40 No Documented Need - 0		
Subtotal - Part B	110	☐
TOTAL, PARTS A AND B - SECTION I	190	☐

II. IMPACT

		Points Possible	Awarded
A.	_______Number of Jobs Created _______Number of Jobs Retained 70+ jobs - 60 points 50-69 jobs - 50 points 30-49 jobs - 40 points 20-29 jobs - 30 points 5-19 jobs - 20 points Under 5 jobs - 0 points	60	_____
B.	$ ________:1 Ratio of Grant Funds to Each Full-Time Equivalent Job. $2,500 or less/job - 100 points $2,501 - $5,000 - 90 points $5,001 - $7,500 - 80 points $7,501 - $10,000 - 70 points $10,001 - $15,000 - 50 points $15,001 - $20,000 - 30 points $20,000+ - 0 points	100	_____
C.	_______Increase to Local Tax Base (In Excess of 50%)	10	_____
D.	_______Immediacy of Impact	20	_____
E.	_______Commitment to Train LMI Persons	20	_____
	TOTAL - SECTION II	210	☐

III. FINANCIAL FEASIBILITY AND COST-EFFECTIVENESS

		Points Possible	Awarded
A.	Gap _______Inadequate equity _______Inadequate private lender financing _______Inability to qualify for other state and federal financing programs _______Locational preference _______Excessive infrastructure costs	50	_____
B.	______:1 Ratio of Private Funds to Requested Grant Funds (Do not include funds designated for general administration in this ratio.) 4:1 - 60 points 3:1 - 50 points 2:1 - 40 points 1:1 - 30 points Less than 1:1 - 0 points	60	_____
C.	______:1 Ratio of Total Leveraged Funds to Requested Grant Funds (Do not include funds designated for general administration in this ratio.) 4:1 - 60 points 3:1 - 50 points 2:1 - 40 points 1:1 - 30 points Less than 1:1 - 0 points	60	_____

		Points Possible	Points Awarded
D.	______% Interest Rate on Grant Funds Over the Term of the Loan 10% to 11% - 30 points 8% to 9% - 20 points 6% to 7% - 10 points 5% or less - 0 points	30	____
	TOTAL - SECTION III	200	

TOTAL POINTS

SECTION I ______
SECTION II ______
SECTION III ______

______**TOTAL POINTS AWARDED**

I recommend that this application be submitted to the Commissioner for approval.

______________________________ ______________
Economic Development Specialist Date

I concur with the above recommendation.

______________________________ ______________
Economic Development Director Date

MINNESOTA DEPARTMENT OF
TRADE AND ECONOMIC DEVELOPMENT

500 Metro Square
121 7th Place East
Saint Paul, Minnesota 55101-2146 USA

February 12, 1996

James R. Nobles
Legislative Auditor
Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Jim:

Thank you for sending us your final report entitled "State Grant and Loan Programs for Business," which we received late Thursday afternoon. Thank you also for extending the deadline for responding to the report from Friday noon to noon today.

We would like to acknowledge that the version at hand is vastly improved from the draft report that we discussed on February 2, when we questioned your staff's objectivity and characterized their research methods and reporting skills as less rigorous than those one might expect to encounter in high-school term paper. To their great credit and yours, they have removed from the final report dozens of the inaccuracies, misunderstandings and mischaracterizations that we found in the version you showed us nine days ago.

To be sure, we could still a find nits to pick, but we are not very interested in doing so. Neither do we want here to challenge those policy recommendations of yours with which we disagree. We do, however, want to address your assertions that the average wage of the 8,300 jobs created with assistance of funds from the Economic Recovery Fund since 1991 has been $8.64 per hour and that the median wage has been $7.20 per hour.

We applaud that you have chosen to evaluate both average and median wage rates, and although you have not included the value of employee benefits in those figures, we appreciate that in the Executive Summary of you report you noted that "approximately 90 percent of the jobs created provided health care, 56 percent dental benefits, 85 percent life insurance, and 62 percent retirement benefits."

We also believe, however, that the methods by which you arrived at those two figures understates the effectiveness of that program and therefore understates the effectiveness of my two predecessors at the Department of Trade and Economic Development.

How? In two important ways, the first of which is by lumping job-expansion efforts funded with state funds together with similar efforts funded with federal Community Development Block Grants.

As you report, federal law requires that 51 percent of the jobs created with the help of block-grant assistance be filled by low- and moderate-income individuals, whose work experiences do not make them likely candidates for the best-paying jobs. That requirement pulls down the average and median and wages of federally funded jobs to levels much lower than comparable state-funded Economic Recovery Fund loans. In your Table Four, you report that the average wage for state-funded Economic Recovery Funds Loans is actually $8.87 per hour, and the median is actually $7.50 per hour. Both figures are significantly higher than the state/federal blended rates you have chosen to cite in your letter accompanying your report to the Legislative Audit Commission.

The other way in which your methodology understates the wages of jobs being created with Economic Recovery Fund loans has to do with the period covered by your study, from July 1990 through July 1995. (That is, during Fiscal Years 1991-1995.)

During roughly the first two years of that period, the United States and the Midwest were in recession and southern Minnesota was suffering the lingering effects of a farm crisis. Not surprisingly, incentives provided during the final months of the Perpich Administration and the early months of the Carlson Administration helped create jobs that might seem less attractive today than they did at the time. Indeed, your Table Three shows that the average wages of jobs created with Economic Recovery Fund loans in Minnesota's Fiscal 1991 and 1992 were $7.36 and $7.57 per hour, respectively, but that by Fiscal 1993, the average had risen to $9.22 per hour.

The chart also shows that the figure slipped to $8.31 in fiscal 1994, before rising to $9.36 is fiscal 1995, but both of those figures are misleading for this reason: When companies accept Economic Recovery Fund loans, they promise to create an-agreed-upon number of jobs at stipulated wage rates during a two-year period. For projects that originated in Fiscal 1994 (which began July 1, 1994), those companies must meet hiring deadlines that will occur at varying points of time between July 1996 to July 1997. For projects that originated in Fiscal 1995 (which began July 1, 1995), hiring deadlines will occur at varying points of time between July 1997 and July 1998.

Naturally, Jim, many of those jobs have been created and counted by your researchers. Others, however, have yet to be created—and, in fact, will be created in the present full-employment, high-wage environment. When they are tallied, they will raise the average and median wages of the jobs counted in your office's study. If your researchers had truly wanted to show the results of five years of loan originations, they would have had to go back to the start of Fiscal 1989. We predict that had they done so, they would have noted steady improvement in the quality of jobs being created with state assistance.

Wage levels of jobs created with the help of Economic Recovery Fund loans are likely to continue to rise. As you know and as your staff might have reported, the Department of Trade and Economic Development is considering requests for Economic Recovery Funds assistance that would result in the creation of significant numbers of jobs paying much more than averages of recent years. Additionally,I have made it clear that I do not expect in 1996 to approve any loan for the purpose of creating jobs paying less than $10 per hour in the Twin Cities metropolitan area of $8 per hour in Greater Minnesota. Through the Governor's Office, the department is also asking the Legislature this year to define in statute criteria for loanmaking through the Economic Recovery Fund.

We do have a second concern about the efforts of your office regarding your study. I am not referring here to the content of the final report, but about the dissemination of data and conclusions reached before anyone in the Department of Trade and Economic Development saw the first draft of the report.

As you have indicated, your office has briefed at least two legislators about your preliminary "discoveries" and answered questions from legislative staffers about your "findings." You and members of your staff have asserted that the rules under which you operate allow such briefings. If so, perhaps those rules should be scrutinized.

The extent to which the legislators shared information received from you with their peers is impossible for us to know, but it is clear that conclusions reached in your preliminary draft report have been treated less confidentially than you have asked me and my staff to treat them. Moreover, it is reasonable to assume that information from those briefings and your preliminary assessments of the Economic Recovery Fund were used to prepare legislation.

As I think you agree, those preliminary assessments were at best flawed—and that's the kindest word we can think to describe them. You will remember, for example that in your office's preliminary report, your staff asserted that:

1) "Many loans [from the Economic Recovery Fund] were originally structured to begin repayment of principal and interest at some date between 5 and 25 years in the future." You will remember, too, that when we asked your staff to name a single loans structured to begin repayment more than five years into the future, they couldn't name one. Normally, repayment begins within 30 days. If there has been an exception to that rule—and perhaps there has, though there haven't been "many"—we would be surprised to have it pointed out to us.

2) In the decision to grant a loan, "DTED does not consider the wages, benefits, or type of jobs created." We think your staff knew better, Jim, and we are pleased that you withdrew this ridiculous assertion from the final report. Someday perhaps you would explain how, after five months of study of our department, it ever got written.

3) The Department's "Capital Access program is one of the best-received...of all of the programs we reviewed." Well, thanks. But look at how your staff came to that conclusion. Although there are at present 543 commercial banks operating in Minnesota, and although (by your count and ours) only 17 of them (that's less that three tenths of 1 percent) have ever participated in the Capital Access program, your staff wanted to call it "one of the best-received." And how did they reach that conclusion? By contacting 12 of the 17 participants and none of the banks that decided not to participate. A similar survey of, say, owners of DeLorean automobiles might show the DeLorean to be the most popular car in America.

Is there more to complain about? Sure. (In the draft report, your staff was estimating in writing that we had 24 "full-time" staff operating the Economic Recovery Fund program, when in fact there are five.) But, as we've said, there is much less to complain about in the present version of your report than there was in the earlier version. You probably won't take it, but we believe you deserve credit for your staff's responsiveness to our concerns.

Sincerely,

Jay Novak
Commissioner

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
CENTENNIAL BUILDING, 658 CEDAR STREET • ST. PAUL, MN 55155 • 612/296-4708 • TDD RELAY 612/297-5353
JAMES R. NOBLES, LEGISLATIVE AUDITOR

February 13, 1996

Members of the Legislative Audit Commission:

Normally, I do not write a rejoinder to a commissioner's response letter. The letter from Commissioner Novak, however, requires some comment.

My staff and I expect to have differences and some conflicts with the agencies we audit and evaluate. There are even steps built into our audit and evaluation procedures to help resolve them. We went through those steps with Commissioner Novak, but unfortunately he is still dissatisfied with our work.

Department heads do, of course, have a different perspective from ours. Indeed, they have a different job--to promote and defend their programs. We respect that role. But, we think our role is important too--to objectively review the facts and report them accurately. In this case, that led us to write a different report than the one Commissioner Novak wanted us to write. I can understand his disappointment.

On the other hand, I do not think the differences between Commissioner Novak and my office are very great or unusual, which makes his letter all the more perplexing and inappropriate. His letter is also, I must say, quite intemperate and not altogether accurate. In my opinion, it is not a letter a commissioner in state government should write.

We commend our report to the Legislature, and to the commissioner. It contains data and analysis that will help the Legislature make policy decisions about loan and grant programs for businesses, and help the commissioner administer them better.

Sincerely,

Jim Nobles

James Nobles
Legislative Auditor

Recent Program Evaluations

Lawful Gambling, January 1990	90-01
Local Government Lobbying, February 1990	90-02
School District Spending, February 1990	90-03
Local Government Spending, March 1990	90-04
Administration of Reimbursement to Community Facilities for the Mentally Retarded, December 1990	90-05
Review of Investment Contract for Workers' Compensation Assigned Risk Plan, April 1990	90-06
Pollution Control Agency, January 1991	91-01
Nursing Homes: A Financial Review, January 1991	91-02
Teacher Compensation, January 1991	91-03
Game and Fish Fund, March 1991	91-04
Greater Minnesota Corporation: Organizational Structure and Accountability, March 1991	91-05
State Investment Performance, April 1991	91-06
Sentencing and Correctional Policy, June 1991	91-07
Minnesota State High School League Update, June 1991	91-08
University of Minnesota Physical Plant Operations: A Follow-Up Review, July 1991	91-09
Truck Safety Regulation, January 1992	92-01
State Contracting for Professional/Technical Services, February 1992	92-02
Public Defender System, February 1992	92-03
Higher Education Administrative and Student Services Spending: Technical Colleges, Community Colleges, and State Universities, March 1992	92-04
Regional Transit Planning, March 1992	92-05
University of Minnesota Supercomputing Services, October 1992	92-06
Petrofund Reimbursement for Leaking Storage Tanks, January 1993	93-01
Airport Planning, February 1993	93-02
Higher Education Programs, February 1993	93-03
Administrative Rulemaking, March 1993	93-04
Truck Safety Regulation, Update, June 1993	93-05
School District Financial Reporting, Update, June 1993	93-06
Public Defender System, Update, December 1993	93-07
Game and Fish Fund Special Stamps and Surcharges, Update, January 1994	94-01
Performance Budgeting, February 1994	94-02
Psychopathic Personality Commitment Law, February 1994	94-03
Higher Education Tuition and State Grants, February 1994	94-04
Motor Vehicle Deputy Registrars, March 1994	94-05
Minnesota Supercomputer Center, June 1994	94-06
Sex Offender Treatment Programs, July 1994	94-07
Residential Facilities for Juvenile Offenders, February 1995	95-01
Health Care Administrative Costs, February 1995	95-02
Guardians Ad Litem, February 1995	95-03
Early Retirement Incentives, March 1995	95-04
State Employee Training: A Best Practices Review, April 1995	95-05
Snow and Ice Control: A Best Practices Review, May 1995	95-06
Funding for Probation Services, January 1996	96-01
Department of Human Rights, January 1996	96-02
Trends in State and Local Government Spending, February 1996	96-03
State Grant and Loan Programs for Businesses, February 1996	96-04
Tax Increment Financing, forthcoming	
Post-Secondary Enrollment Options, forthcoming	
Property Assessments: A Best Practices Review, forthcoming	

Recent Performance Report Reviews

PR95-20	Administration
PR95-01	Agriculture
PR95-06	Commerce
PR95-02	Corrections
PR95-07	Economic Security
PR95-08	Education
PR95-09	Employee Relations
PR95-15	Finance
PR95-10	Health
PR95-16	Human Rights
PR95-19	Human Services
PR95-17	Labor and Industry
PR95-03	Military Affairs
PR95-04	Natural Resources
PR95-21	Pollution Control
PR95-12	Public Safety
PR95-13	Public Service
PR95-14	Revenue
PR95-18	Trade and Economic Development
PR95-11	Transportation
PR95-05	Veterans Affairs

PR95-22	*Development and Use of the 1994 Agency Performance Reports*, July 1995
PR95-23	*State Agency Use of Customer Satisfaction Surveys*, October 1995

Evaluation reports and reviews of agency performance reports can be obtained free of charge from the Program Evaluation Division, Centennial Office Building, First Floor South, Saint Paul, Minnesota 55155, 612/296-4708. A complete list of reports issued is available upon request. Summaries of recent reports are available at the OLA web site: http://www.auditor.leg.state.mn.us.