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STATE OF MINNESOTA

Evaluation Report Summary / March 2016

Iron Range Resources and Rehabilitation Board (IRRRB)

IRRRB has not adequately overseen the use and impacts of its loans and grants.

Key Facts and Findings:

- The Iron Range Resources and Rehabilitation Board (IRRRB) provides loans and grants for economic development in its northeast Minnesota service area. It also owns the Giants Ridge Recreation Area and the Minnesota Discovery Center museum.
- Overall, IRRRB oversight and evaluation of its loans and grants are inadequate.
- IRRRB did not adequately specify objectives—such as job growth—in many *loan* contracts we reviewed, and it collected insufficient evidence on how well loans met their objectives. Whether IRRRB provided loans to certain applicants that may not have needed them was unclear.
- IRRRB does not require most companies to report the number of jobs they create using IRRRB subsidies. For companies that do provide job data, IRRRB relies solely on their self-reported data.
- The database IRRRB uses to maintain information on loans is inaccurate and outdated. It lacks needed information, such as number of jobs created, to allow the agency to evaluate loans or their impacts.
- For IRRRB *grants*, many files we reviewed that referred to job creation contained only vague estimates of job growth and had little evidence of achieving objectives.
- Some of IRRRB's grant programs did not consistently follow agency policies on reviewing applications, monitoring projects, or issuing payments to grantees.
- From 2006 to 2014, Giants Ridge operating losses increased by more than 500 percent. IRRRB has subsidized operating losses with an average $1.9 million yearly. IRRRB has not set sufficient targets to measure how well Giants Ridge meets its stated goals.
- State statutes on IRRRB's governance structure are vulnerable to a constitutional challenge.

Key Recommendations:

- IRRRB should explicitly analyze to what extent loan applicants can complete projects without IRRRB funding.
- IRRRB should take steps, such as specifying in loan contracts the numbers of jobs that companies are to create, to ensure its loans actually help create jobs. It should also improve how it measures job creation.
- IRRRB should more consistently determine how well its grants meet their stated objectives, including job creation.
- IRRRB should ensure that all of its grant programs comply with agency policies.
- IRRRB should regularly analyze the collective impact of its loan and grant programs on the area it serves.
- IRRRB should measure Giants Ridge's performance against its stated goals and determine whether the resort remains consistent with the agency's mission.

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Report Summary

The Iron Range Resources and Rehabilitation Board (IRRRB) is a state agency that has focused on economic development of the Iron Range in northeast Minnesota since 1941. The iron ore industry employed more people on the Iron Range in 2014 than any other single industry. The region has a shrinking labor force and has habitually had higher unemployment rates than elsewhere in the state.

A large part of IRRRB's economic development work is awarding loans and grants. Businesses are the primary recipients of loans; municipalities and nonprofit organizations primarily receive the grants. IRRRB owns the Giants Ridge Recreation Area in Biwabik, which is a public resort that offers golf and skiing, among other activities. In addition, it owns the Minnesota Discovery Center in Chisholm, a museum highlighting the region's history.

IRRRB receives most of its funding from taxes on taconite mining in its service area. Its budget in fiscal year 2015 was $41 million. Beyond its annual budget, IRRRB also had access at the end of that fiscal year to $90.6 million in statutorily defined funds for grants and loans.

A governor-appointed commissioner heads the agency. A board of nine legislators approves agency spending and, by law, the governor also reviews and approves certain expenditures. The term "IRRRB" refers to both the agency and the board overseeing it.

Whether IRRRB provided loans to certain applicants that did not expressly need funding was unclear.

Academic literature suggests the public sector should finance economic development projects only when the development would not have occurred otherwise. This is important for certain IRRRB loans but impractical for loans to companies that can choose to locate outside the region. IRRRB has criteria for reviewing loan applications, but none determines whether a project could proceed without agency funding. IRRRB should make this determination when evaluating loan applications. In cases when the determination does not apply, the agency should document its rationale for giving financial incentives.

Many IRRRB loan contracts we reviewed did not adequately specify objectives for job growth. For many of these loan projects, businesses did not meet job-growth objectives specified in their applications.

State law requires loan and grant agreements over $150,000 to contain measureable and specific objectives, including numbers of jobs to be created. In addition, economic development literature establishes the importance of specifying detailed objectives in loan contracts. Companies for 10 of 16 loans we reviewed forecast job growth in their loan *applications*, but their loan *contracts* did not require job creation.

We reviewed 15 loans with contracts or applications containing job-creation objectives. Only 2 of the 15 showed job growth aligned with objectives. Seven loan recipients had not met their objectives. For six loans, it is still too early to tell whether they will meet their job-creation objectives.

IRRRB should redesign its loan program by adding incentives for companies to meet their job-creation objectives. In contracts for direct loans, IRRRB should specify thresholds for the number of jobs that companies are to create. IRRRB could also provide loans only after companies meet their targets for job creation.

IRRRB's practices for measuring job creation are inadequate.

For many loan projects, IRRRB does not have reliable records of the number of jobs created or retained. Staff do not regularly require companies to submit interim or final reports with job information. By contrast, for "forgivable" loans, in which IRRRB reduces or eliminates a company's debt in return for creating jobs, agency staff require companies to submit evidence of job creation.

To collect information on most loan recipients' employment levels, IRRRB e-mails a questionnaire to companies annually and asks them to report numbers of total full-time-equivalent employees and average hourly wages. The process is inadequate because IRRRB does not require companies to respond. For fiscal year 2014, nearly one in five of the companies queried failed to respond. Staff do not independently verify the job numbers self-reported by companies. In addition, wage information is not sufficiently specific to connect it to jobs created.

IRRRB should improve how it measures loan recipients' job creation. It could expand some of the techniques staff now use to verify job creation for forgivable loans. It should avoid relying solely on self-reported jobs and could use Unemployment Insurance program data in some cases to review numbers of employees before and after loans.

IRRRB cannot evaluate its loan program because it does not maintain an accurate database of loans.

Developed in 1987, IRRRB's existing loan database does not contain reliable data. Sometimes a single loan has been assigned multiple loan numbers, making it appear in the database as multiple loans. The database does not include fields for important data, such as number of jobs created. It contains codes that current staff neither use nor understand, and it does not reflect changes that should occur following certain events, such as a default.

IRRRB should either update or replace its loan database. IRRRB should maintain a database that the agency can use to evaluate loans' impacts on the regional economy.

In IRRRB grant files we reviewed, many contracts did not adequately specify project objectives, such as job creation. Many files contained limited evidence that grant projects actually achieved their objectives.

Not all IRRRB grants are intended to create jobs, but we reviewed grant files that referred to job growth in their applications. For grants, IRRRB typically incorporates the application and its contents into the contract. Many of the grant contracts we reviewed did not adequately specify project objectives. Of 17 grant applications with references to job creation, 7 contained vague or imprecise references to jobs or did not differentiate between job creation directly related to the project and other indirect job creation.

Moreover, many grants we reviewed had no clear evidence on whether they met objectives. As an example, one city applied for a highway construction grant that was to create 10 to 15 construction jobs and add new development in the city. However, the project file had no evidence of completed construction, job creation, or new development. IRRRB should more consistently determine how well its grants meet their objectives. It should require grant recipients to submit final reports specific enough to allow comparing objectives in the application with actual results.

Certain IRRRB grant programs did not consistently follow agency policies.

In fiscal year 2016, IRRRB had 13 grant programs, including one for Public Works grants and another for Culture and Tourism grants. Based on recommendations of Minnesota's Office of Grant Management, IRRRB policy requires staff to evaluate grant applications by rating them on how well they meet program criteria and then ranking them. Through fiscal year 2015, IRRRB had no system to do this. In mid-2015, IRRRB began a new system for evaluating grant applications. However, at the end of 2015, the agency submitted eight grants to the board for approval even though staff had not yet evaluated the applications.

A second IRRRB grant policy requires staff to monitor grant projects until they are complete. This includes filing annual progress reports and a final report at the project's conclusion. Only 3 of 20 grants we reviewed that were required to have progress reports actually had them. In addition, 5 of 19 grants required to have final reports did not.

A third IRRRB grant policy requires the agency to issue grant payments on a reimbursement basis instead of up front. Two IRRRB grant programs have not complied, even though the policy applies to all IRRRB grants.

IRRRB should ensure that all of its grant programs comply with its policies. This is a matter of fairness and accountability in awarding public money.

Giants Ridge operating losses grew substantially from 2006 through 2014. In addition, IRRRB has not set sufficient targets to evaluate how well Giants Ridge is meeting its goals.

Giants Ridge revenues for operations have not kept pace with its expenses since 2006 (in inflation-adjusted dollars). IRRRB has subsidized Giants Ridge operations by $17.4 million from 2006 through 2014—an average of $1.9 million annually. Over this period, IRRRB also paid $6.7 million for Giants Ridge capital investments and $19.8 million to retire bond debt.

IRRRB set four goals for Giants Ridge when it first purchased the resort in 1984: create economic development, attract private-sector development, provide recreational facilities to enhance quality of life for people of the Iron Range, and create a year-round recreation destination.

However, IRRRB has not established sufficient targets to judge how well Giants Ridge is meeting its stated goals. The agency has looked at different performance measures, such as attendance and customer satisfaction, but by themselves, the measures cannot show progress toward Giants Ridge's goals. IRRRB should measure Giants Ridge's performance against its stated goals and determine whether the resort remains consistent with the agency's mission.

The state law that requires members of the IRRRB Board to be legislators is vulnerable to challenge under the Minnesota Constitution.

IRRRB is an agency in the executive branch led by a commissioner appointed by the governor. Yet, state law requires members of the agency's board to be legislators and grants the board substantial power over the agency's spending decisions. This arrangement is vulnerable to a challenge under the Minnesota Constitution's separation of powers clause and its prohibition against legislators holding another public office. We base our conclusion on our review of the plain language of the Minnesota Constitution, historical context from the state constitutional conventions, and opinions from the Minnesota Supreme Court and Attorney General.

Summary of Agency Response

In a letter dated March 4, 2016, IRRRB Commissioner Mark Phillips outlined changes IRRRB plans to make in response to the report's key recommendations. He wrote that the agency intends to obtain more and better information on job creation. He said IRRRB will upgrade its loan database and is already implementing new software for managing the grants it awards. Commissioner Phillips said IRRRB will determine how to best analyze the collective impact of its loans and grants on northeast Minnesota. He said it is necessary to continue offering economic incentives to attract certain businesses to the region; in other situations, however, the agency will expand how it evaluates loan applications by determining whether businesses could complete projects without IRRRB funding. Related to the Giants Ridge Recreation Area, the commissioner said the report's recommendations coincide with the agency's current efforts, which he expects will lead to a strategic plan and improved measures of Giants Ridge performance.

The full evaluation report, *Iron Range Resources and Rehabilitation Board (IRRRB)*, is available at 651-296-4708 or **www.auditor.leg.state.mn.us/ped/2016/irrrb.htm**