OLA

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Evaluation Report Summary / February 2018

Minnesota Investment Fund

The Minnesota Investment Fund has not created the level of investment DEED has claimed, and its impact on jobs is unclear.

Key Facts and Findings:

- The Minnesota Investment Fund (MIF) provides financial assistance to nonretail businesses planning to create or retain jobs.
- MIF funding is limited to $1 million per project, and MIF funds must ordinarily be matched with funding from other sources.
- The Department of Employment and Economic Development (DEED) has wide discretion to administer the MIF program.
- DEED distributes MIF funds through a two-part process; DEED first grants the money to local governments, and the local governments then loan the money to businesses.
- MIF appropriations totaled $51 million for fiscal years 2014 through 2017, a substantial increase over previous funding levels.
- DEED has overstated the amount of private investment leveraged by the MIF program, and its public reporting on the outcomes of MIF projects is incomplete.
- Businesses seeking MIF funding do not have to demonstrate that they truly need state subsidies, raising questions about the impact of those subsidies.
- DEED allowed some businesses to meet their MIF commitments by counting hiring and expenditures that occurred before they received their MIF award approvals.
- DEED does not use consistent criteria to determine the amount of MIF loans or whether the loans will be forgiven.
- DEED often does not require businesses to pay workers at the wage levels listed in their approved MIF applications.
- A statute requiring MIF businesses to pay workers at least a minimum level of compensation is ambiguously worded.
- Local governments sometimes receive money for local revolving loan funds as an outcome of the program, but these funds' purposes and value are unclear.

Key Recommendations:

- The Legislature should require stronger assurances that MIF projects need state assistance in order to proceed.
- The Legislature should consider restructuring the MIF program so that DEED makes loans directly to businesses, ending the creation of local revolving loan funds.
- The Legislature should require DEED to set publicly available criteria for MIF award decisions, the size of awards, and loan forgiveness.
- The Legislature should clarify the law requiring MIF businesses to pay a minimum compensation level to their employees.
- DEED should require businesses to meet or exceed the employee wage levels on which the department based its MIF award decisions.
- DEED should improve the usefulness and accuracy of its public reporting and tighten its administrative procedures.

Room 140 Centennial Building, 658 Cedar Street, St. Paul, Minnesota 55155-1603 • Tel: 651-296-4708 • Fax: 651-296-4712
E-mail: legislative.auditor@state.mn.us • Website: www.auditor.leg.state.mn.us • Minnesota Relay: 1-800-627-3529 or 7-1-1

Report Summary

The Minnesota Investment Fund (MIF), administered by the Department of Employment and Economic Development (DEED), provides funding to nonretail businesses to help increase economic activity.

Businesses and local governments jointly apply for MIF funding, and can receive up to $1 million per project. In nearly all instances, businesses agree to increase employment in order to receive a MIF award. By law, MIF funding is ordinarily limited to 50 percent of a project's total cost.

The Legislature should require businesses to demonstrate that they truly need state assistance.

After several years of little or no funding, legislative appropriations for the MIF program increased substantially starting in Fiscal Year 2014. Appropriations totaled $51 million for fiscal years 2014 through 2017.

In preliminary conversations, DEED staff encourage promising applicants and discourage those that appear unlikely to meet program expectations. Consequently, DEED has approved every MIF application it has formally scored in the last 15 years.

After approval of a MIF application, DEED grants money to the local government, which in turn loans the money to the business. DEED approves the terms of each loan and the requirements each business must meet.

Although the MIF program provides "loans" to businesses, DEED made 74 percent of the MIF loans awarded in fiscal years 2013 through 2017 partially or totally forgivable. When a loan is forgivable, the business does not have to repay the loan if it meets its hiring and wage commitments.

DEED made 138 MIF awards in fiscal years 2008 through 2017, totaling $65.9 million. However, 33 of these projects (involving $14.4 million in awards) were later cancelled.

The MIF program's impacts are unclear because businesses do not have to demonstrate they need the assistance in order to expand.

The MIF program's primary statutory purpose is to create jobs and foster business investment. However, while some MIF awards have likely contributed to job growth, the impact of others is questionable. In the MIF applications we reviewed, businesses typically provided unconvincing explanations about why they needed state assistance. For example, businesses rarely documented that they were unable to obtain private financing or had received competing subsidy offers from other states.

The Legislature should require businesses to demonstrate they need public assistance before receiving MIF funding. Businesses should demonstrate that, without state funding, (1) the business would not have access to sufficient funding to proceed with the project, or (2) the business would pursue the project outside of Minnesota.

DEED's public reports of investments and jobs created through the MIF program are incomplete and sometimes inaccurate.

DEED has publicly estimated that the MIF program leveraged $2.1 billion in private investment from 2013 through 2017. But $1.15 billion of this amount is from a single project, where DEED has inappropriately taken credit for a corporate merger that occurred months before a MIF application was submitted.

We also found inaccuracies in the numbers of jobs a DEED website attributed to the MIF program. In one instance, DEED's website said a project was projected to create 160 jobs when the business actually promised to create only 10.

The Legislature should consider reducing the role of local governments in Minnesota Investment Fund projects.

Local governments help administer the MIF program, but the value of their involvement is questionable.

Local governments play a dual role. They are initially applicants to the MIF program, working together with businesses. But they also fulfill a number of administrative functions, including analyzing the financial health of the business, developing legal contracts, monitoring compliance, and handling financial transactions.

For most local governments, MIF projects occur infrequently. More than half of the 300 cities that have had a MIF project have had only one in the entire history of the program.

As a result, most local government staff have minimal knowledge of a program they are expected to help administer. Some local officials told us they were confused about their responsibilities and that DEED has not always been helpful.

Some local officials told us they acted simply as go-betweens, facilitating communication between DEED and businesses. Principal decisions were made by DEED staff.

When MIF loans are repaid, local governments may keep a portion of the repayments. State law contains no requirements for how local governments may use these repayments. However, DEED has administratively required local governments to use MIF repayments to create local revolving loan funds.

These local revolving funds are often underutilized. We surveyed local governments that had created such funds as a result of MIF projects. Forty-four percent of respondents said that they had never used their funds in the past decade, and an additional 15 percent said they had used them only once.

Involving local governments in MIF awards is unnecessarily complicated and provides minimal benefits. The Legislature should consider streamlining the MIF program so that DEED makes loans directly to businesses. Under this approach, all repayments would be recycled back into DEED's program funds, instead of sitting in local revolving loan funds that are often unused.

DEED's process for making MIF awards is not transparent and does not use consistent criteria.

DEED makes three key decisions regarding potential MIF projects: (1) whether a business should receive a MIF award, (2) how large a loan the business should receive, and (3) whether to forgive the loan.

State statutes offer little guidance for how DEED should make these decisions, implicitly granting DEED wide discretion.

DEED scores each application using department-created scoring criteria, but these criteria are easy to meet. Businesses receive many points for rather modest accomplishments. For example, any project projected to create at least 10 jobs receives the maximum possible points for job creation. DEED staff have also been generous in giving points to applicants for qualitative factors, such as the economic vulnerability of the local community.

DEED staff rarely document their reasoning for the size of MIF loans or decisions regarding loan forgiveness. They make decisions regarding MIF projects on a case-by-case basis, with little apparent consistency from one project to the next. DEED does not publicly explain how applications are scored or how award sizes are determined.

The Legislature should place greater limits on DEED's discretionary authority. Specifically, it should require DEED to set specific, publicly available criteria for MIF award decisions, the size of awards, and loan forgiveness.

DEED has not required businesses to pay workers the wages proposed in their approved MIF applications.

Businesses applying for MIF loans propose to create (or retain) a certain number of jobs at specific wage and benefit levels. DEED takes into account

DEED's administration of the Minnesota Investment Fund program has been lax.

the average wage levels listed in applications when making decisions about awards, award size, and loan forgiveness.

However, when businesses sign the loan agreements that formally require them to meet certain commitments in order to receive state assistance, they usually do not promise to meet these wage levels. Instead, these DEED-approved agreements require workers to be paid at or above a much lower minimum rate. Over the past ten years, 60 percent of loan agreements have required businesses to pay a lower wage level than the originally proposed wages.

A law requiring businesses in the MIF program to pay workers at least a minimum compensation level is poorly worded.

State law requires that businesses participating in the MIF program pay their employees wages and benefits equal to at least 110 percent of the federal poverty guideline for a family of four. As written, the law could be interpreted to apply to all of a business's employees, although DEED enforces it only for new employees associated with the MIF project.

Further, the law does not clearly state whether DEED should enforce a minimum for *hourly* compensation ($13.01 per hour in 2017) or *annual* compensation ($27,060 per year in 2017). If the latter interpretation is used, it would be more difficult for businesses to use part-time employees to meet their MIF hiring obligations, a practice DEED has allowed.

It is also unclear to what extent DEED should require businesses to increase employee compensation each year as needed to keep pace with annual changes in the federal poverty guidelines. The Legislature should clarify the law.

DEED should improve its procedures for ensuring that businesses meet their commitments.

The department allowed some businesses to meet their commitments by counting hiring and expenditures that occurred before they received MIF awards. In some instances, businesses were credited for expenditures or hiring they made before they had even applied for MIF funding.

Further, DEED's files do not contain sufficient information to show that businesses have met their commitments under the MIF program. Monitoring reports have sometimes provided insufficient documentation of businesses' required activities. For example, reports may show all new employees hired but not indicate how many workers left employment during the same reporting period.

Generally, DEED should tighten its administrative procedures for the MIF program.

Summary of Agency Response

In a letter dated February 8, 2018, Department of Employment and Economic Development Commissioner Shawntera Hardy called the report a "valuable assessment" of the Minnesota Investment Fund and said the department would "strongly consider the recommendations." However, she criticized some of the report's findings, which she characterized as "due to an incomplete or inaccurate understanding of MIF." She wrote that DEED has "sound internal controls" and that she was "disappointed" the report did not highlight "important improvements" the department has made "to tighten program administration and improve transparency." She continued, "Hundreds of communities and businesses are strong supporters of the program – yet the report minimizes these perspectives and highlights views from a small number of interviews." Commissioner Hardy also strongly disagreed with "the suggestion to eliminate the role of our local government partners without their approval." Nonetheless, she stated that "there is always opportunity to further improve," and DEED will make some changes.

The full evaluation report, *Minnesota Investment Fund*, is available at 651-296-4708 or:
www.auditor.leg.state.mn.us/ped/2018/mif.htm