

**Performance Audit:
Improvements Can Help
Inform Decisions and
Monitor Progress on
Economic Development
Incentives**

July 2016

July 14, 2016

Members of the City Commission

The City uses a wide variety of incentives to meet specific goals such as faster growth in jobs than population and increasing the non-residential tax base. The City's practices generally address many of the best practices experts recommend for using economic development incentives. But, there are areas where changes would incorporate more of the best practices, strengthening the City's ability to make informed decisions and monitor the success of the City's efforts.

I provided the City Manager, Director of Finance, and City Attorney with a final draft of this report on June 10, 2016. The City Manager's written response is included in the report.

I appreciate the cooperation and assistance I received from City staff as I conducted this performance audit.



Michael Eglinski
City Auditor

Performance Audit: Economic Development Incentives

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Performance Audit: Economic Development Incentives

Results in Brief

The City uses a wide variety of incentives to meet specific goals such as faster growth in jobs than population and increasing the non-residential tax base. The City makes informed decisions about the use of economic development incentives as guided by the City Code and other policies and procedures which generally address the key elements of best practice. The City monitors results of economic development incentives and reports on those efforts through an annual report on support and compliance. Monitoring and communicating the results of monitoring is consistent with best practice.

This performance audit includes a number of recommendations generally intended to strengthen the City's ability to make informed decisions and monitor the success of economic development efforts. Recommendations include implementing a number of best practices, complying with existing requirements of the City Code and resolutions, and strengthening controls over payments the City receives related to economic development incentives. Recommendations are on pages 15-16.

The City Manager's response is included in the report on pages 26-30.

Performance Audit: Economic Development Incentives

Making Informed Decisions

The City makes informed decisions about the use of economic development incentives as guided by the City Code and other policies and procedures which generally address the key elements of best practice. The City could strengthen practices by ensuring that the Public Incentives Review Committee (PIRC) provides annual review of Neighborhood Revitalization Areas (NRA) policy as required by City Commission resolution. The City should consider adopting application fees consistent with existing City policy on user fees. City staff should ensure that applicants provide complete disclosure information when they submit applications. The City should develop procedures to address “pirating” and providing unfair advantages; other types of incentives; rebating Utilities Department fees and charges; and decision-making before formal submission of applications. City staff should provide additional information on risks and uncertainties associated with economic development incentives.

City Code and resolutions guide incentive use

The City Code generally addresses key elements of best practices for incentive policy.¹ Best practice policy elements require having goals and measurable objectives, descriptions of tools and limitations, processes for evaluating applications, required documentation and review, performance standards, and monitoring and compliance.

Table 1 Best Practice Elements

<i>GFOA key best practice element</i>	<i>City Code reference</i>
Goals and measurable objectives	1-2102, 1-2103
Financial incentive tools and limitations	1-2104
Evaluation process	1-2105, 1-2106, 1-2108, 1-2113, 1-2115, 1-2121, 1-2123, 1-2124
May include required documentation and officials who are part of review team	1-2105
Performance standards	1-2107
Monitoring and compliance	1-2108, 1-2109

¹ See *GFOA Best Practice: Developing an Economic Development Incentive Policy*.

The City Code, several resolutions, and other policy and procedure documents guide incentive use. The City makes most of these documents available to applicants and the public on the City’s web page.

Table 2 Policy and Procedure Documents

Document	Addresses
Economic Development Incentives and Tax Abatement Policy (City Code, Chapter 1, Article 21)	Overall policy and procedures for the use of incentives
Additional economic development policies (Resolutions 6952-54, 6789)	Additional policy and procedures for transportation development districts, community improvement districts, neighborhood revitalization areas, and tax increment financing districts
Incentive application form	Standard form for collecting consistent information from applicants to analyze proposals and make informed decisions
Economic development staff roles letter	Document intended to outline general responsibilities and roles of the City, County and Chamber (See Appendix A for a copy of this document)
City ethics policy	Policy and procedures to address conflicts of interest for elected officials, City employees, and appointed members of boards

The City Code allows for flexibility. The City has a wide range of incentives including tax abatements, industrial revenue bond financing, sales tax exemptions, development financing districts, loans, grants, fee rebates and other support. The City uses incentives to encourage a wide range of businesses, including manufacturing, retailing and housing.

Economic development objectives
<p>The City Code sets measurable objectives for the City’s use of economic development incentives. The objectives for economic development are:</p> <ul style="list-style-type: none"> • Job growth in excess of population growth; • Increasing the share of the tax base coming from non-residential growth; and • Increasing career opportunities by attracting high-skilled jobs in expanding industries

The Public Incentives Review Committee (PIRC) should review the City’s Neighborhood Revitalization Areas (NRA) policy and provide feedback to the City Commission on an annual basis. Resolution 6954 calls for reviewing the policy on an annual basis. However, based on a review of agendas and minutes from PIRC meeting from 2012 through 2015, PIRC

hasn't reviewed the City NRA policy. Annual review could help ensure the policy reflects current needs and would comply with the resolution.²

City uses an application process to collect information and help make informed decisions

The City generally requires incentive applicants to provide information through a standard application form. The City Code establishes the application procedure. Staff created an application form that satisfies the requirements and allows for information to be collected consistently. Applicants self-report the information and sign a statement that the information is “true and correct, to the best of my knowledge.”

The reliability of the application information is important because it describes the project and timing of the project, discloses prior problems the applicant may have had, and allows staff to evaluate the cost and benefit of the project. Some of the key data reported by the applicants reflect future plans, such as capital investment and hiring, over a ten year period. These forecasts are subject to uncertainty, such as changing market conditions.

Fees that applicants pay when they apply for incentives range from \$0 to \$2,500 and don't necessarily reflect the cost of processing the applications. According to City staff the fees do not recover costs associated with staff time. While the City's user fee policy doesn't require cost recovery, it indicates that fees should consider cost recovery when developing or implementing fees.³ The City Manager should propose for City Commission consideration application fees consistent with the City's fee policy.

Table 3 Incentive Fees

<i>Incentive</i>	<i>Application Fee</i>
Community Improvement District	\$2,500
Industrial Revenue Bond	\$1,000
Loans, grants, fee rebates	None
Neighborhood Revitalization Area	None
Property tax abatement	\$500
Property tax abatement annual renewal	\$200
Tax Increment Finance	Requires a funding agreement for City costs
Transportation Development District	Allows for a funding agreement for City costs

² Similar annual policy reviews are not required by resolutions that established policies for Community Improvement Districts, Tax Increment Financing Districts and Transportation Development Districts.

³ *City of Lawrence User Fee Policy* adopted by the City Commission August 7, 2012.

The City's process for evaluating requests for incentives generally involves:

- Description of the proposed development and requested incentive
- Determination of eligibility and policy consistency
- Analysis of costs and benefits and need for assistance
- Discussion at public meetings

The specifics can vary depending on the particular incentive requested, for example, not all requests go through a cost-benefit or “but for” analysis. The City's process is generally consistent with recommended practices.⁴

City should strengthen systems for making informed decisions

The City should strengthen systems for evaluating applications for incentives by consistently reporting disclosure information and developing procedures to address “pirating” and unfair advantage.

The City should consistently collect disclosure information on applications for economic development incentives. The City's application form collects information on the company and its owners and involvement in litigation, bankruptcy, defaults, and judgements. The City collected disclosure information from some, but not all applicants for incentives from 2013-2015. The City should consistently collect and report the disclosure information to help inform decisions and ensure applicants are treated consistently.

⁴ See, for example, Lauber and Kaleko, “Due Diligence and Risk Management Measures for Economic Development Incentive Approvals,” *The Missouri Municipal Review*, July 2012, which recommends answering a series of questions. Is the project something the community really needs? Who are the developers? Is the project feasible? Will the community benefit? Is an incentive necessary? Will the developer follow through? See also the best practice summary in the Scope, methods and objectives section of this report.

Table 4 Disclosure Information by Applicant

Applicant	Application Date	Disclosure information:	
		Yes	No
Neuvant House Inc.	April 16, 2013	<input checked="" type="checkbox"/>	
Community Wireless Communications Co. (DBA: Wicked Broadband)	May 9, 2013	<input checked="" type="checkbox"/>	
Sunlite Science & Technology Inc	July 30, 2013	<input checked="" type="checkbox"/>	
1106 Rhode Island Street Investors, LLC	May 30, 2014	<input checked="" type="checkbox"/>	
HERE Kansas, LLC or its assigns	June 10, 2014	<input checked="" type="checkbox"/>	
9 Del Lofts	August 19, 2014	<input checked="" type="checkbox"/>	
Eldridge Hotel	January 14, 2015		<input checked="" type="checkbox"/>
Midwest Health Inc	January 14, 2015	<input checked="" type="checkbox"/>	
The Dwayne Peaslee Technical Training Center, Inc	March 24, 2015		<input checked="" type="checkbox"/>
Integrated Animal Health	April 13, 2015		<input checked="" type="checkbox"/>
800 New Hampshire LLC	May 12, 2015		<input checked="" type="checkbox"/>

The City should develop procedures to avoid “pirating” and ensure incentives don’t provide an unfair advantage for one business over another. The City Code shows the City’s intent to avoid using tax incentives or other public inducements for competing to relocate existing Kanas businesses and to avoid tax abatement that offers an unfair advantage.⁵ The City’s application review practices don’t address these policy elements. Analysis of the impact of a proposed project on existing business could help the Public Incentives Review Committee and the City Commission make informed decisions. Such analysis could also help ensure a consistent and transparent evaluation process.⁶

City should strengthen systems for guiding use of other incentives

The City’s policies and procedures for economic development incentives focus largely on incentives set up in state law, but the City also uses a variety of other incentives. Best practice calls for developing procedures and guidance for making informed decisions about the use of incentives.

⁵ *City Code, Chapter 1, Article 21, section 1-2131 Pirating and 1-2132 No Unfair Advantage.*

⁶ *GFOA Best Practice: Developing and Economic Development Incentive Policy* addresses evaluating of impacts on existing businesses as part of an evaluation process. *GFOA Best Practice: Evaluating and Managing Economic Development Incentives* also addresses market impacts such as displacement or substitution of existing local business and service providers.

Table 5 Other Incentive Examples

Other incentive	Example
Employee training grant	The City and County provided an annual grant for employee training to a business contingent on the employer meeting specific targets outlined in a performance agreement.
Parking assistance	The City and the Chamber of Commerce purchased annual parking passes for employees of a business located downtown that was expanding.
Grant to rebate fees	The City paid a developer a grant that rebated the impact, building permit, system development and other fees related to developing the project.
Relocation expense reimbursement	The City reimbursed a business for costs related to relocating within the City.
Lease subsidy	The City and County committed to pay 36 monthly lease payments for office space for a business locating in Lawrence.

The City should develop procedures for rebating Utilities Department fees and charges. Payments from the Utilities Department for economic development grants could raise concerns about agreements related to bonds the City issued for Utilities Department purposes. City staff noted that economic development grants from the Utilities Department are allowable because the revenue can be used for any lawful purpose of the water and sewer system and that surplus revenue could be transferred to the general fund and used for any purpose.⁷ The City should have procedures to ensure payments are consistent with bond requirements and that the analysis is documented.

City should strengthen systems for actions before applicants submit formal requests for incentives

The City could strengthen its practices by developing procedures for activities that precede the submission of a formal application. Before submitting a formal incentive application, a business may have met with City staff to discuss options, staff may have completed a preliminary cost-benefit analysis, and the business may have received a conditional offer of incentives developed by the City, County and Chamber. Aside from the 2013 staff roles letter, the City hasn't established procedures for these activities which take place before an applicant submits a formal application. Procedures help ensure consistent treatment of potential applicants and increase the level of transparency about the process.

⁷ Note that the specific language in the relevant bond agreement is “any other lawful purpose in connection with the operation of the system *and benefiting the system*” [emphasis added]...or to make lawful transfers to any fund of the Issuer.”

Clearly identifying and communicating risks and uncertainties could help inform decisions

The City should identify and evaluate risks associated with economic development incentives before approving incentives.⁸ Because there are risks associated with any development project, the actual performance of a project may differ from the expected performance. Currently, the City's process doesn't consistently identify and communicate risks to help inform decisions.

Review of four recently approved incentive projects showed limited information about risks or uncertainties involved in the projects. The City Auditor reviewed materials presented to the City Commission and meeting minutes to identify communication about risks and uncertainties. Based on that review, the City Commission received limited information about risks or uncertainties associated with the projects. Communications about risks and uncertainties were limited to information about uncertain impacts on parking related to projects and that conduit debt did not expose the City to any obligation to pay the related debt.

The City's process for evaluating applications doesn't require staff to systematically identify risks and uncertainty, but the City uses performance agreements to mitigate risks. The City can use "pay as you go" incentives to mitigate risks and uncertainties. Under pay as you go agreements, the financial obligation to a project requires that the project perform (e.g. generate property tax or other tax revenues). Performance agreements also provide a mechanism to hold approved incentive projects to account for specific measures included in those agreements.

⁸ For example, see *GFOA Best Practice: Assessing Risk and Uncertainty in Economic Development Projects*.

Risks inherent to economic development projects

The Government Finance Officers Association identified a number of risks inherent to economic development projects that include:

- **Completion:** complete project failure; not achieving results within timeframe or to the desired outcome; an external organization's failure to perform.
- **Financial-related:** revenues falling short; cost overruns; unexpected operation, maintenance or capital costs after project completion; debt limitations; and debt instruments.
- **Regulatory/legal:** jurisdictional authority; negative legal actions against the government related to a project; liability and insurance risks; legislation with potential adverse outcomes.
- **Operational:** negative environmental impacts; displacement of other businesses or residences.

GFOA recommend identifying and evaluating potential risks.

Source: GFOA Best Practice: Assessing Risk and Uncertainty in Economic Development Projects.

Monitoring Results

The City monitors results of economic development incentives and reports on those efforts through an annual report on support and compliance. Monitoring and communicating the results of monitoring is consistent with best practice. The City could strengthen efforts to monitor results by ensuring the annual report goes to the Public Incentive Review Committee and the City Commission by the deadlines set in the City Code. The City should verify some of the data included in the annual report to ensure the data are valid. The City should establish performance agreements for all incentives. The City should monitor and report on the three overall goals for economic development that the City Code establishes.

Annual report provides information on incented projects

The City prepares an annual report on compliance and economic development support to help monitor and oversee the City's efforts. The annual report provides descriptive information about each project receiving incentives, capital investment and employment information when required, and summary information about the incentive programs. The annual report goes to both the Public Incentive Review Committee (PIRC) and City Commission for review and is made available to the public.

Annual reporting to monitor and communicate the results of monitoring is consistent with best practice. City Code establishes the process for annual reporting and review of the annual report. Staff prepares the annual report. Best practice calls for monitoring and communicating the results of the monitoring.⁹

The City should ensure that the annual economic development support and compliance reports are provided to the Public Incentive Review Committee and City Commission by the required deadlines. The City Code requires the report be provided to PIRC by April 1. PIRC's comments and recommendations along with the annual report are to be provided to the City Commission no later than May 1. From 2010-2014, PIRC never received the report by the deadline and the City Commission received the report by the deadline in only one year.

⁹ See for example *GFOA Best Practice: Monitoring Economic Development Performance* and the National State Auditors Association's *Best Practices in Carrying Out State Economic Development Efforts*.

City relies on self-reported data to monitor results

The City should take steps to verify some of the self-reported data in the annual reports. Much of the data in the annual report is self-reported by businesses that received incentives. The businesses compile the data in response to requirements in performance agreements and the City Code. A company representative signs a statement that the information is “correct, to the best of my knowledge.” The City has not taken steps to verify the reported information.¹⁰ A best practice is to take steps to verify reported information.¹¹ In some performance agreements, the City has access to records that could help verify reported information. Verifying data helps improve the reliability of the reporting.

Job creation in applications and performance agreements

The City includes some job creation in cost-benefit analyses, but doesn't always include those same jobs in performance agreements or reporting. This makes it difficult to evaluate the effect of the use of incentives on job creation. Two thirds of the jobs included in applications weren't included in performance agreements.

<i>Analysis of 12 projects approved for incentives</i>	<i>Jobs</i>
Job creation evaluated in cost-benefit analyses	183
Jobs included in performance agreements	61

The City Auditor reviewed 12 projects approved for incentives in 2013-2015. All but two of those projects identified jobs in the application that were included in the cost-benefit analyses. However, only 2 of the 12 projects include jobs in performance agreements.

City should develop performance agreements for all incentives

The City should develop performance agreements for all incentives. Some recipients of incentives have not been required to enter into performance agreements. For example, the City hasn't entered into performance agreements for industrial revenue bonds for sales tax exemptions. Performance agreements help the City evaluate the effectiveness of economic development activities and appear to be required by the City Code.¹²

City should also monitoring overarching goals to provide context

¹⁰ An exception is that the City contracted for a review of transactions related to the 12th and Oread project. Because of on-going dispute between the City and the developer, the project was not included in the scope of this performance audit.

¹¹ For example, see *GFOA Best Practice: Performance Criteria as Part of Development Agreements* which notes that “data reported from the developer should only be used if appropriate validation efforts are taken.”

¹² *City Code 1-2107 Performance Provisions* requires that each company receiving an incentive be accountable for performance provision included in a performance agreement.

The City could improve monitoring by compiling information measuring the achievement of the three goals for economic development. City Code set the three goals:

- Job growth in excess of population growth;
- Increasing the share of the tax base coming from non-residential growth; and
- Increasing career opportunities by attracting high-skilled jobs in expanding industries.

Currently, the City’s reporting focuses on individual projects and incentive programs but doesn’t report on progress related to the general objectives of economic development. Monitoring and reporting on both project and jurisdiction-level performance is a best practice.¹³

STAR measures and economic development

The City and County will measure and report in some economic development measures as part of the sustainability tools for assessing and rating (STAR) communities program. STAR objectives and measures address:

- Business retention and development
- Green market development
- Local economy
- Quality jobs and living wages
- Targeted industry development
- Workforce readiness

The measures are reported for the jurisdiction and could help provide an overview of the City’s economic development.

New accounting rules will provide additional information

The City will begin reporting additional information on economic development incentives in the Comprehensive Annual Financial Report. New accounting rules will require the City to disclose descriptive information and dollar amounts about certain incentives beginning with the financial statements for 2016. The new rule should make certain incentive transactions more transparent and help people better understand the City’s financial position and economic condition.¹⁴ Because the disclosure is required of most local governments, the new rule will also make comparison among local governments easier.

¹³ For example, see *GFOA Best Practice: Monitoring Economic Development Performance*.

¹⁴ *Statement No. 77 of the Government Accounting Standards Board: Tax Abatement Disclosures*. Note that abatement is broadly defined and can include programs with other names, such as exemptions, deductions, credits and rebates. The substance of the transaction rather than the title determines the requirement to disclose the information.

City recently took steps to improve the ability to monitor incentive projects

The City included information on sales tax exemptions in the annual report and is considering strengthening audit access language in performance agreements. Both steps improve the City’s ability to monitor incentive projects.

The City added information on sales tax exemptions to the annual report. The 2015 annual report includes estimated sales tax exemptions related to stand-alone IRB projects. Sales tax exemptions provide a substantial incentive to developers.

Audit access language in performance agreements would clarify expectations about information developers need to maintain and the City’s access to that information. Audit access language often incorporates required record keeping, making records readily available, and passing audit obligations down to subcontractors.

Strengths and Limitations of Data included in Annual Reports	
Strengths:	Limitations:
<ul style="list-style-type: none">• Data made available annually and publicly• Some measures clearly defined in performance agreements and City Code• Report includes wide range of performance measures	<ul style="list-style-type: none">• Measures largely self-reported and not verified• Some measures not clearly defined• Report doesn’t address City’s economic development goals• Monitoring may end before the cost-benefit analysis period ends

Other Issue

The City Manager's Office should strengthen processes for receipt of payments related to economic development. Tracking the receipt of payments is important for occasional and one-time payments. In some cases, payments have been received late and tracking hasn't been adequate. The performance audit on Rock Chalk Park infrastructure monitoring recommended strengthening procedures for receiving application payments because the incentive application payment hadn't been received over a year after the application was approved. A payment of about \$450,000 related to the development of the East Hills Business Park was due from the County in May 2014, but has not been received or waived. A payment of \$75,000 to the City's affordable housing trust fund was received by the City, but after the deadline had past. Prior audit recommendations have included developing policies and procedures for these sorts of payments, providing training and using the city's miscellaneous receivables process for tracking payments. Strengthening process would help ensure payments to the City are made.

Recommendations

The City Auditor recommends taking steps to strengthen the City's ability to make informed decisions about the use of economic development incentives:

1. The City Manager's Office should ensure the Public Incentives Review Committee schedules annual reviews of the City Neighborhood Revitalization Area policy as required by resolution.
2. The City Manager's Office should propose for City Commission consideration application fees consistent with the City's fee policy.
3. The City Manager's Office should establish a control to ensure disclosure requested of applicants is collected and disclosed.
4. The City Manager's Office should develop written procedures to address "pirating" and unfair advantage.
5. The City Manager's Office should develop written procedures to address incentives other than those incentives established by state law.
6. The Finance Department should develop procedures for Utilities Department fee and charge rebates and waivers.
7. The City Manager's Office should develop procedures to guide activities before an applicant submits a formal application.
8. The City Manager's Office should analyze risks and uncertainties related to economic development projects and communicate the results of the analysis to decision-makers.

The City Auditor recommends taking steps to strengthen the City's ability to monitor and communicate the success of economic development efforts:

9. The City Manager's Office should ensure the annual reports go to the Public Incentives Review Committee and the City Commission in accordance with the deadlines established in the City Code.

10. The City Manager's Office should take steps to verify some of the self-reported data used in the annual compliance report.
11. The City Manager's Office should develop procedures to require performance agreements for all incentives.
12. The City Manager's Office should measure and report on the City's three overall goals for economic development.
13. The City Manager's Office should work with the City Attorney to include audit access language in performance agreements.

The City Auditor recommends one action to strengthen controls over City revenue related to payments received by the City Manager's Office:

14. The City Manager's Office should work with the Finance Department to include payments to the City related to economic development in the City's billing system.

Performance Audit: Economic Development Incentives

Scope, methods and objectives

The objectives of this performance audit are to determine if the City follows best practices for:

- Making informed decisions about using incentives
- Monitoring the success of efforts

The performance audit focused on the City's system for making decisions and monitoring progress. The performance audit work did not systematically review performance agreements or audit compliance with those agreements, did not evaluate the City's cost-benefit model, and did not include specific analysis or review of the 12th and Oread project. While the City Auditor was conducting fieldwork for this performance audit, the City and the developer of 12th and Oread were involved in a dispute.

To understand the City's system for making decisions about using incentives and monitoring the success of those incentives, the City Auditor interviewed City staff and reviewed relevant documents. The auditor interviewed staff in the City Manager's Office and the Finance Department. Among documents the auditor reviewed were the City Code; agendas, materials and minutes for Public Incentives Review Committee and City Commission meetings; materials from City Commission study sessions; annual reports on economic development support and compliance; incentive applications; and performance agreements.

The City Auditor developed the best practice framework by reviewing relevant literature and sharing the framework with management. In particular, the framework incorporates many of the practices outlined by the Government Finance Officers Association (GFOA). GFOA adopt and publish best practices. The City Auditor reviewed the following GFOA best practices:

Assessing Risk and Uncertainty in Economic Development Projects
Coordinating Economic Development and Capital Planning
Creation, Implementation, and Evaluation of Tax Increment Financing
Developing an Economic Development Incentive Policy
Enhancing Tax Abatement Transparency
Evaluating and Managing Economic Development Incentives
Evaluating Data and Financial Assumptions in Development Proposals
Monitoring Economic Development Performance
Performance Criteria as a Part of Development Agreements
Public-Private Partnerships (P3)
The Role of the Finance Officer in Economic Development

Additional sources of best practices included:

Best Practices in Carrying Out State Economic Development Efforts, National State Auditors Association, 2004.

Lauber and Kaleko, *Due Diligence and Risk Management Measures for Economic Development Incentive Approvals*, The Missouri Municipal Review, July 2012.

Stallmann and Johnson, *Economic Development Incentive Programs: Some Best Practices*, Truman Policy Research, Harry S. Truman School of Public Affairs, October 2011.

The exhibit below summarizes the best practices.

Making informed decisions
<p>Clearly define rules, policies, procedures and guidance including goals, objectives, requirements, terms and processes.</p> <p>Establish a system to collect information. Applications should: summarize the project, demonstrate financial and professional capability, and summarize benefits and assistance requested.</p> <p>Evaluate the developer. Consider financial resources; seek disclosure of conflicts, etc. Consider a 3rd party to evaluate developer finances and track record as part of due diligence. The finance director or budget officer should be included in the analysis of impacts, risks and uncertainties.</p> <p>Establish procedures to address actual or perceived conflicts of interest for staff.</p> <p>Evaluate data and assumptions used to evaluate proposals.</p> <p>Systematically identify and evaluate risks and uncertainty. Communicate the risks and uncertainties to stakeholders and citizens.</p> <p>Document all applications, supporting documents, agreements, compliance provisions, screening processes, risks assessments, term sheets, award decisions, etc.</p>
Monitoring progress
<p>Clearly define specific goals and criteria for incentive recipients, and actions taken should the outcomes differ. Ensure goals are defined and can be objectively measured or assessed. Take steps to validate data reported by developers.</p> <p>Establish a system to identify and manage performance agreement risks. Document and maintain records.</p> <p>Monitor and report on the overall economic development of the community.</p> <p>Make the results of monitoring publicly available.</p>
Best practices themes
<ul style="list-style-type: none">• Follow consistent, goal-driven approaches to using incentives• Evaluate and communicate risks and uncertainties• Be skeptical and analytical in evaluating proposals and progress• Monitor and report on projects, programs and the local economy

The City Auditor conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The City Auditor believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

The City Auditor provided the City Manager with a preliminary draft report and recommendations on June 6 and a final draft report on June 10, 2016. The City Manager's response is attached.

Performance Audit: Economic Development Incentives

Appendix A: Staff Roles Letter

Economic Development Staff Roles Letter

The Lawrence Chamber of Commerce, City of Lawrence and Douglas County all value the importance of economic development and wish to work cooperatively on projects for the benefit of the community and region. The three organizations will work as partners to further economic development.

The staff of the organizations wished to clarify roles and responsibilities amongst themselves. Thus, the purpose of this letter is to outline general responsibilities and roles, understanding that cooperation and communication amongst the three economic development partners is essential to achieve the economic development outcomes.

The Chamber of Commerce will serve as the marketing and project management entity for the public/private economic development partnership.

Requests for Information (RFIs) and other economic development inquiries related to potential expansion or relocation of businesses:

1. RFIs and other economic development inquiries typically come from the Kansas Department of Commerce or Kansas City Area Development Council (KCADC) and are received by the Chamber. The Chamber of Commerce will take the lead in coordinating the responses to these RFI.
2. Upon receipt of an RFI requiring City/County information regarding sites or incentives, the Chamber will forward the RFI, deadline for receiving information back, and any other relevant information to: David Corliss, City Manager; Diane Stoddard, Assistant City Manager; Britt Crum-Cano, Economic Development Coordinator; and Craig Weinaug, County Administrator.
3. The City will perform cost-benefit analysis, if necessary, related to any incentive requests. Analytical results will be shared between the City, County and Chamber to assist in determining a conditional/preliminary incentive offer.
4. The Chamber will work with the City and/or County related to any wording on conditional incentive offers. All incentive offers should be conditioned on the necessary public process and governing body approvals.
5. For sites within the City, the City will coordinate any information related to land use requirements, infrastructure, City-owned utilities, and other City service information. For sites within the unincorporated County, the County will coordinate any information related to land use requirements, infrastructure, and other County service information.
6. The Chamber will ensure the County is consulted if the request has the potential to affect the County, including impacting County-owned sites or sites located within unincorporated Douglas County and potential incentive offers that might change County revenues. Upon completion of the RFI, the Chamber will forward a completed response back to the City and/or County.
7. The Chamber will notify the City and/or County regarding the outcome of RFI responses.
8. In the event that an inquiry comes in through the City or County, each party will keep the others in the communication loop by sharing information about the inquiry. The detail involved with this communication will vary according to the inquiry. This is not meant to include general redevelopment and other related activities that are governed by other policies/processes.

Joint Economic Development Council (JEDC)

Per the ordinance establishing the Joint Economic Development Council (JEDC), the Chamber will take the lead in chairing the JEDC, meeting coordination, meeting notification, agendas and minutes.

Public Incentive Review Committee (PIRC)

Per the ordinance establishing the Public Incentive Review Committee (PIRC), the City will take the lead in chairing the PIRC, meeting coordination, meeting notification, agendas and minutes.

Regular Meetings

As a general practice, the Chamber, City, County staffs and elected officials should meet on at least a monthly basis to discuss project status and other economic development issues. The Chamber staff will take the lead in scheduling and preparing an agenda for these meetings, with assistance from City staff. For the meetings, Chamber staff will prepare a report indicating the status of economic development projects. City staff will take notes on the meetings.

Annual Reports

The City will take the lead in organizing an annual joint economic development report, and will work with Chamber and County staff and others, such as the Bioscience and Technology Business Center, to complete the report. The City will also take the lead in annual City compliance reporting, showing compliance status related to outstanding tax abatements and other economic development tools.

Marketing

- The Chamber will take the lead in general community marketing for economic development purposes.
- The City and the Chamber will cooperate regarding the marketing efforts related to City-owned properties, such as the business park located on the former Farmland property, and the Lawrence Municipal Airport sites.

Confidentiality

- There is an understanding amongst the parties that relocation and expansion information is highly sensitive and a high degree of confidentiality is required. This also needs to be balanced with the need to keep elected officials informed about potential projects, particularly those which may require government financial participation, and ensure that government funders of economic development activities are aware of how government funds are being utilized.

External communications

- Chamber will take the lead in making announcements on projects with appropriate consultation with the County and the City and the business.

Approved February 6, 2013 by:



David L. Corliss, City Manager, City of Lawrence



Craig Weinaug, County Administrator, Douglas County



Greg Williams, CEO, Lawrence Chamber of Commerce

Performance Audit: Economic Development Incentives

Management's Response

City Code requires a written response addressing agreement or disagreement with findings and recommendations, reasons for disagreement, plans for implementing solutions, and a timetable for completing such activities.



City of Lawrence

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June 27, 2016

Mr. Michael Eglinski
City Auditor

Re: Economic Development Performance Audit

Dear Michael,

I received your performance audit report regarding the City's economic development incentives. I appreciate your review of this important topic, which is currently under review at the City Commission level, and also by several of the city's advisory boards. I will respond to each of your recommendations specifically in this correspondence. However, first I would like to make a few general comments related to the audit.

The City Manager's Office staff takes particular pride in its work in the area of economic development. The function requires extensive coordination with applicants, community partners, the advisory board, and the City Commission both during the application approval process, and after incentives are approved. Oftentimes, the incentives are in place from ten to twenty years and require ongoing monitoring. Britt Crum-Cano, the City's Economic Development Coordinator, has annually improved the City's economic development compliance report. I would place our annual report up against nearly any economic development compliance report in the country- it is extensive, thorough and informative. I would also point out that the City of Lawrence was meeting the suggested economic development tracking best practices recently adopted by the Government Finance Officers' Association (GFOA) long prior to GFOA recommending these practices. We know that our community and stakeholders demand thorough accountability and we take that charge quite seriously.

Improvements in processes and reporting can always be made. Several of the recommendations included in your performance audit can be incorporated quite easily or are already underway. Other recommendations suggest additional analysis or changes in reporting. These additional tasks would require additional expertise and/or resources beyond existing staff. In some cases third parties would be required to conduct analytical work that is beyond the expertise of current staff. While this analysis and/or additional auditing of company certifications may be helpful from time to time



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and is appropriate in some cases, we believe that this additional analysis is not necessary in most cases and will elaborate on this further within this correspondence.

Responses to Recommendations:

1. The City Manager's Office should ensure the Public Incentives Review Committee schedules annual reviews of the City Neighborhood Revitalization Area (NRA) policy as required by resolution.

As there is no specific need to review this particular policy on an annual basis and while this NRA policy is under current review, I will be suggesting striking this language. I do believe it would be appropriate for the advisory boards involved in economic development to review the policies from time to time and, of course, the policies are subject to review and modification by the City Commission at any time. Establishing such timeframes as a matter of policy can be problematic, as you have demonstrated.

2. The City Manager's Office should propose for City Commission consideration application fees consistent with the City's fee policy.

Fee revisions are currently part of the review discussion. Direction on this issue from a policy level will be provided during this process. Staff is recommending adjustments in fees.

3. The City Manager's Office should establish a control to ensure disclosure requested of applicants is collected and disclosed.

Additional information has recently been required on the city's application form. All of the information submitted on the application form is made available to the public. Staff concurs that additional disclosure information should be provided related to projects requesting up-front incentives, such as loans or grants. With the majority of incentives being pay-as-you-go, staff does not believe that additional due diligence work would add value to pay-as-you-go incentives. In these cases, no incentives are provided until the project has been completed and annual performance is shown. Staff believes that the analysis and due diligence should be commensurate with public risk. In the case of a fairly recent request for upfront incentives from an applicant, a third party was engaged for more extensive due diligence, due to the possible risk to public funds that may be difficult to "clawback" in the case of under-performance.

4. The City Manager's Office should develop written procedures to address "pirating" and unfair advantage.

Staff believes that these issues are adequately covered in either state statute and/or city policies that relate to certain economic development tools.

5. The City Manager's Office should develop written procedures to address incentives other than those incentives established by state law.

The City's overarching economic development policy does cover loans, grants, infrastructure or other forms of incentives. The City Manager's Office will work with the Finance Department to develop procedures related to fee reimbursements.

6. The City Manager's Office should develop procedures to guide activities before an applicant submits a formal application.

Staff does not believe that formal procedures are necessary for informal discussions between potential applicants and staff.

7. The City Manager's Office should analyze risks and uncertainties related to economic development projects and communicate the results of the analysis to decision-makers.

The vast majority of incentives are provided on a pay-as-you-go basis, or are earned only after performance occurs. For example, a company that has been granted a property tax abatement must perform annually before that year's abatement is granted. The result of this is that the programs really carry no risk to the City in the event of underperformance. Incentive adjustments in the case of underperformance are built into the performance agreements. The exception to this would be instances where grants are provided to a company. Again, this has been done very infrequently and only in small increments to date. Analyzing a company's financial position is a time consuming process and requires expertise beyond what is available on city staff. In the case of a company several years ago, which was requesting a significant grant, staff did believe that it was prudent to analyze the company's financial position and a third party firm with experience in such matters was engaged. Staff believes that this should be a case by case determination, not a blanket requirement.

8. The City Manager's Office should ensure the annual reports go to the Public Incentives Review Committee and the City Commission in accordance with the deadlines established in the City Code.

The Code does establish timeframes for the completion of the report, which are generally followed. It is acknowledged that the Public Incentives Review Committee may not meet to review the report prior to April 1 and that the City Commission may not review the report on its agenda by May 1. In light of this, staff recommends altering these dates in the code to make it more flexible by generally specifying an

April 1 completion date of the report. Other than it being specifically stated in the code, there is no particular relevance to the current dates in the code, with the exception of enabling the completion of the report as soon as possible after the end of the year. Requiring the completion of the report by April 1 and distribution of the report to the PIRC and City Commission would be reasonable.

9. The City Manager's Office should take steps to verify some of the self-reported data used in the annual compliance report.

In the city's performance agreements, staff has the ability to access records to verify company certifications when needed if there is a question about the reliability of the information provided by the company. For example, if a company reports 100 employees but the parking lot is largely empty, that would warrant follow up. If this were to be done in every instance it would require additional staff time which likely isn't commensurate with the potential risk that the company is reporting inaccurately.

10. The City Manager's Office should develop procedures to require performance agreements for all incentives.

See response to recommendation 5.

11. The City Manager's Office should measure and report on the City's three overall goals for economic development.

As written, the goal to have "job growth in excess of population growth" is too broad and does not convey what the community is actually trying to achieve. For example, taken literally, the economic development team is charged with bringing in volumes of jobs, regardless of the quality, pay level, or industry. This does not take into consideration additional complications that a large influx of low-paying jobs would have on the community, such as the impact on affordable housing and additional local services required.

Although goals are high-level statements that provide the overall context for what the community is trying to accomplish, they must be logical and given careful consideration. As such, goals should be reexamined and redefined as part of a strategic plan that incorporates objectives (performance measures which are specific, concrete, measurable, and time framed that would lead to achieving the goal), action steps (processes and actions that meet the objective), time frames (timelines for accomplishing action steps), and measurement benchmarks.

Staff agrees that annual reporting on economic development goals would be in line with best practices and suggests that reporting requirements align with a reexamination of economic goals through the strategic planning process. Measurable goals and objectives are essential for evaluating progress. A strategic

planning process would allow the community to identify SMART (Specific, Measurable, Attainable, Relevant, and Time-bound) goals and objectives, which would accommodate annual progress reporting.

12. The City Manager's Office should work with the City Attorney to include audit access language in performance agreements.

Staff has already discussed this and it will be incorporated into future agreements.

13. The City Manager's Office should work with the Finance Department to include payments to the City related to economic development in the City's billing system.

This has been incorporated into current practice.

Thank you for your recommendations on this important topic. Again, we take this topic quite seriously and have implemented, or are in the process of implementing several of your recommendations. The remaining recommendations must strike a balance between the time/expense involved and potential risk. We believe in these areas we do have an appropriate balance and address any performance/compliance issues when needed. Finally, our extensive reporting provides transparency for the public on an ongoing basis and is continually being improved from year to year.

Sincerely,



Thomas M. Markus
City Manager

c: Diane Stoddard, Assistant City Manager
Casey Toomay, Assistant City Manager
Britt Crum-Cano, Economic Development Coordinator